OPPORTUNITIES TO ADVANCE THEMATIC BONDS AND SUKUK IN INDONESIA

A Knowledge Brief

March 2024
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Enquiries to: communications.id@undp.org

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Design and layout by Agnes Kurniawan.
This brief presents an overview of the current situation and highlights the opportunities for Indonesia to increase the volume of thematic bond and sukuk issuance that contribute to achieving the country’s commitment to sustainability and climate agenda. This involves expanding the range of bond types issued, such as SustainabilityLinked and Transition Bonds, and reaping the benefits of issuing bonds and sukuk in local currency, considering Indonesia’s economic growth trajectory and other macroeconomic factors.

Indonesia is a pioneer in issuing sovereign thematic bonds and sukuk such as the Green Sukuk, SDG Bond, and Blue Bond, but the private sector issuance of thematic bonds/sukuk is nascent, with most issuances occurring in the foreign market.

Globally, there is an upswing in the volume of thematic bonds and sukuk issuance, which can be attributed to critical factors, primarily the confluence of ESG and Net Zero commitments, regulatory support, and the burgeoning demand from sustainability-conscious investors.

Local issuers face cost and resource barriers to thematic bond and sukuk issuance. These include developing a framework, undergoing external review, identifying eligible projects, and complying with impact reporting requirements.

Local investors are interested in thematic bonds and sukuk as they align with ESG reporting and offer diversification opportunities within existing portfolios. The Indonesian market has a growing appetite for new types of debt instruments, alignment with international standards, and impact reporting.

Development partners in Indonesia can support the ecosystem by providing technical assistance and capacity-building activities to encourage more issuers to engage in thematic bond and sukuk initiatives. Greater education and awareness-building efforts are required to showcase the benefits of thematic bonds/sukuk and align market expectations.
Indonesia is highly vulnerable to a wide range of physical risks stemming from climate change. The World Bank reports that between 1990 and 2021, Indonesia was hit by over 300 natural disasters, which impacted more than 11 million people. The frequency of these disasters is increasing, with climate-related disasters accounting for 70 percent of the total. Moreover, the country faces additional challenges to achieve its vision to become a developed country by 2045. To achieve this, Indonesia needs to reduce inequality across different socio-economic backgrounds, ethnicities, gender and geographical regions, improve the quality of education, increase employment and business opportunities, and prioritize new and renewable energy sources while minimizing environmental damage.

In response to these issues and challenges, Indonesia has firmly committed to enhancing its efforts to achieve the Sustainable Development Goals (SDGs) and create a low-carbon future. These efforts are incorporated into the Medium-Term National Development Plan, which places the achievement of the SDGs as a top priority for the country moving forward. Post-pandemic, BAPPENAS has estimated that the total funding requirement for Indonesia's SDGs (between 2021-2030) is projected at approximately USD 8.7 trillion (IDR 122,000 trillion), accompanied by a broader financing gap of USD 1.7 trillion (IDR 24,000 trillion), i.e., a 70 percent increase from the pre-pandemic figure. Meeting these increased financing needs will require tapping into the public and private sectors to facilitate the rollout of SDG-aligned financial instruments and the development of capacity and an enabling environment to utilize finance effectively.

Since 2018, to fulfil its climate and social commitments, the Government of Indonesia has pioneered sovereign thematic or GSS+ (Green, Social, Sustainable, and Other) debt instruments and sukuk, issuing a cumulative amount of over USD 9.5 billion in the international and domestic market. 

2 Authors calculations
Proceeds from these bonds/sukuk are exclusively allocated towards projects with a substantial impact on a socially inclusive sustainable economy—including the Government of Indonesia’s issuances of Green Sukuk since 2018, Indonesia SDG Bond since 2021, and the distribution of Blue Bond in 2023. Moreover, the corporate sector in Indonesia has issued a couple of thematic bonds and sukuk in the domestic currency.

Figure 1 presents the outstanding amount of sustainable bonds for Indonesia. The chart reflects the progress of sustainable bonds over the last five years, showing a five-fold rise in the market size. Government issuances comprise the bulk of the total market share, with most of the issuances in green sukuk and foreign currency denominated.

In comparison, corporate local currency issuance is less than ten percent of the total market share. Issuances in local currency need to be encouraged as they provide benefits like mitigating risks associated with foreign currency debt and reducing default risks, particularly relevant in the current macroeconomic and financial context.

Figure 1: Consolidated Sustainable Bonds outstanding in Indonesia.

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There are two types of thematic bonds in the market: (1) Use of Proceeds Bonds and (2) Key Performance Indicators Bonds. The main difference is in the Use of Proceeds Bonds - the proceeds must be used to finance or refinance eligible projects with targeted purposes (e.g., green, social). In contrast, Key Performance Indicators Bonds are not proceeds-based, i.e., proceeds may be used for general corporate purposes but linked to the performance of specific sustainability-related indicators. Figure 2 illustrates the two types of thematic bonds with examples.

This brief seeks to share knowledge on thematic bonds focusing on Indonesia, critical steps in the bond lifecycle, case studies, considerations and challenges in issuance, and new and upcoming bonds that may interest stakeholders.

**Figure 2: Types of Thematic Bonds**

- **Green Bond**: Finance new and/or refinance projects that contribute positively to the environment and/or climate.
- **Blue Bond**: Finance new and/or refinance projects that contribute positively to the environment and/or climate.
- **Social Bond**: Finance new and/or refinance projects that address social issues or seek to achieve positive social outcomes.
- **Sustainability Bond**: Encompasses green, blue, social, and gender issues. SDGs bonds can also be issued under this framework.
- **Transition Bond**: Finance new and/or existing eligible projects to implement net-zero transition.
- **Sustainability Linked Bond**: Linked with Key Performance Indicators.

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use-of-proceeds  KPI-linked
The financial world has recently witnessed a significant shift towards sustainable and responsible investing. Public or private investors are increasingly looking for opportunities that align with their sustainability commitments and are eager to support projects and initiatives that positively impact the world. This shift has led to sustainable finance that connects financial markets with responsible investing.

