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Maintaining Financial Sector Integrity: Integrating Sustainable Finance into Financial Regulation

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Abstract

This article invetigates whether the integration of sustainable finance into the Indonesian financial regulatory framework aligns with established principles of financial regulation and whether such integration strengthens or potentially undermines financial sector integrity. This study assesses Indonesia's sustainable finance framework through a normative legal research approach. The study applies indicators derived from the principles of financial regulation, namely prudential risk integration, transparency and disclosure reliability, market integrity, supervisory effectiveness, and enforceability of sustainability-related obligations. Sustainable finance aims to incorporate environmental and social risks, especially those related to climate, into financial decision-making, but its regulatory implementation prompts significant inquiries about prudence, transparency, market integrity, and public confidence. The research indicates that Indonesia's sustainable finance governance faces three critical challenges: legitimacy risks stemming from vague green product classifications that enable greenwashing and erode trust, reputational risks caused by a lack of rigorous verification and mispricing concerns. Additional shortcomings include weak verification mechanisms for sustainability claims and the risk of symbolic compliance without substantive integration into prudential supervision. The research further finds that sustainable finance has a dual nature: when firmly rooted in legal authority, incorporated into prudential oversight, backed by uniform disclosure frameworks, and upheld through reliable supervisory systems, it boosts systemic resilience and strengthens regulatory legitimacy. On the other hand, disjointed execution, lax verification criteria, symbolic compliance, and inadequate enforcement can lead to greenwashing, regulatory arbitrage, mispricing, and reputational spillover, thereby threatening reputation of financial sector. The research finds that the effectiveness of sustainable finance in Indonesia relies on careful regulatory frameworks, strong institutional capabilities, and efficient enforcement to maintain the integrity of the financial sector.

Keywords

Sustainable Finance, Financial Regulation, Financial Sector Integrity, Greenwashing

A. Introduction

Over the past decade, environmental sustainability has transitioned from a peripheral issue into a primary systemic concern, requiring multilateral policy interventions by the international community. This trend began with the realization that business activities that had been conducted so far damaged the environment. According to the Human Development Report 2021/2022, human activities that generate pollution and involve the massive use of plastics contribute significantly to climate change and environmental degradation, conditions that have become the defining characteristics of the Anthropocene era.[1] Andri Gunawan Wibisono argues that the Anthropocene era imposes a duty

[1] UN Development Programme, "Human Development Report 2021/2022: Uncertain Times, Unsettled Lives: Shaping Our Future in a Transforming World", 34, https://hdr.undp.org/system/files/documents/global-report-document/hdr2021-22reportenglish_0.pdf, (accessed on 28 February 2026).

of action upon both individuals and communities.[2] In the business context, this statement has influenced business entities to operate not solely for financial profitability, but also with regard to social and environmental sustainability.

Since 1991, financial institutions around the world have recognized that the financial sector can have a significant impact on the transition from a conventional economy to a sustainable economy, as was further emphasized at the Rio Summit in 1992.[3] This commitment was initiated by several banking institutions and was later followed by several insurance and reinsurance companies around the world. Furthermore, the global momentum toward sustainable business practices intensified with the introduction of the Equator Principles (EP) in 2003, representing a voluntary commitment by various global financial institutions. These institutions pledged to screen and categorize financed projects based on key environmental indicators.[4] Adherence to these principles indicates that financial institutions have incorporated mechanisms to assess and mitigate social and environmental risks across international project finance activities. This condition later shifted a paradigm in multiple jurisdictions: adopting sustainable finance under the financial regulation, including Indonesia.

Sustainability in economic activity started with the multinational commitments established in global forums. Early momentum can be traced to international agreements emphasizing the balance of economic and environmental considerations, such as the 1972 Stockholm Declaration and the 2016 Paris Agreement. Domestically, Indonesia advanced environmental governance through Law No. 32 of 2009 on Environmental Protection and Management/*Undang-Undang No. 32 Tahun 2009 tentang Perlindungan dan Pengelolaan Lingkungan Hidup* ("Law No. 32 of 2009"), ratified the Paris Agreement on Climate Change 2015-2030 through Law No. 16 of 2016/*Undang-Undang No. 16 Tahun 2016 tentang Pengesahan Paris Agreement To The United Nations Framework Convention On Climate Change (Persetujuan Paris Atas Konvensi Kerangka Kerja Perserikatan Bangsa-Bangsa mengenai Perubahan Iklim)* ("Law

[2] Susanto, Antono Adhi, "Reconstruction of the 1945 Constitution for Strengthening the Legal Framework of Indonesia Environmental Law" Vol 21, No. 2 (2024): 184, https://doi.org/https://doi.org/10.31078/jk2122.
[3] UN Environment Programme, 'History of Statement', https://www.unepfi.org/about/unep-fi-statement/history-of-the-statement/, (accessed 9 February 2026)
[4] Gualinga, Emil Sirén. Thesis, "The Rights of Indigenous Peoples – The Missing Piece in ESG and Sustainable Finance.", Copenhagen Business School, (2022): 34.

No. 16 of 2016"), and institutionalized the UN Sustainable Development Goals (SDGs) through Presidential Regulation No. 59 of 2017/*Peraturan Presiden No. 59 Tahun 2017 tentang Pelaksanaan Pencapaian Tujuan Pembangunan Berkelanjutan* ("President Regulation No. 59 of 2017"). At this stage, sustainable business practices are no longer optional, but imperative. The central issue, therefore, is not whether sustainable finance exists in Indonesia, but whether its regulatory integration is sufficiently robust to safeguard financial integrity and public trust.

