

Client Update: Indonesia
29 September 2023

Indonesia's Carbon Exchange is Here. What Businesses Need to Know



Back in January of this year, Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector ("**P2SK Law**") granted the authority to regulate and oversee financial services activities in the carbon exchange sector to the Financial Services Authority (*Otoritas Jasa Keuangan* or "**OJK**"). As a follow-up to this authority, OJK has issued:

- OJK Regulation No. 14 of 2023 on Carbon Trading through Carbon Exchange ("**OJK Regulation**"), which contains the guideline and reference for carbon exchange operators as well as OJK to regulate, supervise, and coordinate with relevant ministries or institutions for carbon trading in Indonesia through the nation's carbon exchange.
- OJK Circular Letter No. 12/SEOJK.04/2023 on the Procedures for Organising Carbon Trading through Carbon Exchange ("**OJK Circular**").

Concurrently with the two rules, OJK approved PT Bursa Efek Indonesia (the operator of the Indonesia Stock Exchange, or "**IDX**") to become the operator of the carbon exchange. Upon such approval, IDX promptly issued a set of regulations to allow business owners to commence trading in the exchange. Lastly, on 26 September, President Joko Widodo officially launched the carbon exchange.

Below is the gist of the OJK Regulation and OJK Circular.

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Carbon Units

Carbon Units represent proof of ownership of carbon in the form of a certificate or technical approval representing one ton of carbon dioxide. This ownership is recorded in the National Registry System for Climate Change Control (*Sistem Registri Nasional Pengendalian Perubahan Iklim* or "**SRN PPI**"). Carbon Units traded through the carbon exchange are considered securities (*efek*), and are regulated similarly to securities in the capital market sector.

Carbon Units traded through the carbon exchange can be in the form of a Business Entity Emission Cap Approval (*Persetujuan Batas Atas Emisi Pelaku Usaha* or "**PTBAE-PU**") or Greenhouse Gas Emission Reduction Certificate (*Sertifikat Pengurangan Emisi Gas Rumah Kaca* or "**SPE-GRK**"). This means that companies engaged in renewable energy or decarbonisation activities will be able to issue and sell carbon credits in the form of SPE-GRK instruments, while emitters such as coal power plant operators can buy those credits to compensate for their carbon emissions that exceed the cap set on their PTBAE-PU.

Trading of Carbon Units

Carbon Units can be traded:

- a. Directly between parties (private placement); and
- b. In a carbon exchange organised and provided by the carbon exchange operator (currently, the IDX is the only carbon exchange operator).

Every Carbon Unit transacted in the carbon exchange must be recorded in the SRN PPI and by the carbon exchange operator. The OJK Regulation also allows the operator to facilitate the trading of Carbon Units from foreign countries listed in the SRN PPI or Carbon Units not listed in the SRN PPI, subject to certain conditions.

Foreign Carbon Units

With respect to Foreign Carbon Units, the OJK Circular regulates that Foreign Carbon Units that are not listed in the SRN PPI but facilitated for trading by the carbon exchange operator must:

- a. Be registered, validated, and verified by an institution accredited by an international registration system operator;
- b. Meet the requirements for trading on foreign carbon exchanges; and
- c. Fulfill other requirements as established by OJK under the coordination with the Minister of Environment and Forestry.

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Carbon Exchange Operator

As mentioned earlier, IDX is the only carbon exchange operator for now. As such, IDX is responsible for organising and providing the carbon exchange. A party intending to become a carbon exchange operator must apply to the OJK and have a paid-up and issued capital of at least IDR100 billion, which must not come from loans. OJK is also authorised to designate a party deemed to exercise control over the carbon exchange operator as that operator's controlling shareholder.

Interestingly, the OJK Regulation regulates that a carbon exchange operator can engage in "other activities" with the approval of OJK. However, the scope of these "other activities" has not been further detailed in the OJK Regulation. Using the IDX as an example, however, the "other activities" can include the activities of operating a stock exchange, which is IDX's activities before being approved as a carbon exchange operator.

Requirements for System and Facilities

The OJK Circular details the system and facilities a carbon exchange operator must implement to operate and supervise Carbon Unit trading. Among others, such system and facilities must connect with the SRN PPI so that only Carbon Units that have been verified, validated, and registered with the SRN PPI may be traded in the carbon exchange. It must also be connected with the system of the custodian and settlement institutions, clearing and guarantee institutions, and any other system deemed necessary to support carbon exchange activities.

Furthermore, the carbon exchange operator must implement internal control mechanisms, including conducting periodic testing of the system's capacity, performance, and security, as well as evaluating the vulnerability of its system and data centres against threats (internal or external) and natural disasters.

Organisation of Carbon Trading

The organisation of carbon trading through the carbon exchange must be carried out and provided by the carbon exchange operator by considering the requirements in the OJK Regulation, namely:

- a. The Carbon Unit trading must be regular, fair, and efficient, and efficient carbon trading is reflected by quick transaction settlements with relatively low costs.
- b. The Carbon Unit trading must be organised and provided using an electronic system to continuously track and record Carbon Unit transactions as long as such Carbon Units have not been retired for the fulfilment of emission reduction obligations by any particular buyer.
- c. The carbon exchange operator must provide a Carbon Unit trading system that:

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- (i) Functions as a marketplace where parties can make an offer to buy and sell Carbon Units; and
 - (ii) Accommodates the settlement of Carbon Unit transactions, both in terms of payment of funds and transfer of the Carbon Units, among parties within the same sector or different sectors based on the law. In relation to this point, the carbon exchange operator must ensure that parties involved in Carbon Unit transactions have adequate funds and Carbon Units and carry out risk management.
- d. The carbon exchange operator must not conduct Carbon Unit transactions for its interests.