Global bond markets, with over USD 133 trillion in value outstanding, are a potential source of financing for sustainable development. Bonds are the largest asset class in global financial markets, twice the size of equity markets, and have shown resilience during periods of crisis.\(^4\) The global market for thematic bonds has grown to more than USD 4.2 trillion in value outstanding by the end of 2023.\(^5\) This market has grown at a cumulative annual rate of 80 percent, almost doubling in size each year since 2014.

At the same time, the market has grown increasingly diverse, with the launch of new products and innovative features, of which the advent of sustainability-linked bonds is the most prominent.

The rise in volume of thematic bonds globally can be attributed to critical factors, primarily the confluence of Environmental, Social, and Governance (ESG) and Net Zero commitments, regulations and incentives to support the market and the burgeoning demand from sustainability-conscious investors.

Green bonds have become increasingly popular as we prioritize action on climate change. These financial instruments comprise the vast majority of issuances, as they allow investors to support environmentally friendly projects and initiatives. The COVID-19 pandemic has also highlighted the importance of financing social projects like affordable housing, food security, employment generation, etc.

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5 OECD. 2022. Green, Social, Sustainability and Sustainability-Linked Bonds in Developing Countries: How can Donors support Public Sector issuers? [link]
6 Climate Bonds Initiative. 2023. Q3 Market Update: Green Bonds hit $2.5tn, GSS+ passed $4tn [link]
Consequently, social bonds were issued to address social issues, including the impact of the pandemic. Over the last few years, sustainability bonds, a mixture of both green and social bonds, have emerged as a viable financing instrument for addressing environmental and societal challenges.

Another critical driver for issuing sustainable bonds is the potential to enhance the green or sustainability credentials of the issuer as well as diversify the investor base. More recent entrants to the green bond market increasingly view green bonds as an enabler for changing their business model (e.g., eco-hotel).

Over the years, Sukuk (Islamic Bond) has gained prominence as an attractive financing option as it represents a unique and Sharia-compliant approach to raising capital. With its expanding reach and potential, the instrument presents intriguing opportunities to the discerning investor. The global sukuk market size reached USD 915 Billion in 2022.

-looking forward, it is expected that the market would reach USD 2,276 Billion by 2028, exhibiting a growth rate (CAGR) of 16.2% during 2023-2028.

Recent empirical analyses have shown that firms’ stock price increases when they announce the issue of certified green bonds and financed projects, unlike conventional bonds. An underlying reason for this price rise is that a green bond signals the profitability of green projects to investors.

The increasing number of dedicated Green Bond funds and the emergence of Social and Sustainability Bond funds demonstrate the growing demand for sustainable debt. This demand has resulted in market expansion, complemented by regulations and market incentives. Assessing the market developments and trends, we expect thematic bonds will continue to grow globally and increase their share in the bond market.

KEY STEPS IN ISSUANCE PROCESS

Once a potential issuer decides to issue a thematic bond/sukuk, particularly tied to the use of proceeds, it needs to undergo three stages, Pre-Issuance, Issuance, and Post-Issuance.

- **Pre-Issuance** – This stage involves engaging stakeholders, framework development, second-party opinion, and project selection.

- **Issuance** – After the pre-issuance process and external review, the next step is launching the thematic bond/sukuk into the market. This involves structuring the offer, preparing the investor presentation, book building, pricing, and managing the transactions.

- **Post-Issuance** – The final stage in the issuance process involves an Impact Report that seeks to quantify the environmental or social impact of a project/asset and an assurance report on allocation of proceeds.

The details of the critical stages in thematic bond/sukuk issuance broken down into steps are mentioned below:

*Figure 3: Key Stages and Steps in Thematic Bond/Sukuk Issuance*

**Pre-Issuance Stage**

**ENGAGE STAKEHOLDERS**

To understand the market situation, the issuer needs to engage with stakeholders such as regulators, investors, and international bodies to help understand the trends in the thematic bonds, market demand, frameworks, and existing incentives. A feasibility assessment may determine the issuer readiness to issue the bonds/sukuk.
A regulatory framework for thematic bonds/sukuk is critical as it defines green/social activities to resolve ambiguity in the selection of projects. The framework assures investors of the use-of-proceeds and avoids the risk of impact washing.

The current landscape of thematic bonds/sukuk is complex, with various thematic bond guidelines and standards available in the market. Green/Social/Sustainability (GSS) Bond Principles and Climate Bond Standards are the most adopted international guidelines for issuing thematic bonds/sukuk.

According to the GSS Bond Principles, a GSS bond is defined as any bond instrument with proceeds exclusively dedicated to finance eligible projects aligned with the four main components of the Green Bond Principles: (i) use of proceeds; (ii) evaluation and selection process; (iii) management of proceeds; and (iv) reporting.

Following the thematic bond/sukuk framework, the issuer identifies eligible assets from their portfolio. The assets must be equal to or greater than the size of the bond/sukuk.

Select an independent verifier to assess the thematic credentials of the bond/sukuk in order to assure investors. An independent review can be a second-party opinion, third-party verification, or a green/social rating.

A second-party opinion provides a view on the green/social aspects of the bond/sukuk from an external expert, typically an expert on social and environmental issues. The consultation focuses on reviewing the issuer's environmental and social criteria to select projects for funding. Issuers are given some level of comfort that their 'green' or 'social' criteria are appropriate, and investors can be confident that the issuer tends to invest the proceeds appropriately.

The GSS Bond Principles recognize third-party independent assurance as the most rigorous form of assessment. Widely applied to financial and non-financial reporting, it is conducted by audit professionals in line with national and/or international professional standards such as the International Standard on Assurance Engagements 3000 (ISAE 3000) and relevant quality and independent professional standards to ensure that the assurers are genuinely independent of the bond/sukuk issuer. Third-party assurance gives investors the highest confidence that the bond/sukuk issuer’s processes to track the management of proceeds or to report on outcomes are robust.