Existing literature on sustainable finance has predominantly focused on disclosure frameworks, ESG metrics, green bond markets, and corporate sustainability practices. Many literatures evaluate the effectiveness of ESG reporting regimes, investor behavior, or market growth in sustainable assets. While these contributions are significant, they often treat sustainable finance as a discrete policy domain rather than as an integral component of financial regulation. Relatively limited attention has been devoted to examining how the integration of sustainability objectives affects the foundational goals of financial regulation itself, including systemic stability, market integrity, and protecting investors and/or customers.[5] We should take note, that the quality of regulatory integration determines whether sustainable finance strengthens financial system resilience or generates integrity and reputational risks. A coherent prudential framework can internalize climate-related risks and enhance market discipline. Conversely, when implemented in a fragmented, disclosure-driven, or weakly enforced manner, it may foster greenwashing, regulatory arbitrage, and reputational contagion, which threaten the financial sector's integrity as a whole.

B. Method

This study is a qualitative research that adheres to the normative legal research typology. According to Irwansyah, the normative method is a method to investigate secondary data (library materials).[6] The secondary data refers to the source of data, which

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[5] Veerle A. Colaert, "The Changing Nature of Financial Regulation. Sustainable Finance as a New Policy Objective", Common Market Law Review, 59 (6), (April 1, 2022): 3, https://ssrn.com/abstract=4087166 or http://dx.doi.org/10.2139/ssrn.4087166.

[6] Irwansyah, "Penelitian Hukum: Pilihan Metode dan Praktik Penulisan Artikel", Edited by Ahsan Yunus, 5th Edition, Yogyakarta: Mirra Buana Media, (2022): 42.

consists of primary, secondary, and non-legal sources.[7] Primary legal sources in this paper include the 1945 Constitution of the Republic of Indonesia, Law No. 32 of 2009, Law No. 4 of 2023 concerning the Development and Strengthening of the Financial Sector/*Undang-Undang No. 4 Tahun 2023 tentang Pengembangan dan Penguatan Sektor Keuangan* ("PPSK Law"), OJK Regulation No. 51/POJK.03/2017 concerning the Implementation of SF for Financial Services Institutions, Issuers, and Public Companies/*Peraturan Otoritas Jasa Keuangan No. 51/POJK.03/2017 tentang Penerapan Keuangan Berkelanjutan bagi Lembaga Jasa Keuangan, Emiten, dan Perusahaan Publik*, OJK Regulation No. 18 of 2023 concerning the Issuance of and Requirements for Sustainability-Based Debt Securities and Sukuk/*Peraturan Otoritas Jasa Keuangan No. 18 Tahun 2023 tentang Penerbitan dan Persyaratan Efek Bersifat Utang dan Sukuk Berlandaskan Keberlanjutan*, and other relevant regulations. Subsequently, secondary legal sources include legal books, articles, and any academics paper. Finally, non-legal sources include newsletters, reports, and any non-legal writing. The findings from the literature and document studies were then related to related theories, written descriptively, and examined qualitatively.

C. Result and Discussion

The integration of sustainable finance into financial regulation presents opportunities and challenges. On one hand, it enhances the contribution of finance to inclusive growth and mitigation of climate change,[8] and strengthen the resilience and competitiveness of financial institutions.[9] On the other hand, if inadequately designed or enforced, it risks producing legitimacy deficits that may erode confidence in both financial institutions and regulators. For developing countries such as Indonesia, where financial stability and public trust remain fundamental to the economic development, the stakes of this integration are particularly high.

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[7] Marzuki, Peter Mahmud, 'Penelitian Hukum', 19th Edition, Jakarta: Kencana, 2024, 181.

[8] Colaert, Verlee, 'The Changing Nature of Financial Regulation Sustainable Finance as a New Policy Goal,' Vol. 04, (2022): 9.

[9] Prabowo, Hayu S. 'Implementation of Sustainable Finance Regulation for Financial Institutions in Indonesia,' Jurnal Ilmu Manajemen dan Ekonomika, Vol 16, No. 1, (2023): 5.

1. Financial Sector and Financial Regulation

This section will start with the definition of the financial sector. There are many literatures that define the financial sector (is defined in other literature as a financial system). However, we can simplify the financial sector as a part of the economy made up of firms and institutions that provide financial services to commercial and retail customers.[10] Under PPSK Law (as defined below), financial sector ecosystem includes (i) institutions in the financial sector; (ii) banking; (iii) capital markets, money markets, and foreign exchange markets; (iv) insurance and guarantees; (v) financing services; (vi) pension funds, and retirement security programs; (vii) cooperative activities in the financial services sector; (viii) microfinance institutions; (ix) financial conglomerates; (x) Financial Sector Technology Innovation; (xi) bullion business activities; (xii) Implementation of Sustainable Finance; and (xiii) consumer protection in the financial services sector. Thus, regulation also outlines the stability of the financial system, the development of human resources in the financial sector, guidance, supervision, and law enforcement in the financial sector.

Financial sector plays a systemic role in sustaining macroeconomic stability and economic development. Efficient financial systems will generate lower transaction costs, less information asymmetries[11] between borrowers and lenders, and promote capital formation, which makes it easier for businesses to access financing[12] and supports the economy as a whole. Conversely, dysfunction within the financial sector can produce systemic economic consequences, such as increase in unemployment and economic hardship,[13] generating credit contractions, and asset price collapses.

The systemic importance of the financial sector derives from its interconnectedness with the 'real economy'.[14] Financial institutions are linked through credit exposures, derivatives contracts, liquidity

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[10] Will Kentor, "Financial Sector Explained: Key Players, Importance, and Economic Impact." https://www.investopedia.com/terms/f/financial_sector.asp (Accessed 11 February 2026).