Overview of IDX Regulations on Carbon Exchange

As mentioned earlier, IDX has issued regulations to regulate trading rules in the carbon exchange, the registration of carbon units in the carbon exchange, fees for carbon exchange service users, standardisation and categories of carbon units, and supervision of carbon trading through the carbon exchange.

One of the defining provisions under these IDR regulations is that the exchange is divided into four different segments: the auction market, the negotiated market, the regular market, and the non-regular market. These segments would determine how the Carbon Unit is traded.

OJK's Role

With respect to carbon trading, OJK's authority includes regulating, licensing, supervising, and developing carbon trading through carbon exchanges.

Moreover, OJK has the right to assess the competence and suitability, including conducting fit and proper tests, for every candidate of directors, commissioners, and shareholders of a carbon exchange operator. Therefore, these individuals will not be able to be appointed by the general meeting of shareholders until they have passed OJK's assessment.

Naturally, OJK is also authorised to supervise carbon exchange operators, carbon exchange participants, any supporting market infrastructure, carbon unit transactions, governance, risk management, consumer protection, and parties, products, and/or activities related to carbon trading in the carbon exchange. As part of its supervisory authority, OJK may impose administrative sanctions and specific actions on violating parties. Administrative sanctions can be in the form of written warnings, fines, business activity restriction or suspension, revocation of business licence, cancellation of approval, and deregistration.

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What's Next?

Through the OJK Regulation and the OJK Circular, the government showcases its commitment to mobilising market incentives to meet its emission cut targets. The sets of rules being put in place are expected to ensure an accountable market mechanism—at par with more advanced carbon exchanges that operate in other countries such as the EU, Canada, China, Japan, New Zealand, South Korea, Switzerland, and the United States.

As much as this swift effort is commendable, it remains to be seen whether in practice, the carbon exchange operator can answer some foreseeable challenges, for example, preventing the double selling of Carbon Unit that has been retired and integrating with offshore registries and exchanges in relation to the sale of Foreign Carbon Units.

Moreover, there are gaps that need to be filled in. As mentioned above, Carbon Unit can be traded either directly among parties (i.e. a private placement) or through the carbon exchange. Considering that the mandate given by the P2SK Law to OJK is strictly limited to carbon trading through carbon exchange, the OJK Regulation and OJK Circular do not impose any rules in relation to such carbon trading through private placement. We would expect that further regulation will be issued by the Minister of Environment and Forestry on this matter.

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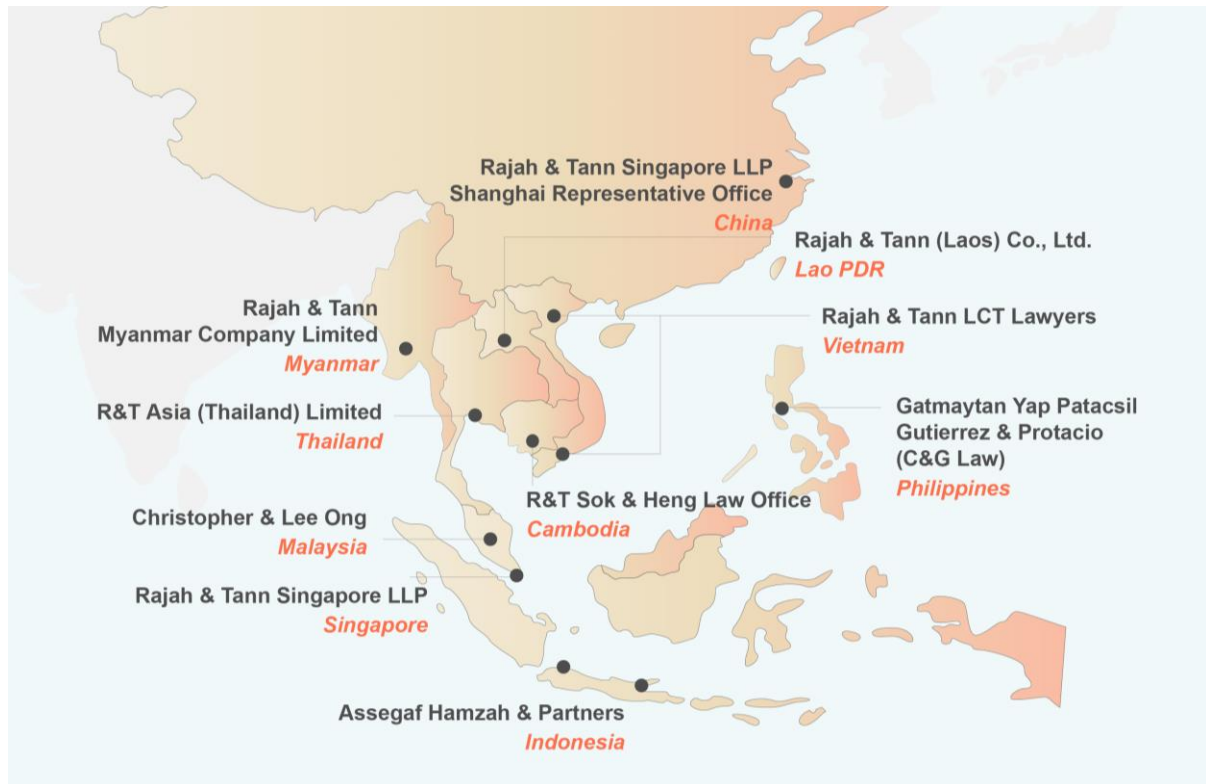
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