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8 In addition, currently ISSA 5000 General Requirements for Sustainability Assurance Engagements is being reviewed and is expected to be published in 2024.
**Issuance Stage**

**ISSUE THE THEMATIC BOND/SUKUK**

After the pre-issuance process and external review is completed, the next step is launching the thematic bond/sukuk into the market. When issuing thematic bond/sukuk, the issuers may include their climate or social attributes in their marketing material and investor documents to generate demand from sustainability-conscious investors. The issuance stage involves the following five stages, as highlighted in the figure below:

*Figure 4: Stages in Pricing of Bond/Sukuk*

- Stage 1: Structuring of the offer
- Stage 2: Preparation of the investor presentation
- Stage 3: Book Building
- Stage 4: Pricing
- Stage 5: Managing the transactions

**Post-Issuance Stage**

**MONITOR AND REPORT**

An allocation and impact report is developed that seeks to quantify the social and/or environmental impact of a project/asset through quantitative and qualitative information. The allocation section details a list of projects funded by thematic bond/sukuk proceeds. Further, the methods and critical underlying assumptions used in preparing the performance indicators and metrics, including the impact created, are mentioned in the impact section.

**ASSURANCE PROCESS**

For this step, the issuer engages an auditor to evaluate the project selection process based on the thematic bond/sukuk framework. The auditor also assesses the allocation of proceeds to eligible environmental or social projects as disclosed in the impact report.

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9 The issuance process is similar to a conventional bond. For further details please refer to this report https://www.unescap.org/kp/2021/introduction-issuing-thematic-bonds
In September 2021, the Republic of Indonesia issued an SDG Bond worth EUR 500 million (USD 584 million). This was the first sovereign SDG-labelled bond issued in Southeast Asia and the first issued in line with the Republic of Indonesia SDG Government Securities Framework that covers green, blue, and social sectors.

The Indonesia SDG Bond has financed four projects across three sectors under four ministries: health, education, religious affairs, and information and communication technology. More than half of the proceeds (55 percent) were directed to the education sector through scholarships for elementary school students, about a third of the proceeds (34 percent) was allocated for basic vaccination while the remaining amount (11 percent) facilitated internet access in Borderline Frontier, Outermost, and Least Developed Regions in Indonesia.

UNDP worked in partnership with the Ministry of Finance during all stages of the technical aspects of SDG Bond’s pre-issuance and post-issuance stage. This collaboration included developing a feasibility study and the securities framework, supporting the verification process, and the impact reporting.

The projects positively impacted 41 million Indonesians, including 5.4 million female students and 30 million children. Further details on the bond’s impact are detailed in the table below:

<table>
<thead>
<tr>
<th>Beneficiaries</th>
<th>Impact</th>
<th>Associated SDGs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children</td>
<td>Routine Base Vaccination 30 million children</td>
<td>3. Good Health &amp; Well-being</td>
</tr>
</tbody>
</table>
Investors are increasingly drawn to thematic bonds/sukuk as they offer a unique investment opportunity by aligning with investors’ impact targets of addressing global challenges like climate change and sustainability. Thematic bonds/sukuk have emerged as a powerful and attractive avenue for such investors, and their interest extends far beyond traditional financial metrics. Important considerations for these investors are:

A. Alignment with ESG Principles
Investment decisions are now increasingly influenced by Environmental, Social, and Governance (ESG) considerations. Thematic bonds are generally created with ESG principles in mind, providing investors an opportunity to invest in line with broader sustainability objectives. Investors tend to favor thematic bonds/sukuk issued by entities that prioritize responsible business practices and contribute positively towards society.

B. Risk Mitigation
Many investors recognize the long-term risks of global challenges, such as climate change and social unrest. Thematic bonds/sukuk often support projects and initiatives aimed at mitigating these risks. As a result, investors view thematic bonds/sukuk as a strategic means of diversifying their portfolios and managing risks associated with issues that could impact financial markets in the future.

C. Measurable Impact
Transparency and accountability are essential for investors. Thematic bonds/sukuk often entail rigorous reporting requirements, ensuring that the use of proceeds and the progress toward thematic goals are transparently tracked and reported. Investors seek bonds that provide clear and measurable impact metrics to evaluate the effectiveness of their investments.

“As sustainable finance is becoming increasingly sophisticated – the level of reporting that investors now demand is high. Labelled bonds must meaningfully contribute to climate goals and issuer investment attractiveness. For a labelled bond, the end investor must know what the money is going for.”

Jason Mortimer
Head of Sustainable Investment – Fixed Income, Nomura Asset Management
D. Diversification and Portfolio Resilience
Investing in thematic bonds/sukuk allows investors to diversify their portfolios beyond traditional asset classes. This diversification can help improve overall portfolio resilience and reduce exposure to economic and market fluctuations. Thematic bonds represent an appealing way to add an element of stability to an investment strategy, especially in the face of global uncertainties.

E. Market Incentives
Following regulations from the Bank of Indonesia, local financial institutions must maintain 20 percent of their assets in ESG instruments (the requirement will be gradually increased to 25 percent in 2023 and 30 percent in 2024). This provision has resulted in increased demand for green or SDG-linked financing.

F. Transition Finance:
The OJK has recently introduced the Taxonomy for Indonesian Sustainable Finance (TKBI),11 which represents an evolution from the initial Indonesian Green Taxonomy. This comprehensive taxonomy categorizes economic activities that contribute to sustainable development goals (SDGs), encompassing economic, environmental, and social dimensions. It serves as a roadmap to enhance capital allocation and promote sustainable financing, aligning with Indonesia's goal of achieving Net Zero Emissions (NZE) by 2060 or earlier. Notably, the recent TKBI assessment results classify the activity not only as "Green" but also as "Transition," signalling its dual significance in promoting environmental sustainability and transition towards a low-carbon economy.