[11] Charles Goodhart, et al. "Financial Regulation: Why, how and where now?" London: Routledge (2005): 137

[12] Hongzhi Wang, et al. "Financial development, legal systems and SME finance: Cross-country evidence." International Review of Economics & Finance. Volume 88, (November 2023): 984.

[13] John Armour, et. al. "Principles of Financial Regulation." ECGI Working Paper Series in Law: Law Working Paper N 277/2014 (June 2016): 8.

[14] Daniela Tavasci and Jan Toporowski (Ed.), "Minsky, Crisis and Development." Palgrave Macmillan (2010): 145-154.

dependencies, and shared market infrastructures. This interconnected structure produces network externalities: distress in one institution may trigger contagion effects that threaten the broader system. Furthermore, technological advancements nowadays have deeply integrated cross-national financial systems thereby amplifying the potential to transmit problems and disruptions from place to place and institution to institution at almost breakneck speed.[15]

Financial system stability rests upon a constellation of fundamental determinants, including macroeconomic fundamentals,[16] an adequate regulatory framework,[17] , reciprocal connections between institutions and markets,[18] public trust to regulator,[19] and external influences such as global political dynamics and policy trajectories.[20] This understanding in line with Yandle's theory on the causes of the financial crisis, which recognize that the public trust may be one of the causes of the financial crisis.[21] Although these factors interact in complex and mutually reinforcing ways, this paper will deeply concentrate on the confidence in market integrity factor. Confidence operates as the invisible infrastructure sustaining financial transactions. Without trust, liquidity evaporates, and the system's intermediation function may be disrupted. From the perspective of legitimacy theory and market integrity principles, confidence is maintained when regulatory institutions and market participants consistently act in a transparent, prudent, and accountable manner.

Integrity on its own can be defined as "the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition"[22]. Integrity in the context of financial sector on the other hand refers to the consistency between institutional conduct, regulatory standards, and public expectations of fairness, transparency, and prudence. It includes legal compliance, sufficient disclosure, adequate risk management, and ethical market behavior. Financial integrity ensures that markets function on the basis of reliable information and enforceable

[15] Goodhart, et al. "Financial Regulation: Why, how and where now?."
[16] Brunnermeier, et al. "The Fundamental Principles of Financial Regulation." London, (2009). 10
[17] OpCit. Armour, et al. 132.
[18] *Ibid.* 110.
[19] *Ibid.* 796.
[20] *Ibid.* 802.
[21] Kukuh Komandoko. "Krisis Sistem Keuangan di Indonesia" Rajawali Pers (2023): 14.
[22] Erhard, W., & Jensen, M. C. "Putting integrity into finance: A purely positive approach" (No. w19986). National Bureau of Economic Research. (2014): 3

commitments. Without a strong reputation or integrity, financial products offered within the financial system may not be trusted by the public, which has potential to tear asunder the very systems by which they make their livelihood.[23] Conversely, when public trust in financial products and in the financial sector as a whole is well maintained, the possibility of financial crises can be significantly reduced.

Trust or confidence operates at multiple levels within the financial system. At the micro level, investors must trust issuers' or financial institution disclosures. At the meso level, institutions must trust counterparties' solvency and compliance. At the macro level, the public must trust regulatory authorities to oversee markets effectively and impartially. However, as Beetham's theory of legitimacy emphasizes, that power relationship is not legitimate because people believe in its legitimacy, but because it can be justified in terms of their beliefs.[24] Accordingly, trust in financial markets is grounded not only in perception but in the demonstrable alignment between institutional behaviour, regulatory conduct, and societal expectations of fairness, transparency, and accountability. The actions of financial institutions and regulators therefore directly shape public confidence in market integrity: consistent and justifiable conduct strengthens stability, whereas opaque or inconsistent behaviour risks, such as Misleading disclosures, regulatory capture, or supervisory negligence, will eroding legitimacy and undermining financial resilience.

In this context, emerging regulatory domains, such as sustainable finance, that should be evaluated in light of their impact on financial integrity. If sustainability claims are weakly verified or inconsistently enforced, they may generate information distortions and reputational risks. Greenwashing, for example, represents not merely a marketing concern but an integrity breach that can undermine confidence in both financial institutions and regulators. Thus, integrity and trust are not peripheral ethical values; they are structural prerequisites for systemic stability.

The second point to be discussed under this section is financial regulation. Financial regulation refers to the process of rulemaking as

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[23] Anil Hira, et. al. (Ed.), "The Failure of Financial Regulation, Why a Major Crisis Could Happen Again." Palgrave Macmillan, Springer (2019): 237.

[24] Fabienne Peter,, "Political Legitimacy", The Stanford Encyclopedia of Philosophy (Summer 2025 Edition), Edward N. Zalta & Uri Nodelman (eds.), URL = <https://plato.stanford.edu/archives/sum2025/entries/legitimacy/>. (accessed 12 February 2026),

well as the supervision and enforcement of rules[25] in the financial sector. Main purpose of financial regulation is to make market functions better than it would in the absence of it. We understand that the following purpose may too abstract to understand. Based on multiple sources, there are three core objectives of financial regulation, including consumer and/or investor[26] protection, financial stability, and promotion of systemic efficiency and competition.[27] Unlike regulations in ordinary industries, financial regulation addresses a sector characterized by high leverage, interconnectedness, opacity, and systemic externalities, so this sector known as heavily regulated industries.[28] In fact, its scope extends beyond individual firm conduct to the resilience of the financial system as a whole (microprudential and macroprudential regulation).[29]

Financial systems in most countries of the world have been shown to have a fragile structure and the evolution of financial regulation has been shaped by multiple crises. Early banking regulations emerged in response to bank runs and depositor losses, emphasizing prudential safeguards such as reserve requirements and capital buffers. The Great Depression catalyzed comprehensive regulatory reforms aimed at restoring confidence, including separation of banking activities and enhanced disclosure in capital markets. Subsequent decades witnessed cycles of deregulation and re-regulation, often influenced by prevailing economic ideologies. The 2008 global financial crisis marked a decisive shift towards macroprudential supervision, a lesson learned when financial regulation was comprehensively outmanoeuvred by financial markets and institutions, leaving it exposed to the failures and contagion that occurred in 2008.[30] This historical trajectory reveals a consistent pattern: financial regulation expands in response to perceived systemic vulnerabilities.

