Climate Markets & Investment Association

Submission on modalities and procedures for financing results based actions

Para 69 of 1/CP17: ***"Invites Parties and accredited observers to submit to the secretariat, by 5 March 2012, their views on modalities and procedures for financing results-based actions…"***

Key Messages - In CMIA's capacity as an active participant in the development of REDD+ (including as an observer to the Forest Carbon Partnership Facility and the Forest Investment Program), we suggest five key messages that can assist develop successful modalities for results-based finance:

1. ***Strong safeguards are important to the private sector***. Any mechanism with an objective of drawing in patient capital to support long-term REDD+ objectives will have a better chance of success where reputable investors know that strong safeguards are fundamental.

2. ***Market-based approaches can be more than current carbon markets***. The discussion of market based approaches to assist achieve REDD+ objectives often assumes there is only one form of market design available. There is not. Enhancing the capacity of markets to assist achieve REDD+ goals can occur through both: (A) the evolution of carbon market design in order to underpin sectoral scale solutions that have environmental and social integrity; and (B) consideration of innovative new market designs that create incentives for governments and private sector actors to alter the unsustainable land use choices inherent in many existing commodity markets.

3. ***Recognise and build upon REDD+ country strategies***. Not all countries are at the beginning of Phase 1. Initiatives such as FCPF and UN-REDD have enabled developing countries to document clear implementation strategies for REDD+. In numerous cases these directly deal with key elements necessary for testing results-based finance. Provisional modalities and procedures that draw from these strategies will have a greater chance of success.

4. ***Involve the private sector during phase 2 demonstration activities***. The Durban LCA decision on REDD+ recognises that the private sector may be a source of results-based finance and that appropriate market-based approaches may be developed in light of demonstration activities. It is imperative that opportunities are pursued under Phase 2 to test approaches that involve the private sector. By doing so, key modalities under development (such as approval procedures, benefit sharing, consultation and accounting for results) can be tested and refined.

5. ***Robust MRV is important***. REDD+ offers opportunities to deliver multiple benefits beyond the mitigation of climate change. However, the objectives of a REDD+ mechanism in the context of the UNFCCC should remain at the forefront. That is, ensuring that REDD+ can form a significant element toward mitigating dangerous climate change. As such, being able to scientifically measure and account for success based upon tonnes of carbon dioxide avoided or sequestered is critical to measuring our success in meeting these objectives.

To support Parties' discussions, we outline in this submission:

A. The importance of moving forward quickly on results based finance.
B. Opportunities for bilateral and multilateral initiatives to leverage private sector finance
C. The need to integrate results based finance with demand side measures

A. The importance of moving forward quickly on results based finance

Parties need to be both ambitious and pragmatic in order to move forward on results based finance. Our starting point is:

- There has been broad consensus amongst developed and developing Parties to ambitiously pursue slowing, halting and reversing deforestation and forest degradation globally by 2020;

- A substantive body of decisions has established the key principles and guidance for a future operational REDD+ mechanism under the UNFCCC;

- There is a commitment inherent in those REDD+ principles that, if a developing country implements REDD+ actions in accordance with those principles they will be able to move to receiving predictable financial flows for such successful implementation;

- On the basis of that commitment, a large group of developing countries have invested significant resources and political capital in moving forward with the implementation of REDD+ strategies in accordance with those principles.

It is therefore imperative that the decision at Durban to delay a global agreement until 2015 and implementation to 2020 does not also delay moving forward with financing results based REDD+ actions by developing countries. This is where ambition and pragmatism is critical to maintain the promise of REDD+. Developed and developing countries need to agree what is possible and then move forward urgently. Available options include:

- Recognise the progress made by developing countries in the development and implementation of REDD+ strategies (including through participation in UN-REDD and the FCPF Readiness Fund) by increasing the capacity to pilot results-based financing, such as through increasing the size of the FCPF Carbon Fund (which aims to provide payments for verified results).[1]

[1] The FCPF Readiness Fund has 36 participating REDD+ countries. Even allowing for the fact that some of these are unlikely to move forward, there are fifteen countries with approved REDD Preparation Plans now moving to implementation and another 9 countries with plans that are moving toward approval. Against this the FCPF Carbon Fund - intended to trial payment for verified results - is currently likely to be only able to support four or five REDD+ programs in these countries.

- Ramping up bilateral agreements by which countries will set out achievable milestones for REDD+ countries to meet in order to access scaled up results-based finance.

- Developed and developing countries bilaterally develop arrangements which can achieve the equivalent to the above through a combination of public and private sector finance (including by creating incentives that provide a return on investment for private sector investors that assist achieve such verified results).

- Support the this increased deployment of bilateral finance by developing a framework for enabling a Party financing results based REDD+ actions before 2020 to have the comfort that such early action support may be partially recognised against mitigation commitments.[2]

In calling for enhanced bilateral action in the period through to 2020 we also note two key lessons from the direct involvement of CMIA members in assisting REDD+ countries national strategies:

- Enhanced bilateral action must be coordinated with existing multilateral initiatives; and

- More work needs to be done on the tools to identify the most cost-effective mitigation opportunities under REDD+ for a country, including those which enable governments to assess the cost-effectiveness of current policies and measures and the real costs of new measures such as enhanced forest governance enforcement.