G. Guarantee
A major concern for investors in emerging economies is default risk. An option to mitigate this risk is to invest in guaranteed bonds. These debt securities come with a secondary guarantee from a third party. The guarantee ensures that the investor will receive their principal and interest payments, even if the issuer defaults for reasons such as bankruptcy or insolvency.

Guarantees provide the bedrock of confidence in the thematic bond market, offering investors a shield of assurance that not only safeguards their investments but also catalyses the development of the sustainable financial landscape.

Anuj Awasthi
Vice President Operations, Credit Guarantee & Investment Facility
Issuers need to identify financially viable projects with measurable impact potential that align with their thematic goals. Such projects may only sometimes be readily available, necessitating extensive research, feasibility studies, and collaboration with various stakeholders. Additionally, regulatory and compliance requirements related to the chosen theme must be meticulously observed, often requiring complex navigation. Furthermore, the long-term commitment to maintaining the thematic integrity of these projects, along with the continuous assessment of risks and impact, is essential. The success of thematic bonds/sukuk also relies on market demand and investor appetite for specific themes and projects, which can fluctuate. Ultimately, this process involves good financial judgement and a deep understanding of the theme itself, making it a multifaceted challenge for thematic bond/sukuk issuers.

A. Additional cost and resources
Creating a thematic bond/sukuk framework that is in line with the issuer's objectives takes time, effort, and financial investment. This process involves not only coming up with the thematic aspect but also establishing measurable impact goals. To ensure the validity of the thematic bond/sukuk framework, external reviewers must be involved due to the specialized nature of the evaluation. However, hiring such reviewers can be costly, particularly given the lack of domestic reviewers available, which can put a strain on the issuer's financial resources. Additionally, the issuer must provide annual reports on the allocation and impact of the bond/sukuk until its full allocation. Ensuring the credibility of these reports for investors necessitates a robust assurance process, which requires further commitment from the issuer.

B. Pipeline
Besides framework development and reporting, thematic bond/sukuk issuers may encounter challenges in identifying and developing a pipeline of projects aligned with their chosen themes.

C. Lack of Incentives
The issuers' believe that the existing incentives in Indonesia, such as the 75 percent registration fee discount for
The Monetary Authority of Singapore (MAS) implemented a 3-year Green Bond Grant Scheme (GBGS) in 2017, which was later modified into a Sustainable Bond Grant Scheme (SBGS). The Sustainable Bond Grant Scheme (SBGS) offsets up to 125,000 Singapore Dollars of expenses incurred for external reviews of eligible thematic bonds and promotes the adoption of internationally recognized standards and taxonomies.

Currently, there is a 5-year income tax exemption on issuance costs of Sustainable and Responsible Investment sukuk approved or authorized by or lodged with the Securities Commission. Additionally, there is a grant amount of 90 percent of the actual external review cost subject to a maximum of 300,000 Malaysian Ringgit.

Indonesia Financial Services Authority (OJK) imposes a 75 percent registration fee discount for sustainable bond issuances. Indonesia Stock Exchange (IDX) implements a 50 percent listing fee discount for green bonds.

This viewpoint underscores thematic bond projects' complexity and long-term nature, where the potential benefits of contributing to sustainability or other thematic objectives outweigh the immediate financial incentives. It also indicates that the existing incentives may need to be further enhanced or complemented with other measures to encourage more issuers to engage in thematic bond initiatives, recognizing the broader socio-economic and environmental benefits that these bonds can bring.

In the region, the Governments of Singapore and Malaysia are encouraging thematic bonds/sukuk issuance through the following incentive schemes:

Table 2: Incentives Schemes for Thematic Bonds or Sukuk in the region

- The Monetary Authority of Singapore (MAS) implemented a 3-year Green Bond Grant Scheme (GBGS) in 2017, which was later modified into a Sustainable Bond Grant Scheme (SBGS).
- The Sustainable Bond Grant Scheme (SBGS) offsets up to 125,000 Singapore Dollars of expenses incurred for external reviews of eligible thematic bonds and promotes the adoption of internationally recognized standards and taxonomies.
- Currently, there is a 5-year income tax exemption on issuance costs of Sustainable and Responsible Investment sukuk approved or authorized by or lodged with the Securities Commission.
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- Indonesia Financial Services Authority (OJK) imposes a 75 percent registration fee discount for sustainable bond issuances.
- Indonesia Stock Exchange (IDX) implements a 50 percent listing fee discount for green bonds.

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13. 1 USD = 1.35 SGD
14. 1 USD = 4.67 Malaysian Ringgit
15. 20140911_FB-2014.pdf (idx.co.id)
D. Knowledge and Capacity constraint

A substantial portion of potential issuers remain unconvinced of the merits of thematic bonds/sukuk. This scepticism is rooted in a lack of awareness about green and other thematic bonds/sukuk and the perception that these instruments do not offer significant advantages. Furthermore, there’s a prevalent belief that issuing thematic bonds/sukuk is considered a long-term goal rather than an immediate priority for a significant market share.

On the other side of the equation, most investors cite the absence of a pipeline of green or social projects as a significant barrier to developing the thematic bond/sukuk market in Indonesia.

The challenge in measuring sustainability performance and identifying impactful projects reflects the technical complexities in the field, indicating that developing the capacity for these assessments is crucial for the wider adoption of thematic bonds and sustainable finance practices.

The discussions suggest the need for greater education and awareness-building efforts to showcase thematic bonds/sukuk' benefits and align market expectations regarding the timing of their issuance and capacity building within the market to harness the full potential of thematic bonds/sukuk.