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[25] Christopher Ruof, "Regulating Financial Innovation: Fintech and the Information Deficit." Palgrave Macmillan, Springer: Germany (2023): 32-37.

[26] Veerle Colaert, "The Changing Nature of Financial Regulation Sustainable Finance as a New Policy Goal.", Jan Ronse Institute, Working Paper No. 2022/04 (April 2022): 30.

[27] Ruof, "Regulating Financial Innovation: Fintech and the Information Deficit."

[28] Ruof, "Regulating Financial Innovation: Fintech and the Information Deficit."

[29] Markus Brunnermeier, et. al., "The Fundamental Principles of Financial Regulation.", International Center for Monetary and Banking Studies (June 2009): 79.

[30] OpCit. Armour, et al. 142-148.

2. Basic Principles of Financial Regulation

Despite jurisdictional differences, financial regulation has several objectives. *First*, enforcing monopoly powers, preventing tremendous distortion to competition, and preserving market integrity. *Second*, protecting the daily needs of citizens in condition when the information is costly or hard to obtain and oversight could affect prosperity. *Third*, the existence of sufficient coverage of market failure.[31] Modern financial supervision is increasingly adopting a risk-based approach, allocating supervisory resources to areas with high technological complexity and systemic risk.[32] These principles collectively aim to maintain confidence in the financial system, raise public awareness of the financial system, protect consumers, and prevent and reduce financial crimes.[33]

Conceptually, risk lies at the core of financial regulation. Financial institutions inherently engage in maturity transformation, leverage, and risk pooling. While prudent risk-taking is indispensable for economic growth, excessive or poorly managed risk may generate systemic instability. Accordingly, the primary function of regulatory frameworks is to identify, measure, and mitigate risks before they crystallize into crises.

Traditionally, financial sector regulation has focused on credit risk, market risk, operational risk, and liquidity risk. However, evolving economic dynamics have revealed the growing significance of emerging risk categories, such as climate-related physical and transition risks which may materially affect asset valuations and the resilience of financial institutions.[34] If such risks are not properly internalized within supervisory and fundamental frameworks, they may accumulate in a latent and unmonitored manner, potentially amplifying systemic vulnerabilities over time.

The above discussion shows that financial regulation plays a crucial role in maintaining stability in the financial sector. Indeed, approaches

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[31] Brunnermeier, Markus, et al. "The Fundamental Principles of Financial Regulation." London, (2009).

[32] Sherif Youseff, et al. "Risk-Based Supervision Models for FinTech and Digital Asset Providers." Researchgate (2026)

[33] Rajesh Kumar,"Chapter 2 - Regulatory Environment of Financial Institutions.", Editor(s): Rajesh Kumar, Strategies of Banks and Other Financial Institutions, Academic Press (2014): 31-60, ISBN 9780124169975, https://doi.org/10.1016/B978-0-12-416997-5.00002-6. (https://www.sciencedirect.com/science/article/pii/B9780124169975000026)

[34] Hyeyoon Park, and Jakob Skovgaard. "Whose Risk Counts? Climate Risk Frames in Global Green Finance Governance Complex." Earth System Governance, 26 (2025): 1-12.

to financial regulation have always evolved over time, from one crisis to another. In this context, the financial sector's systemic importance and reliance on public confidence necessitate regulatory frameworks that preserve stability, transparency, and trust. Integrity is not and never an incidental outcome but part of structural objective of financial regulation.[35]

When regulatory frameworks are coherent, enforceable, and risk-sensitive, they reinforce institutional legitimacy and market confidence. Conversely, fragmented or weakly enforced regulation may erode credibility and amplify systemic vulnerabilities. Emerging regulatory domains, such as sustainable finance, must therefore be evaluated against their capacity to align with the foundational principles of prudence, transparency, and integrity. Financial regulation is not merely a technical exercise in rule-making; it is a governance mechanism designed to sustain trust in a sector upon which the broader economy depends. Any expansion of regulatory mandates, including the integration of sustainability objectives, must be calibrated to strengthen rather than compromise this foundational integrity.

3. Sustainable Finance in Indonesia: An Overview

Sustainable finance is regulated under Article 33, paragraph (4) of the 1945 Constitution of the Republic of Indonesia. Implicitly, the article serves as an umbrella for green investment regulation in Indonesia,[36] requiring the economic activities to prioritize environmental welfare. To implement this mandate, the Government of the Republic of Indonesia has issued the National Long-Term Development Plan ("**RPJPN**") and National Medium-Term Development Plan ("**RPJMN**"). In 2025-2045 RPJPN, to outline the constitutional mandate, the government uses 'Towards a Sovereign, United, Advanced, and Sustainable Indonesia' as the vision, demonstrating the long-term concern of sustainability. This is further operationalized in the 2025–2029 RPJMN, where the Prabowo administration explicitly lists sustainability as its second strategic priority.

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[35] Colaert, "The Changing Nature of Financial Regulation. Sustainable Finance as a New Policy Objective."

[36] Supriyadi, Aditya Prastian, Mustafa Lutfi, and Kurniasih Bahagiati, 'Strengthening Indonesia's Green Investment Law: Legal Reconceptualisation toward Net-Zero Emissions under Green Constitution and Maslahah', Vol 16, No. 2 (2025): 440. https://doi.org/10.18860/j.v16i2.35169.

