

1. Overview

We appreciate the opportunity to participate in the work of the Standing Committee on Finance and to highlight our private sector experience in working to mitigate climate change through large-scale forest conservation and restoration. By focusing on forests in the months leading up to the 2015 COP the SCF has underscored the vital role that these forest ecosystems will play in securing a safe pathway through to a lower carbon future. The challenge for the SCF is in determining how much such conservation will and should cost, how the risks and benefits of such conservation are to be justly distributed, and how to tie such activities into other efforts to promote economic growth. We believe that, however this dialogue evolves, the private sector is critical in delivering both the forest protection and resource productivity gains that are necessary for climate change mitigation and ecosystem preservation. We would be happy to discuss or present on any of the issues we raise or the case study we highlight below.

As the SCF considers various types of approaches to managing the often location-specific risks and challenges of working on natural landscapes, it is important to consider what “pay for performance” actually means, because virtually every mechanism you examine will depend on this concept in some way. Permian Global works on protecting and restoring forest landscapes because the science, much of which has only recently emerged,¹ makes clear that forest protection and restoration is a very large and underutilized climate mitigation option. The opportunity is huge and the costs relatively low, especially if we recognize and deal with the problem of forest degradation. We can capture this opportunity, however, only if we undertake the difficult but critical carbon accounting exercises necessary to understand whether indeed the pay is for performance – true performance.

The trend in the global conversation around forest protection is towards emphasizing production intensification and “sustainable” uses of forest landscapes. Modern forest science and economic development history both demonstrate that such approaches will destroy more forests and release more carbon unless attached to rigorous protection efforts. Permian Global’s position is that we can and should marry production improvements with protection schemes, but that these should be true protection schemes that a) conserve undisturbed forests and seek to revitalize degraded forests, and b) are held to high carbon accounting standards. This is the context in which we offer our insights to the work of the SCF.

2. Introduction to Permian Global

¹ An excellent synthesis of recent forest science insights, as well as a good general primer on the state of tropical forests, can be found at *Tropical Forests: A Review*, International Sustainability Unit, 2015, London. Recent work by the World Resources Institute, Center for Global Development, and the New Climate Economy report also similarly highlight the latest insights about the importance of and opportunity in forest protection and restoration.

Permian Global is a London-based, for-profit investment advisory firm committed to addressing climate change through the long-term protection and restoration of critical forest ecosystems. Our focus is on avoiding deforestation, avoiding forest degradation in all its forms, and managing degraded forests to enable their recovery. We prioritize large-scale forests that provide the greatest emissions mitigation and those that provide the greatest co-benefits in terms of biodiversity and social value. Permian Global's revenue comes from the production and sale of high-quality verified carbon credits, generated through large-scale protection and restoration of natural forests and sold to voluntary corporate, government, and multilateral purchasers. We expect global carbon markets to continue to develop after years of challenges and will look to sell into those markets as well.

Permian Global has established formal partnerships with a range of organizations that share our core values and who collaborate with us on the implementation of projects. They include institutions at the forefront of climate science; national and regional governments in the countries where we operate; expert local implementation partners such as established environmental and conservation NGOs; and private sector actors in both extractive and protective industries. We recognize that forest conservation which is disconnected from landscape or jurisdictional schemes is unlikely to achieve the scale needed, and where possible will look to join in landscape-based approaches to spatial planning, resource use, and ecosystem service preservation. While we currently rely on sales of carbon credits to generate revenues for conservation and returns for our investors, we believe that there is a future of payment flows that might compensate for a whole range of ecosystem services, including emissions reductions and productivity enhancements. As an aside, some effort of the SCF might be usefully applied to considerations of such integrated schemes, as they could answer the demand for both increased productivity and protection.

Our experienced team has expertise in the fields of investment management, forest recovery and conservation, ecology, international policy, and marketing. At its nucleus is a group of investment professionals who built a very successful investment firm, and a number of individuals with substantial international environmental conservation achievements. Combined together with a network of eminent scientists, this has allowed us to build on proven techniques for habitat management.

3. How we seek to pay for our forest conservation efforts

Large-scale forest protection will only be possible if it is a commercial proposition. We currently see two worlds for financing forest protection through offset sales: an emerging world of compliance markets, and the world we live in now, where navigating the patchwork of potential corporate and government purchasers involves heavy transaction costs and site-specific negotiations. We encourage members of the SCF and interested parties to continue work towards compliance markets, or similar mechanisms like carbon taxes, and to seek the inclusion of natural forest credits in those schemes. We believe that time will demonstrate that forests will be one of the most critical climate mitigation channels which can provide the quantities of carbon credits required at reasonable cost, and as such their inclusion will help reduce both the economic and political costs of creating robust carbon markets.² We would be happy to

² It is worth noting that forest recovery provides the only feasible short-term route to reduce (rather than simply slow the growth of) the level of atmospheric carbon dioxide, which is already at a point that potentially threatens the prospect of a return to climate stability. Given the amount of carbon in the atmosphere today, the need to inexpensively remove and sequester carbon *must* become an increasingly important theme in the climate debate.

share additional thoughts on how carbon markets might develop to include forestry credits, and we would encourage learning from those markets where forest credits are currently accepted.