![Interaction with students in Lombok - recipients of the "Smart Indonesia Program" funded by the SDG Bond](image-url)
Bank Negara Indonesia or BNI issued a green bond with a principal amount of IDR 5 trillion (USD 337 million) in 2022. BNI is the first national bank in Indonesia to issue green bonds denominated in rupiah. The debt securities were divided into 2 series, i.e., A Series, with a total principal value of IDR 4 trillion and a term of 3 years, and B Series, with a total principal value of IDR 1 trillion and a term of 3 years. The average coupon rate was 6.45%. BNI’s green bond generated immense interest from investors during the book building, and the bonds were oversubscribed by 3.1 times.

Prior to the Green Bond Issue in March 2023, BNI developed a Green Bond Framework and engaged an external verifier to issue a Second-Party Opinion (SPO). According to the BNI’s Green Bond Report published in June 2023, BNI has managed to allocate 77% of proceeds from BNI 2022 Green Bonds. The details of the allocation among various sectors are presented below. The majority of the allocation is for Sustainable Transportation (62%), followed by Waste to Energy and Waste Management (15%), and the Renewable Energy sector (11%).

For impact reporting, BNI provided environmental impact metrics and other impacts. A summary of their achievements is presented in the following table:

<table>
<thead>
<tr>
<th>Beneficiaries</th>
<th>Impact</th>
<th>Alignment with SDGs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sustainable Transportation</td>
<td>Avoided GHG Emissions per year (tCO2eq/year)</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td></td>
<td>109,823</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td>Waste to Energy and Waste Management</td>
<td>Total raw materials recycled (Ton/year)</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td></td>
<td>150,410</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td>Renewable Energy</td>
<td>Avoided GHG Emissions per year (tCO2eq/year)</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td></td>
<td>54,587</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td>Green Buildings</td>
<td>Avoided GHG Emissions per year (tCO2eq/year)</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td></td>
<td>69,339</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td>Sustainable Natural Resources and Land Use</td>
<td>Number of hectares protected and/certified (in Ha)</td>
<td><img src="image" alt="Icon" /></td>
</tr>
<tr>
<td></td>
<td>314,387</td>
<td><img src="image" alt="Icon" /></td>
</tr>
</tbody>
</table>

A. Blue Bonds

Blue bonds are debt financial instruments designed to support sustainable marine and address ocean-related challenges. The term "blue bond" is derived from the "blue economy," which refers to sustainable economic activities connected to the oceans, seas, and coastal areas. The bond's proceeds are typically directed towards initiatives such as marine conservation, marine renewable energy projects, coastal protection, sustainable fisheries management, and reducing marine pollution. Blue bonds are a subset of green bonds, and the issuance commonly follows ICMA’s Green Bond Principles. Recently, ICMA and other development partners developed a global practitioner’s guide for bonds to finance the blue economy.\(^{17}\) This document helps identify eligible blue projects and guides integration with Sustainability Linked Bonds.

The Republic of Seychelles is the world’s first issuer of blue bonds. Issued in 2018, USD 15 million was raised through private placement. The proceeds of the bond were used for three areas, expanding, and improving marine protected areas, supporting the transition to sustainable fisheries, and developing Seychelles' blue economy. In 2019, Norges Bank Investment Management (NBIM), the manager of Norway's sovereign wealth fund issued a USD 1.5 billion corporate blue bond. The proceeds from the blue bond were dedicated to projects aimed at promoting clean oceans, sustainable fisheries, and renewable energy solutions in the maritime sector.

Following the success of its green Sukuk and SDG bond issuances, the Government of Indonesia issued a Blue Bond in May 2023 in the Japanese capital market. The samurai Blue Bond raised 20.7 billion JPY (~ USD 150 million\(^{18}\)) for 7- and 10-year tenors. This issuance refers to the SDGs Government Securities Framework (SDGs Framework) issued by the Government of Indonesia in 2021 and marks the world’s first publicly offered sovereign Blue Bond aligned with ICMA principles.


\(^{18}\) 1 USD = 138.88 Japanese Yen
**B. Transition Bond**

Transition bonds are an emerging class of bonds, the proceeds of which are used to fund an entity's transition towards a reduced environmental impact or to reduce their carbon emissions. Transition bonds offer an option to move from brown to green - or to a less brown story - thereby providing a fundraising opportunity for carbon-intensive companies that want to reduce the environmental impact of their business and create long-term sustainable change. This bond is often issued in sectors that usually would not qualify for green bonds, such as large carbon-emitting industries like oil and gas, iron and steel, chemicals, aviation and shipping. ICMA has been updating its transition finance handbook regularly and seeks to provide clear guidance and common expectations to capital markets participants on the practices, actions and disclosures to be made available when raising funds in debt markets for climate transition-related purposes.19

There are several definitions of transition -activities in the market, but they have yet to be internationally agreed upon. A common criticism around transition financing is just how ambitious many of these transition financing instruments are with the absence of clear international standards raising concerns about the potential for “transition-washing”, i.e., a company’s environmental performance or intentions are exaggerated or misrepresented. This, in turn, has led to the investor community being concerned about what is meant by transition financing. The lack of agreement on the definition is preventing market growth.

In this regard, the second version of the ASEAN Sustainable Finance Taxonomy published in 2023 has been updated to enable a just transition towards sustainable finance adoption. The newest version includes coal phase-out as an activity eligible for classification as a sustainable finance activity. This inclusion will guide countries in the region including Indonesia to expedite investments to phase out brown energy.20

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Bank of China (BOC) is one of the largest Chinese state-owned commercial banks. It has an extensive business and lending portfolio to clients across various geographies and sectors. In line with the Government’s commitment to achieve an emissions peak before 2030 and carbon neutrality before 2060, BOC has embarked on financing transition activities to reduce the organization’s carbon footprint and carbon risk exposure in credit portfolios. The transition strategy adopted by the BoC is science-based and includes targets and pathways referring to the International Capital Markets Association (ICMA) Climate Transition Finance Handbook.