Speaking directly with regard to sustainable finance, the awareness has grown steadily in Indonesia over the past decade. This momentum began in 2015, when OJK introduced the "Roadmap for Sustainable Finance in Indonesia 2015–2019" ("**Roadmap Phase I**"), which outlined key elements including sustainable finance principles, sustainable business classifications, incentives development, and industry outreach. However, a formal definition of sustainable finance emerged only with OJK Regulation No. 51/POJK.03/2017 concerning the Implementation of SF for Financial Services Institutions, Issuers, and Public Companies ("**OJK Reg No. 51/2017**"), which was later refined under PPSK Law. Sustainable Finance is defined as an ecosystem with comprehensive support in the form of policies, regulations, norms, standards, products, transactions, and financial services that harmonize economic, environmental, and social interests in financing sustainable activities and financing transitions towards sustainable economic growth.

Furthermore, the expansion and implementation of sustainable finance within the Indonesian financial landscape necessitates a strategic harmonization with the foundational frameworks established in both Roadmap Phase I and the Sustainable Finance Roadmap Phase II (2021-2025): The Future of Finance ("**Roadmap Phase II**"). To ensure this growth aligns with international sustainability standards, regulators have designed a set of fundamental sustainable finance principles that govern institutional conduct, including (a) Responsible Investment; (b) Management of Social and Environmental Risks; (c) Informative Communication; (d) Development of Priority Sectors; (e) Sustainable Business Strategy and Practice; (f) Governance; (g) Inclusive; and (h) Coordination and Collaboration. These principles remain the authoritative reference for the industry to date and have been formally institutionalized through OJK Regulation No. 51/2017.

OJK Regulation No. 51/2017 also governs ESG aspects, including the introduction of ESG metrics in general. Under Appendix II, environmental aspects are split into direct and indirect impact categories. The direct impact category requires more extensive reporting, covering areas such as flora and fauna protection, emission controls, and waste management mechanisms. Regarding social aspects, the regulation focuses on workforce equality, consumer treatment, and labor development programs. These requirements facilitate the integration of social governance under OJK Regulation No. 51/2017. Finally, the governance aspects mandate strategic oversight for the Board of Directors and the Board of Commissioners to implement risk management and champion sustainable finance initiatives. Additionally, the regulation encourages companies to set up a dedicated internal unit to manage these responsibilities.

The implementation of SF in the financial sector has progressed considerably. Based on data from OJK, as of June 2025, commercial bank lending and financing/refinancing for green business activities grew substantially:[37]

2019	2020	2021	2022	2023	2024
705,154	1,269,082	1,520,396	1,753,566	1,915,591	2,047,366

*(*on billion Rupiah)*

In the capital markets, derivatives, and carbon exchange sectors, 74 sustainability-linked bond or sukuk instruments have been issued, with total value of transactions up to Rp65.766 trillion. These include 35 Green Bonds, 23 Social Bonds, 13 Sustainability Bonds, and 3 Sustainability-Linked Bonds. Although the availability of such instruments enhance flexibility and encourages sustainable finance, their overall share remains modest representing 8.84% of outstanding bonds and sukuk. [38]

Apart from Law No. 4 of 2023, several regulations also govern the sustainable finance framework, as set forth below:

No.	Regulation	Key Provisions
1.	Law No. 25 of 2007	Requiring all direct investments to implement corporate social responsibility[39] and uphold environmental conservation.[40]
2.	Law No. 40 of 2007	Requiring companies engaged in natural resources-related activities to implement corporate social responsibility.[41]

[37] Financial Services Authority (OJK), "Statistics on Indonesian Sustainable Financial Instruments as of June 2025", OJK, https://keuanganberkelanjutan.ojk.go.id/keuanganberkelanjutan/Uploads/Statistik/Statistik_25091512573862.pdf, accessed February 20, 2026.

[38] *Ibid.*

[39] Article 15 (b) of Law No. 25 of 2007 concerning Direct Investment. Hereinafter referred to as "**Law No. 25 of 2007**".

[40] Law No. 25 of 2007. Article 16 (d).

[41] Article 74 (1) of Law No. 40 of 2007 concerning Limited Liability Company.

3.	Law No. 32 of 2009	Requiring the national and local government to develop and implement the environmental economic instruments, which include: 1. development planning and economic activities; 2. environmental financing; and 3. incentives and/or disincentives.
4.	GR Reg No. 46 of 2017	Requiring the development of environmentally-oriented Financial Institutions, which are intended to:[42] 1. implement financing mechanisms that incorporate environmental considerations; promote regulatory compliance; and 2. incentivize green investment.

OJK has also issued Roadmap Phase I (2015–2019) and Roadmap Phase II (2021–2025), Green Taxonomy 1.0 (2020), TKBI (2024), and the Indonesian Sustainable Finance Taxonomy (Version 2, 2025). These instruments serve to reduce ambiguity and prevent greenwashing, social washing, and impact washing by establishing clear ESG-aligned standards.[43] Moreover, Bank Indonesia, the Central Bank of Indonesia, as the monetary and macroprudential authority, contributes through tools such as the Green Calculator, designed to enhance emissions transparency, guide reduction strategies, and support progress toward a net-zero emissions (NZE) economy. [44]

Another pivotal milestone of sustainable finance has occurred in 2018, when the financial services authority (*Otoritas Jasa Keuangan*) launched the 'First Movers on Sustainable Banking' pilot project. This initiative strategically mobilized eight commercial banks representing approximately 46% of national banking assets, positioning these entities

[42] Article 42 (2) of the Government Regulation No. 46 of 2018 concerning Environmental Economic Instruments.