B. Opportunities for bilateral and multilateral initiatives to leverage private sector finance

The Durban LCA decision on REDD+ recognises that appropriate market-based approaches may be developed in light of demonstration activities. CMIA reiterates that, not only do appropriately designed carbon markets have the potential to drive public and private sector investment at scale, there is now the technical capacity and possible design elements available to address past concerns regarding permanence, leakage and the measurement of changes in carbon stocks. Furthermore, appropriate design elements can be included in compliance markets to ensure the inclusion of carbon credits from REDD+ activities does not undermine necessary domestic action. These include ambitious targets by countries combined with appropriate limits to the amount of credits that can be used by compliance entities. [3]

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[2] This is consistent with 1/CP17 at paragraphs 79 and 80, which calls for a framework for approaches that enhance the cost-effectiveness of and promote mitigation actions so long as they meet standards that deliver real, permanent, additional and verified mitigation outcomes, avoid double counting of effort, and achieve a net decrease and/or avoidance of greenhouse gas emissions.

[3] For example, the European Commission has determined that the use of offsets from REDD+ activities would not undermine the carbon price signal in the EU ETS if developed countries increased the ambition of their emission reduction targets - see Commission Staff Working Document Part 2 at page 83 (Brussels, 28.1.2009 SEC(2009) 101). See also the analysis conducted by the Eliasch Review (2008) and summarised from page 174.

In the period prior to Parties reaching further decisions regarding the role of market based approaches such as carbon markets, there remains a critical need to involve the private sector. The reasons are twofold:

- Current levels of public funding for REDD+ committed and proposed by donor nations through various multilateral and bilateral processes are critical but are unlikely to reach the level of significant and sustained financing necessary. Success therefore lies in creating the architecture to harness a variety of regulatory and other policies, funding sources, and deployment models from both the public and private sector.

- A financial deployment mechanism that wholly relies on public agencies to make such deployment will fail to deliver against the expectations of developing countries. Rather, a financial mechanism that enables appropriately authorised and regulated private sector entities to participate will fundamentally enhance the speed and effectiveness of the deployment against developing country strategies. To use one example, from 2002 to 2008, the World Bank has calculated that the Clean Development Mechanism mobilised **~$95 billion** for on the ground investments in developing countries (versus official development assistance for mitigation of ~$19 billion over 2002 to 2007).[4]

It is therefore imperative that opportunities are pursued in the near term to test approaches that involve the private sector in results based finance. By doing so, key modalities under development (such as approval procedures, benefit sharing, consultation and accounting for results) can be tested and the appropriate long term role of the private sector refined.

A variety of tried and tested tools are available to multilateral and bilateral entities to assist draw private capital to assist environmental goals.[5] Many of these have been deployed in sectors such as the enhanced deployment of renewable energy and are compatible with ODA spending[6]. However, they can also be utilised to support REDD+ actions at scale. The broad types of intervention include:

Forward purchase commitment - this type of commitment is similar to that used in different sectors to address market failures. For instance, a direct commitment to suitably to a provincial entity nested within a national program with part of the purchase commitment being used to underpin the investment of emission reduction projects within the provincial strategy.

Concessional finance - Concessional lending (eg long maturity, grace periods, low interest rate etc) can be used to make certain investments financially attractive by improving the internal rates of return on such investments.

[4] World Bank - World Development Report, page 262.
[5] These tools have been analysed across a number or reports, including*: Workstream 7: Public Interventions to stimulate Private Investment in Adaptation and Mitigation*, of the *Report of the Secretary-General's High-level Advisory Group on Climate Change Financing* (November 2010); see also section 4 of *Meeting the Climate Challenge: Using Public Funds to Leverage Private Investment in Developing Countries* (coordinated by Lord Nicholas Stern, Chair of the Grantham Institute for Climate Change and the Environment at the London School of Economics).
[6] As confirmed by the OECD in *Promoting Private Investment for Development - The Role of ODA* (OECD 2006).

Guarantees - Guarantee instruments are used to improve conditions for investment in, or lending to, projects by mitigating risks that lenders and investors would not be willing or able to accept. An example is a loan guarantee which would cover the loss due to a debt service default for lenders up to an agreed portion of the actual loss, with a view to drawing in commercial finance at competitive rates to sustainable land use investments that would otherwise not be capable of attracting finance (for example, a community forest management scheme combined with post harvest processing facilities).

Equity - Equity can be deployed to enable a project to attract additional debt or equity investment and thus fund eligible investments that would otherwise be considered too risky to. There are a variety of ways in which the structure of the equity stake can be designed to provide further comfort (eg subordinated returns).

There are a number of concrete proposals available to financing parties that have been developed specifically to assist drive near term demonstration program that are: at scale; embedded in host-country national strategies; and capable of drawing in significant co-investment by the private sector.