In 2021, BOC issued Transition Bonds worth CNY 3.3 billion (USD 778 million) in the offshore market. The net proceeds were utilized to fund eight Natural Gas based Cogeneration Projects (92.2 percent of the total amount issued) and one Waste Heat Recovery and Power Generation Project (7.8 percent of the total amount issued) at a cement plant. The allocation amount and the annual GHG emission reduction is highlighted in the table below:

<table>
<thead>
<tr>
<th>Projects</th>
<th>Allocated amount (CNY million)</th>
<th>Annual GHG Emissions Reduces (CO₂ tons)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Utility Industry (Natural Gas based Cogeneration Projects)</td>
<td>4,636.18</td>
<td>143,613.50</td>
</tr>
<tr>
<td>Cement Industry (Power Generation Projects at Cement Plants)</td>
<td>390.4</td>
<td>10,818.67</td>
</tr>
</tbody>
</table>

For the eligible projects, it is based on the principles of “Avoidance of Carbon Lock-in” and “Do No Significant Harm”. Moreover, the list does not include “Explicitly Excluded Projects” such as coal-related projects, nuclear-related projects, mining and quarrying-related projects, etc.
C. Sustainability Linked Bonds

Sustainability-linked instruments are an innovative class of financial products with great potential in sustainable finance. The development of this type of instrument was triggered by the introduction of a Sustainability Linked Loan in the financial market in 2019. Following this, ICMA published the Sustainability-Linked Bond Principles (SLBP) in June 2020, outlining guidelines for issuing Sustainability Linked Bonds (SLBs).

SLBs are bonds where the proceeds from the issuance are not ring-fenced for green or sustainable purposes unlike use-of-proceeds bonds (green, social, sustainable). SLB make public an organization’s intention to achieve certain goals and are designed to incentivize the achievement of sustainability targets by tying pricing usually through coupon rates to issuers’ achievements. SLB implementation hinges on selecting relevant KPIs and ambitious Sustainable Performance Targets (SPTs).

Sustainability-linked bonds are the fastest-growing segment of the sustainable finance market, with a total issuance of USD 100 billion in 2021 up from USD 9 billion in 2020, a ten-fold rise in the market size in a year. The most common targets relate to reducing carbon emissions, and SLB issuers are mainly companies operating in sectors that are challenging to decarbonize. Following the developments in the market and its importance in transition finance, OJK has included SLB in the new regulation concerning the Issuance and Requirements of Sustainability-based Debt Securities or Sukuk (OJK Regulation Number 18/2023).

Investors are divided by region for the type of thematic bond to support transition finance. European investors prefer SLBs due to adherence to EU Taxonomy, while Asian investors, especially from Japan, support Transition bond activities.

In response to evolving trends and demand, OJK recognizes the necessity of broadening the current regulations to include social, sustainability, and sustainability-linked bonds/sukuk, and sukuk-linked waqf. This expansion is expected to positively impact the size of the local market by encouraging new and existing issuers to offer various types of thematic bonds/sukuk, thereby providing investors a broad range of options.

Dien Sukmarini
Analyst of Capital Market and Islamic Capital Market Development Directorate, Indonesia Financial Services Authority (OJK)

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23 OJK Regulation Number 18 Year 2023 covers the Issuance and Requirements of Sustainability-based Debt Securities or Sukuk, which include Green Bond/Sukuk, Social Bond/Sukuk, Sustainability Bond/Sukuk, Sustainability-Linked Bond/Sukuk, and Sukuk-linked Waqf.
### Table 5: Emerging instruments for Transition Finance

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Key Points</th>
</tr>
</thead>
</table>
| Transition Bonds | • Several guidelines are available for transition bonds in the market – among which the Climate Transition Handbook published by the International Capital Markets Association (ICMA) is the most widely used. The document sets out guidance on issuing a transition bond but is silent on when a transition label should be used. Currently there is a lack of clarity regarding what constitutes a transition bond. This lack of a clear set of definitions unfavourably impacts how investors perceive transition-labelled bonds. Therefore, there is a need for more explicit taxonomy to be developed in the market to define what constitutes transition bonds. 
• From interviews with underwriters and investors in the Asia Pacific region, there was a common refrain that investors who are committed to ESG and sustainable finance tend to view “transition” projects critically. With investors beginning to report sustainability metrics, declaring “net zero” targets, and introduce exclusion policies for carbon-intensive industries, they may be reluctant to put their capital towards transition bond that is financing “amber” projects (which are still contentious under the ASEAN Taxonomy) – while non ESG investors who normally invest in conventional Indonesian sovereign bonds may still be interested in this bond. 
• Aside from concerns on transition washing, critics argue that the term 'transition bonds' has been used to divert attention away from the actual mechanisms for transitioning and verifying progress over time. Though transition is a relevant topic, a new or separate label is not seen as necessary, and that the market should move away from labels and only refer to 'use of proceeds' style bonds where targeted impact is disclosed and the key outcome indicator – regardless of the proceeds. 
• It is therefore important for issuers looking to finance transition through transition bonds to have a clear and science-based pathway linked to their net-zero commitments and aligned with targets in the Paris Agreement. |
| Sustainability Linked Bonds | • SLB offers flexibility as the issuer is free to use proceeds from such bonds (brown or green), as long as it meets its sustainability improvement targets – in this case, the proceeds can be used to provide financing support for instance to PLN to accelerate the retirement of a certain number of coal plants within a specified timeframe, while also specifying the projected emission reduction target from this activity. 
• SLB offers flexibility and versatility for issuers while providing scientific and measurable outcomes and impact for investors. There is also a market consensus on their definition, alongside an established mechanism for reporting, which may reduce the confusion within investment decisions. A few examples exist of countries (e.g., Uruguay and Chile) and businesses/institutions choosing this approach over transition-labelled bond issuance to finance transition activities. 
• While sales of transition bonds have been slow in 2021, the issuance of sustainability-linked bonds with climate-transition targets has been increasing – where more than 70 percent of the USD 15 billion of sustainability-linked bonds sold include climate targets. 
• There are some concerns about SLB, regarding how ambitious the Sustainable Performance Targets are, or the step-up coupon rate is not strong, but overall the market views it as a credible instrument in the transition phase for companies. |

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Case Study 4: Uruguay Sovereign Sustainability-Linked Bond

Uruguay’s USD 1.5 billion Sustainability-Linked Bond (SLB), issued in October 2022 is one of the first issuances of sovereign SLB. This SLB directly links the government’s financing strategy and cost of capital to achieving Uruguay’s climate and nature-based goals set under the Paris Agreement. The SLB embeds two Key Performance Indicators (KPIs): (i) reducing the intensity of Greenhouse Gas (GHG) emissions in the economy and (ii) preserving the area of native forests in the country. The KPIs are measured by Sustainability Performance Targets (SPTs) that align with Uruguay’s first Nationally Determined Contribution (NDC) as shown in the table below. This bond has a penalty/reward structure for performance, with a step-up in the coupon if targets are missed and a step-down if they are exceeded.