[43] Otoritas Jasa Keuangan "Taxonomy for Sustainable Finance in Indonesia Version 2, 2025," www.ojk.go.id, accessed November 24, 2025

[44] Bank of Indonesia, "Green Economy," Bank of Indonesia, https://www.bi.go.id/id/fungsi-utama/stabilitas-sistem-keuangan/keuangan-hijau/default.aspx, accessed November 25, 2025.

as pioneers to spearhead the domestic transition toward sustainable banking practices.[45] While the subsequent implementation has demonstrated significant progress, driven by the alignment of all stakeholders of financial sectors, including regulators and major financial institutions, the supervisory mandate with regard to sustainable finance remains a critical point.[46] The regulators shall maintain their supervisory diligence to ensure that the implementation of sustainable finance is genuinely put into realization in accordance with its intended statutory purpose. This proactive supervision is essential not only to preserve public trust in financial institutions but also to safeguard the broader integrity and resilience of the financial sector.

4. Sustainable Finance in Indonesia: An Overview

Sustainable Conceptually, sustainable finance is designed to internalize environmental and social risks within financial or business decision-making. This concept emerges from the recognition that extreme climate change poses substantial challenges to both the economy and the financial system.[47] Indeed, the primary objective of sustainable finance is to mitigate systemic risks in the future. Yet paradoxically, if poorly designed or weakly enforced, sustainable finance may generate new forms of regulatory and integrity risk. This paradox arises from the interaction between symbolic commitment and incomplete institutional embedding. When sustainability frameworks are publicly promoted but not substantively integrated into prudential oversight, they create expectations without corresponding enforcement capacity. The gap between regulatory rhetoric and regulatory practice can undermine credibility, which reduces financial sector integrity.

This risk could be understood through legitimacy theory. Based on this theory, companies should be able to adapt to the value systems that have been implemented by society.[48] The goal is for the company's

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[45] Setyowati, A. B. "Governing sustainable finance: Insights from Indonesia." Climate Policy, 23(1) (2023): 108–121. https://doi.org/10.1080/14693062.2020.1858741.

[46] Mark Carney, "Breaking the Tragedy of the Horizon: Climate Change and Financial Stability" (September 2015): 4.

[47] Pongsak Luangaram et al., "Climate Risk and Financial Stability: A Systemic Risk Perspective from Thailand." International Review of Economics and Finance, 106 (2026): 1-22. https://www.sciencedirect.com/science/article/pii/S1059056026000894.

[48] Nurna Aziza. "*Anteseden Pengungkapan Lingkungan dan Pengaruhnya Terhadap Image Perusahaan (Studi Empiris pada Perusahaan Manufaktur Indonesia)*." Jurnal Fairness Volume

existence and activities to be legitimized by society. Returning to legitimacy risk, this risk is different from conventional financial risk. This risk relates to a decline in trust in regulatory institutions and market integrity. When stakeholders perceive the sustainability framework as superficial or inconsistently applied, skepticism can spread from ESG-labeled products to the regulatory system as a whole. Therefore, sustainable finance has a dual potential: it can either strengthen systemic trust and ensure the financial stability, or it can disrupt the stability through widespread reputational impacts, such as greenwashing.

Greenwashing represents the most visible manifestation of integrity failure within sustainable finance. It occurs when financial institutions market products or strategies as environmentally sustainable without substantive alignment with environmental objectives. For instance, banks or non-bank financial institutions may extend credit to companies whose products are not environmentally friendly. Given that existing technical guidelines lack the necessary criteria to validate green product classifications.[49] Some companies may overstate their environmental and/or social effort.[50] The purpose is to obtain a competitive advantage[51] in the market and public trust. In short, greenwashing constitutes misrepresentation.

From an information asymmetry perspective, sustainability claims amplify existing informational imbalances. ESG metrics are complex, evolving, and often ambiguous. Retail investors particularly lack the capacity to independently verify environmental impact claims accurately. If regulatory frameworks fail to standardize definitions and enforce compliance clearly, institutions may exploit this asymmetry. As previously discussed, this phenomenon may be understood through the lens of legitimacy theory. Corporations tend to seek societal approval and stakeholder trust by presenting themselves as engaging in

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4, No. 1 (2014): 1-22. https://ejournal.unib.ac.id/index.php/fairness/article/view/15294.

[49] Yuanitasari, Deviana, Kusmayanti, Hazar, and Suwandono, Agus. 'Menelaah Greenwashing: Perlindungan Hukum Konsumen Di Tengah Tren Produk Ramah Lingkungan.' Jurnal Hukum Lingkungan Tata Ruang dan Agraria Departemen Hukum Lingkungan Tata Ruang dan Agraria, Fakultas Hukum Universitas Padjadjaran 04, no. April (2025): 134.

[50] Shaocong Bo and Enrico Battisi. "Green Finance and Greenwashing: Charting a Sustainable path Foward." Qualitative Research in Financial Market, Vol. 18 No. 1 (2026): 85-104

[51] Posi Olatubosun and Sethi Nyazenga. "Greenwashing and responsible investment practices: empirical evidence from Zimbabwe." Qualitative Research in Financial Markets, Vol. 13 (1) (2021): 16–36.

sustainable and environmentally responsible (ESG) practices. However, in practice, such commitments often ambiguous or biased. This practice will erode stakeholder legitimacy,[52] also public trust on sustainability movement.