CMIA recognises that there should be certain elements present before results based finance should flow. Key elements are set out below. We emphasise however that Parties must be prepared to support step-wise approaches that enable finance to flow whilst these elements continue to be further refined. Those elements include:

- Scientifically robust forest emission reference levels developed through a transparent review process.
- Conservative crediting levels that support environmental integrity of verified emissions reductions used as the basis for payment of results based finance.
- National or significant subnational scale boundaries for tracking performance against reference and crediting levels.
- REDD+ activities forming the basis of results based finance are implemented in accordance with environmental and social safeguards that are consistent with UNFCCC decisions, including a transparent and equitable benefit sharing regime supported by key governance arrangements such as grievance procedures and clear legal rights for stakeholders.
- Robust governance of all participants, including financial governance of domestic delivery agencies and regulation of any private sector entities authorised to participate.

- Management of leakage and permanence in accordance with internationally recognised standards (such as buffers or conservative discount factors in crediting levels).

There has now been sufficient progress to enable ambitious Parties to test results based finance at scale whilst having the confidence that these elements are addressed. To give just some examples:

- There is a body of material from UNFCCC decisions, multilateral initiatives such as the FCPF and leading voluntary sector standards such as the VCS and CCBA that can underpin the design of accounting and programmatic elements such as reference levels, monitoring systems and safeguards;

- A large number of REDD+ country strategies exist which intend to move forward with province or landscape scale subnational programs that will be nested within a national approach;

- Work such as that undertaken by the Voluntary Carbon Standard on jurisdiction scale crediting for verified results provides a clear conceptual framework by which developing countries could nest jurisdictions within a national program or projects within either;

- A number of REDD+ countries are already designing and implementing regimes by which any private sector investor wishing to participate in their national strategy will be authorised against criteria tied to the objectives of that strategy.

C. The need to integrate results based finance with demand side measures

The discussion of market based approaches to assist achieve REDD+ objectives often assumes there is only one form of market design available. There is not. Enhancing the capacity of markets to assist achieve REDD+ goals can also occur through the implementation of innovative new market designs that create incentives for governments and private sector actors to alter the unsustainable land use choices inherent in many existing commodity markets.[7]

Addressing economic dynamics is one of the key components in initiatives aimed at catalysing sustainable land-use. One of the most powerful elements of REDD+ is precisely the potential it has to reverse the short term economic incentives that bring about unsustainable land-use practices by providing set of alternative revenue streams that provide the incremental costs needed to shift practices over the longer term to those that will keep forests intact. This shift needs to be sustainable over time and represent a net benefit for communities. For that reason REDD+ projects should enable the implementation of alternative economical activities that improve the livelihoods

[7] Some of these markets are already in development. For instance, the Ecosystem Marketplace 2011 Update on Biodiversity Markets reviewed 45 existing compensatory mitigation programs around the world, ranging from programs with active mitigation banking of biodiversity credits to programs channelling development impact fees to policies that drive one-off offsets. The global annual market size was valued at *"USD 2.4-4.0 billion at minimum, and likely much more, as 80% of existing programs are not transparent enough to estimate their market size"*.

of inhabitants of the project area. Furthermore, REDD+ activities should engage those responsible for the major drivers of deforestation such as the agricultural and timber sectors. The ongoing work on certification standards for sustainable commodity production and procurement is key here and must continue. However, these efforts need to be integrated with other initiatives, including:

- increased demand-side action by developed countries to implement rules and/or incentives for consumers and companies to channel their purchasing power to such commodities; and

- integrating sustainable commodity initiatives within a country with other REDD+ activities in order that they are mutually reinforcing.

Finally, we would emphasise that there is a significant body of work beyond commodity roundtables like that can be drawn from by Parties to assist create integrated schemes involving the public and private sectors. Examples include:

Business and Biodiversity Offsets Programme: a partnership between companies, financial institutions, governments and civil society organizations to explore biodiversity offsets

Green Development Initiative: Which aims to establish an international BioAreas Standard & Registry for CBD-compliant area management in order to facilitate increased private sector support for conservation and responsible use.

Forest Footprint Disclosure Project: Each year, FFDP Disclosure Requests are sent to corporates asking them to report to investors on how they are managing their exposure to deforestation. These requests are sent out on behalf of 70 financial institutions, who manage over US$ 7 trillion in assets.

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About the Climate Markets and Investment Association

The Climate Markets & Investment Association (CMIA) is an international trade association representing firms that finance, invest in, and provide enabling support to activities that reduce emissions. CMIA's membership account for 75 per cent of the global carbon market .

Composed of businesses at the cutting edge of the services sector that work to reduce emissions through the market mechanisms of the United Nations Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol, CMIA was created to ensure that the progressive business voice is heard, and to promote market friendly climate change policy. Our members provide highly-skilled jobs and add value to the economy through services to, and capital injections into, the growing global carbon market.

CMIA's membership comprises over 60 companies including financial institutions, asset managers, investment and carbon funds, project developers, lawyers, accountants, verifiers, emissions brokers, and IT firms.

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