To maintain transparency and accountability, the government requested the United Nations Development Programme (UNDP) to act as external verifiers for both Key Performance Indicators (KPIs). The External Verification Report concludes that the KPIs were prepared according to the methodologies outlined in the sovereign SLB Framework. The report also mentions that the KPIs adhere to the methodology and good practices established in the 2006 Intergovernmental Panel on Climate Change (IPCC) Guidelines and the relevant provisions and guiding principles of the Methods and Guidance (MGD) of the Global Forest Observations Initiative (GFOI). Further, the data and information used in this report comply with the quality principles in terms of Transparency, Accuracy, Consistency, Comparability and Completeness established by the Intergovernmental Panel on Climate Change (IPCC).25

Table 6: KPIs and SPTs for Uruguay's SLB

<table>
<thead>
<tr>
<th>KPI 1: Reduction of aggregate gross GHG emissions (in CO2eq) per real GDP unit with respect to reference year 1990 (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SPT 1.1</strong></td>
</tr>
<tr>
<td><strong>SPT 1.2</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>KPI 2: Maintenance of native forest area (in hectares) with respect to reference year 2012 (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SPT 2.1</strong></td>
</tr>
<tr>
<td><strong>SPT 2.2</strong></td>
</tr>
</tbody>
</table>

D. Gender Bonds

Gender Bonds are a new debt instrument that channels financial resources to support sustainable development, mainly fostering gender equality and advancing women’s empowerment. Gender bonds are usually “use-of-proceeds” bonds and are a subset of social bonds following the ICMA Social Bond Principles; however, gender considerations can also be included in KPIs of performance-based bonds.26

Gender bonds provide an opportunity for issuers to demonstrate their commitment-to advancing gender equality while diversifying their investor base and accessing new sources of financing.

Though the market is nascent, there are indications that the appetite for these bonds is growing steadily. In the region, Impact Investment Exchange (IIX) has successfully issued Women Livelihood Bonds since 2017 to finance gender equality. To date, the organization has successfully raised USD 228 million and is empowering over 2.6 million women and girls in emerging markets.27

Panel discussion on the approaches to widen adoption of Thematic Bonds in Indonesia.

Issuing SLBs follows a similar process to use-of-proceeds thematic bonds. According to ICMA’s Sustainability-Linked Bond Principles (SLBP), there are five core components for the issuance of SLB frameworks that must be set forth for SLB issuance. These are: (1) Selection of Key Performance Indicators (KPIs); (2) Calibration of Sustainability Performance Targets (SPTs); (3) Bond characteristics; (4) Reporting; and (5) Verification.

**Figure 7: Key Components in Issuance of SLBs.**

1. **Selection of KPIs**
   - The KPIs chosen should be relevant, material, follow a consistent methodology and able to be benchmarked.

2. **Calibration of SPTs**
   - SPTs should be ambitious using benchmarks and should be consistent with the issuer’s sustainability strategy.

3. **Bond Characteristics**
   - Disclose how the bond financial and/or structural characteristics are adjusted depending on the SPTs being met or not.

4. **Reporting**
   - Transparently report on the KPI performance on an annual basis.

5. **Verification**
   - Issuers should seek independent and external verification of the SPTs.

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### Selection of Key Performance Indicators (KPIs)

Following the SLBP, the KPIs should be: (i) relevant, core and material to the issuer’s overall business, and of high strategic significance to the borrower’s current and/or future operations; (ii) measurable or quantifiable on a consistent methodological basis; (iii) externally verifiable; and (iv) able to be benchmarked, i.e., as much as possible using an external reference or definitions to facilitate the assessment of the SPTs level of ambition.

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2 Calibration of Sustainability Performance Targets (SPTs)

The calibration of SPT(s) per KPI is vital to determine the level of ambition and realism in structuring SLBs. The SPTs should be ambitious, i.e. (i) represent a material improvement in the respective KPIs and be beyond a “Business as Usual” trajectory; (ii) where possible, be compared to a benchmark or an external reference; (iii) be consistent with the borrower’s overall strategic sustainability / ESG strategy; and (iv) be determined on a predefined timeline, set before (or concurrently with) the issuance of the bond.

An SLB framework should disclose target-setting details such as timelines for achieving targets, trigger events, frequency of SPTs, and verified baseline/reference points for KPIs. The calibration process should also consider recalculations or adjustments to the baselines, competition and confidentiality considerations, and associated risks. The issuer’s ESG and operating strategy should be described to reach SPTs along with any other key factors beyond their control.

3 Bond Characteristics

The cornerstone of SLB is that the bond’s financial and/or structural characteristics can vary depending on whether the selected KPI(s) reach (or not) the predefined SPT(s). Trigger events can impact these characteristics, with variations in the coupon being the most common example. It is recommended that these variations of the bond’s financial and/or structural characteristics should be commensurate and meaningful relative to the issuer’s original bond financial characteristics.