Theoretical implications extend beyond public and/or investor protection. Widespread greenwashing may trigger a "market for lemons" dynamic, in which investors discount all sustainability-labelled products due to uncertainty about authenticity. This condition happens because investors or public are less likely to support companies that engage in deceptive manipulation and falsify their promises.[53] Such phenomenon undermines the allocative function of sustainable finance. Capital may fail to flow toward genuinely sustainable activities, weakening environmental objectives while eroding stakeholder and investor confidence.[54]

Moreover, greenwashing exposes regulators to relevant reputational liability risk.[55] If sustainability-labelled instruments experience controversy or scandal, public scrutiny often shifts toward supervisory authorities. The question becomes not merely whether firms misrepresented sustainability, but whether regulators failed to prevent it. In emerging financial systems, where regulatory legitimacy remains consolidating, such episodes can have disproportionate reputational impact.

A second integrity risk arises from regulatory arbitrage. Frank Partnoy defined Regulatory Arbitrage as "*those financial transactions designed specifically to reduce costs or capture profit opportunities created by different regulations or laws*".[56] When sustainability criteria lack precision or supervisory consequences, financial institutions may engage in symbolic compliance, meeting formal reporting requirements while maintaining

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[52] Dinar Yoga Baskoro Aji and Zainal Alim Adiwijaya. "Systematic Literature Review: Greenwashing and its Impacts on Sustainability and Corporate Practices." Jurnal Bisnis Mahasiswa, Vol. 5 No. 2, (2025): 536-548. https://doi.org/10.60036/jbm.524.
[53] Aji and Adiwijaya. "Systematic Literature Review: Greenwashing and its Impacts on Sustainability and Corporate Practices.", 538.
[54] Michael T. Lee and Robyn L. Raschke. "Stakeholder legitimacy in firm greening and financial performance: What about greenwashing temptations?." Journal of Business Research, 155 (2023), 113393. https://doi.org/10.1016/J.JBUSRES.2022.113393.
[55] KPMG. "The Challange of Greenwashing: An International Regulatory Overview." KPMG International (2024). https://assets.kpmg.com/content/dam/kpmg/cy/pdf/2024/the-challenge-of-greenwashing-report.pdf
[56] Frank Partnoy. "Financial Derivatives and the Costs of Regulatory Arbitrage." The Journal of Corporation Law (1997). https://api.semanticscholar.org/CorpusID:158129170.

business models largely unaffected by sustainability risk. Symbolic compliance means a way in which states adopt the formal attributes of compliance while avoiding substantive behavioural change. In the sustainability context, the likelihood of symbolic compliance increases when sustainability obligations are conceived as governance norms, rather than as prudential requirements integrated into regulatory supervision and enforcement mechanisms.[57] Institutions may produce sustainability reports, adopt internal ESG committees, or align with voluntary standards, without materially adjusting credit allocation or risk exposure. The ecolabel products, for instance, do not have rigorous standards according to current legislation, which can mislead consumers and allow companies to exploit loopholes in their environmental claims.[58] In such cases, sustainable finance functions as reputational branding rather than substantially transforming their risk. From a systemic perspective, symbolic compliance will create vulnerability and the absence of immediate instability. At this point, regulators should encourage firms to engage in substantive practices rather than relying on reporting as a mere compliance strategy.[59]

Reputational risk occupies a central position in financial systems characterized by high leverage and informational opacity. Reputation functions as a form of capital, sustaining investor confidence and depositor trust. When reputational damage occurs, its effects can extend beyond individual institutions. If a major sustainability-labelled financial product is exposed as misleading, public perception may generalize skepticism to other institutions and to the regulatory framework itself. In markets where sustainable finance is promoted, reputational damage can undermine public trust in ecolabels and environmental preservation efforts in general.[60]

The integration of sustainability into financial regulation therefore, raises stakes for supervisory authorities. Such risk, makes the sustainability movement become not merely a policy objective but a

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[57] Xiu Li. "Symbolic Compliance in the EU ESG Disclosure Regulation." Journal of Applied Economics and Policy Studies 18(11) (2025):68-72, DOI:10.54254/2977-5701/2025.3026.

[58] Yang, et al. "Corporate Good Deed and Service Failure : Does Being Good Lead to Forgiveness ?" Journal of Hospitality Marketing & Management 33, no. 8 (2024): 1040–70. https://doi.org/10.1080/19368623.2024.2362732.

[59] Yann Truong, et al. "Understanding The Impact of Symbolic and Substantive Environmental Actions on Organizational Reputation." Scienedirect (2021): 1-48.

[60] Deviana Yuanitasari, et al. "Consumer Protection Against False Ecolabel Claims: A Legal Analysis in Indonesia." Jurnal Poros Hukum Padjajaran, Vol. 6 No. 1 (2024): 31-47.

reputational commitment. In Indonesia's context, where financial sector credibility has been strengthened, sustainable finance represents both opportunity and vulnerability. Effective integration can signal forward-looking governance and enhance international confidence. Conversely, high-profile sustainability controversies may damage public trust. If trust erosion leads to withdrawal of funds from sustainability-linked instruments or broader market segments, liquidity pressures could emerge. While such scenarios remain speculative, they illustrate how integrity failures may translate into financial instability.

Another risk of weak sustainable finance integration concerns mispricing. Based on research conducted by Kolling and Busch, the products which labelled by sustainability attributes have a superior position.[61] This practice is used by financial institutions to give a signal to the investor.[62] However, if sustainability labels are inconsistently defined or weakly verified, markets may misprice both sustainable and unsustainable assets. These conditions are possible, given that the OJK Reg No. 51 of 2017 does not provide what the environmental documents are mandatory to give as the consideration of credit provisions.[63] OJK Reg No. 51 of 2017, shows that financial regulation seeks to prevent precisely such mispricing dynamics by enhancing transparency and prudential oversight. If sustainable finance frameworks fail to produce reliable information, they may exacerbate rather than mitigate valuation distortions.