4 Reporting

To address transparency and accountability requirements, issuers of SLBs must publish, and keep readily available and easily accessible the following documentation: (i) up-to-date information on the performance of the selected KPI(s), including baselines where relevant; (ii) a verification assurance report relative to the SPT outlining the performance against the SPTs and the related impact, and timing of such impact, on the bond’s financial and/or structural characteristics; and (iii) any information enabling investors to monitor the level of ambition of the SPTs (e.g., any update in the issuer’s sustainability strategy or on the related KPI/ESG governance, and more generally any information relevant to the analysis of the KPIs and SPTs).

5 Verification

Issuers of SLBs should get their performance level verified against each SPT for each KPI by an external reviewer at least once a year, and in case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB financial and/or structural characteristics, until after the last SPT trigger event of the bond has been reached. The verification of the performance against the SPTs should be made public and is a necessary element for the SLBP.
A. Further incentives are required to drive local issuances
Sustainable finance is still nascent for local companies in Indonesia and requires regulatory support in terms of incentives to catalyze the market. Though there are existing incentives provided by OJK as mentioned previously, they are not considered to be a deciding factor by prospective issuers to enter the market.

To help spur the market, some incentives to be considered are:

- **Financial grants** to issuers for complying with thematic bond/sukuk standards (developing framework, external verification, impact reporting);
- **Tax incentives**, such as reduced or deferred tax, for issuers and investors involved in thematic bonds to make them more financially attractive.

B. Building a local ecosystem of verifiers
As the domestic thematic bond/sukuk market continues to expand and evolve, there is an ever-increasing need to ensure its integrity, transparency, and trustworthiness. One pivotal aspect in achieving this is improving the quantity as well as the quality of local verifiers.

While the role of local verifiers is indispensable, there are several reasons why enhancing their capacity is imperative for Indonesia’s bond market:

- **International Integration**: As Indonesia's bond/sukuk market integrates more with international markets, there is a need for local verifiers to understand and speak the 'local language' while meeting the global standards and expectations.
- **Market Trust**: Enhancing local verifiers' capacity helps build and maintain trust in the bond/sukuk market, both among domestic and international investors.
- **Market Complexity**: The bond/sukuk market is becoming increasingly complex, with a diverse range of issuers, products, and structures, as also aligned with the continuous update of domestic market regulation. This complexity demands more comprehensive and sophisticated local verification capabilities.
C. Guarantees for local currency-denominated bonds
Guarantees in the local currency bond market offer several benefits. Firstly, borrowers can repay their debt using the local currency, which helps them protect against exchange rate fluctuations. Secondly, borrowers can secure a favourable fixed interest rate throughout the bond's life. Thirdly, borrowers can easily access capital markets, diversifying from traditional funding sources like banks. Fourthly, longer-term bonds can match income streams and investment goals, avoiding reliance on short-term loans that may expose them to refinancing risk.

There are organizations that support guarantees in local currency-denominated issuances and is worth exploring for prospective thematic bond issuers.

D. Thematic bonds/sukuk have the potential to finance just energy transition and sustainable development
With the current commitment to move towards just energy transition pathway, Transition labelled Bond/Sukuk can be an alternative source of financing this effort. As no definite framework or guidelines are available, issuers could consider using Green or SLB bond principles following the ICMA framework. SLB will be more relevant for industries in the brown sector and seeking a pathway to achieve sustainability.

SLB can be a useful tool to finance broader sustainability objectives such as addressing social justice, reducing inequality, enhancing access to education and employment opportunities, and achieving climate targets.

E. Role of development partners in assisting prospective issuers and promoting the enabling environment
Development partners play a pivotal role in facilitating the growth and success of thematic bonds/sukuk by providing expertise, credibility, as well as technical and financial support. By sharing knowledge and best practices, development partners help align thematic bonds/sukuk with sustainability goals, making them appealing to investors. Their financial backing can also mitigate risks and fosters partnerships between public and private sectors, expanding the investor base. Their role is especially important for these reasons:
• **Expertise and Guidance**: Development partners possess extensive experience in development finance and sustainable projects. Their expertise can help issuers design and structure thematic bonds/sukuk to align with specific social or environmental goals, ensuring that the funds raised are directed towards impactful initiatives.

• **Credibility and Trust**: The involvement of reputable development partners can enhance the credibility of thematic bonds/sukuk. Their endorsement and oversight can instil confidence in investors that the bond proceeds will be used as intended, promoting transparency and trust in the market.

• **Technical Assistance**: Thematic bonds/sukuk often involve complex requirements related to pipeline identification and preparation, impact measurement, reporting, and compliance with sustainability standards. Development partners can offer technical assistance to issuers, helping them navigate these intricacies and meet the necessary regulatory and reporting obligations.

• **Capacity Building**: Development partners can provide training and capacity-building programs for issuers to enhance their ability to design, manage, monitor, and report on the bond/sukuk program effectively. Additionally, development partners can extend their support through knowledge-sharing, workshops, and training sessions tailored for pertinent market participants. This includes equipping potential local verifiers with the necessary skills and insights to actively contribute to the growth and success of the thematic bond/sukuk market.

• **Market Development**: The active participation of development partners can contribute to the growth and development of the thematic bond/sukuk market. Their involvement can attract more investors interested in impact-driven investments, thereby expanding the pool of capital available for sustainable projects.

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**Key Messages**

The United Nations Development Programme (UNDP), continues to actively support developing and deploying innovative financing instruments and mechanisms for SDGs in Indonesia. UNDP offers three main services to potential issuers. Firstly, Technical Assistance (TA) is provided throughout the pre-issuance phase, including feasibility study and thematic bonds/sukuk frameworks development as well as project selection. This assistance continues in the post-issuance phase for impact reporting and assurance process. Secondly, UNDP provides Institutional Strengthening and Capacity Building activities by conducting capacity assessments, developing standard operating procedures, and organizing in-depth of trainings and workshops. Thirdly, UNDP supports Campaign and Advocacy by utilizing its national, regional, and global network to increase visibility and raise awareness of thematic debt instruments and sukuk.