The cumulative effect of greenwashing, symbolic compliance, and reputational contagion is the potential delegitimization of financial regulation. Delegitimization occurs when regulatory frameworks are perceived as ineffective, inconsistent, or captured by private interests (regulatory capture).[64] Sustainable finance heightens this risk because it operates at the intersection of financial governance and public policy. Environmental sustainability carries ethical values. If regulatory commitments in this domain appear performative, public trust may erode not only in financial institutions but in regulatory institutions themselves. Reduced trust in regulatory oversight can discourage

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[61] Christopher Kolling and Timo Busch. "Sustainability Labels Matter." Finance Research Letters 73 (2025): 2-7. https://doi.org/10.1016/j.frl.2024.106609.
[62] *Ibid.*
[63] Besafina Hanan Amarany. Skripsi, "*Tinjauan Yuridis Adopsi Dan Perkembangan Konsep Keuangan Berkelanjutan (Sustainable Finance) dalam Hukum Indonesia*." Universitas Indonesia, (2020): 100.
[64] James Shipton. "The Regulatory State: Faults, Flaws, and False Assumptions." Melbourne Regulation and Design Network – Policy Brief (February 2025): 1-14.

investment and amplify market volatility. Therefore, sustainable finance shall be understood as a legitimacy-sensitive domain. Its success depends not solely on formal compliance or formalistic.

The foregoing analysis suggests that sustainable finance may undermine financial integrity under certain conditions, including the absence of clear statutory authority or effective supervisory consequences. Second, disclosure practices that lack independent verification, particularly where regulatory frameworks exist without standardized metrics or meaningful enforcement mechanisms. Third, situations in which climate-related risks fail to materially influence capital allocation decisions or supervisory assessments. Fourth, circumstances where regulatory sanctions for misleading sustainability-related claims are infrequent, ambiguous, or inconsistently applied. Finally, challenges arise where supervisory authorities lack the technical capacity and resources necessary to conduct forward-looking assessments of sustainability-related risks.

When such conditions above appear, sustainable finance becomes vulnerable and will threaten the financial sector integrity. Conversely, when sustainability is internalized within prudential supervision, supported by stronger regulatory intensity,[65] closer coordination between stakeholders,[66] standardized disclosure and credible enforcement, it strengthens rather than weakens financial integrity. However, regulators shall lead to drive alignment between sustainability statements and verifiable actions, as well as in building cultures that support ongoing alignment.[67] In short, the distinction lies not in policy aspiration but in regulatory design and its enforcement.

As aforementioned, Sustainable finance brings both opportunities and challenges. It promises alignment between financial markets and long-term environmental resilience which will reduce systemic risk in

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65 Y. N. Zhao and Riaz, M. U. "On the Factors Influencing Green Purchase Intention: A Meta Analysis Approach." Frontiers in Psychology, Vol. 12, (2021). https://doi.org/10.3389/fpsyg.2021.644020

66 Agne Sneideriene and Renata Legenzova. "Greenwashing prevention in environmental, social, and governance (ESG) disclosures: A bibliometric analysis." Research in International Business and Finance, Vo. 74 (2025): 1 – 28, https://doi.org/10.1016/j.ribaf.2024.102720.

67 Miriam Wrobel and Alana Fishman. "Greenwashing: The Emerging Liability." Harvard Law School Forum on Corporate Governance (2025). https://corpgov.law.harvard.edu/2025/01/02/greenwashing-the-emerging-liability-landscape/, accessed February 23, 2026.

financial system.[68] Yet if inadequately integrated, it risks generating integrity failures that undermine the foundational trust upon which financial systems depend.

Conceptually, the drive to promote sustainable practices in the financial sector can be achieved through financial regulation by promoting 'Sustainable Finance', which represents a structural transformation of financial governance. Its success depends not on aspirational language or normative textualization, but on coherent regulatory integration, in both formally and substantively. By anchoring sustainability within statutory authority, prudential supervision, standardized transparent disclosure, and credible enforcement, regulators can internalize environmental risk while preserving institutional legitimacy. In emerging market contexts such as Indonesia, this calibrated integration is essential to prevent reputational spillovers and systemic trust erosion. Sustainable finance shall properly integrated to enhances the resilience and credibility of financial systems. Poorly integrated, it risks becoming a source of integrity failure. The distinction lies in regulatory design.

D. Conclusion

This study shows that incorporating sustainable finance into financial regulation is not just an environmental policy option, but rather a fundamental governance matter closely related to the integrity of the financial sector. In Indonesia, the framework for sustainable finance has progressed notably via legal mandates, OJK guidelines, taxonomies, and oversight plans. The success of this framework relies on how thoroughly it is incorporated into prudential supervision. Sustainable finance enhances systemic resilience solely when climate and social risks are truly integrated into risk evaluation, disclosure criteria are uniform and trustworthy, and enforcement strategies are reliable. Alternatively, dangers like greenwashing, superficial compliance, regulatory circumvention, mispricing, and reputational spillover could damage public confidence and weaken the credibility of financial regulation itself. The main problem lies not in the presence of sustainable finance standards, but rather in the consistency, regulatory strength, and enforcement effectiveness backing them.

This research is significant due to the fact that financial integrity forms the unseen framework of economic stability. In developing

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[68] Carney, "Breaking the Tragedy of the Horizon: Climate Change and Financial Stability."

markets like Indonesia, where public trust is vital for progress, sustainable finance should serve as a regulatory tool instead of merely a branding term. Subsequent studies should investigate actual supervisory methods, patterns of enforcement regarding sustainability violations, and the quantifiable effects of integrating climate risk on capital distribution and systemic stability. An anticipatory examination of regulatory capability, inter-agency collaboration, and the efficacy of Indonesia's sustainable finance taxonomy would enhance the guarantee that sustainability goals support, rather than undermine the integrity of the financial system.

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