Compliance markets could and should be important mechanisms for efficiently internalizing the carbon costs of economic activity, but while we work towards their establishment, the current world provides for a range of project finance and credit sales options. It is, however, far from a streamlined or efficient space. We will discuss one project below, but in general financing for projects involves cost- and time-intensive searches for a patchwork of different types of investors, ranging from philanthropic institutions willing to use grant and endowment capital to support these projects in a variety of ways, to government agencies offering, generally, risk guarantees, to profit-seeking investors of several kinds. We note that such mosaic-type funding is typical of project development in many different types of sectors, although the search costs for the capital are potentially higher in forest conservation than in other fields.

Unsurprisingly, the goal of bringing in private capital is made particularly challenging by the credit sales side of the equation. Permian Global sees a number of pathways to generating revenues for forest conservation in the near term, including some potential compliance market activity as part of jurisdictional structures, direct sales to country and multilateral purchasers, and direct sales to corporate purchasers in the voluntary market. With respect to accelerating development of these revenue sources in the short term, Permian Global sees at least two areas where SCF members can be of immediate assistance:

- Improving the “payment for performance” standards so that funds flow only into projects that demonstrate actual and meaningful impact on carbon. SCF members are encouraged to track the latest science, which demonstrates that forest degradation is a much more significant problem than previously understood, and, moreover, that many “sustainable” forest practices in fact promote such degradation, thus disrupting significantly the ability of forests to capture and store carbon. Put in the emerging vernacular of “production and protection,” carbon credits or other funding mechanisms must support the protection side of the paradigm, which has often been ignored or misunderstood in the discussion.
- Removing roadblocks to the dispersal of funds already set aside to support forest conservation. A number of funds have been set aside to invest in and/or pay for forest conservation performance, but few deals of substantial size, and therefore climate and ecosystem impact, have been accomplished. This is due in part to operational challenges associated with interactions between the funders and forest countries, MRV issues, and other associated hurdles. We believe, however, that many of these hurdles can be overcome – and, moreover, we think the emergence of good, large projects in many places should serve as a catalyst to tackling these roadblocks.

On a longer term basis, a move away from disparate funding or compensation mechanisms targeted at different aspects of landscape preservation and enhancement towards a bundled, landscape-funded approach might be more efficient and effective. How such spatial plan-based mechanisms might interact with compliance markets is unknown, but certainly most corporate purchasers and presumably governments are interested in acquiring a bundle of assets – including water quality, seed bank preservation, carbon reduction, and economic development through improved agricultural and extractive industry efficiency gains – rather than being put in the unenviable position of acquiring such assets one by one. The SCF and its participants could be an ideal forum to discuss and test how we might

move towards landscape-based funding, beginning by identifying anchor conservation/“protection” areas around which could be built an ecosystem of production-based activities.

4. The Indonesia project: a case study

In order to ground the discussion in an actual landscape, we thought it would be helpful to describe the challenges and opportunities of one of our first investments, a project in Central Kalimantan, Indonesia. Conservation of this area is critical both for the tremendous carbon stocks it contains and because the signal its preservation (or, if we do not succeed, its destruction) will send to stakeholders in Indonesia and throughout the world. At the same time, we also believe in the commercial opportunity available in saving this crucial ecosystem. We or our project partner PT. RMU would be happy to discuss the project and its market potential as it now stands, or how such a project might embed in a larger protection and production financing plan.

a. Overview

i. Project Area

The Katingan project is centered on one of the largest remaining intact peat land forest sites in Indonesian Borneo. The 500k acres (200k ha) peat dome is largely un-drained and over 90% is still covered by natural forest. The area is rich in biodiversity, with several highly endangered bird species and over 60 mammal species, including as many as 6,000 wild orangutan.

The project area is bordered by 34 villages along the adjoining Mentaya and Katingan Rivers. The majority of these local communities rely on small-scale agriculture for their livelihoods, within the narrow riverine belt of mineral soils, supplemented with fishing and collecting forest products. The project works actively with all of these communities to improve livelihoods through initiatives aimed at small-business development, land tenure reform, health and education; in addition to becoming a major employer in the region.

ii. Institutional arrangements

To protect and restore the site, Permian Global has partnered with the local Indonesian company PT Rimba Makmur Utama (PT. RMU). Together this partnership now holds a 60-year Ecosystem Restoration Concession license (with the opportunity for a 35-year extension) for around half of the peat dome (i.e., approximately 267k acres or 108k ha) and is in the process of achieving the concession rights to the remaining area of the Katingan site. It is anticipated this will be secured in mid-2015. The Ecosystem Restoration Concession license gives the partnership full management rights and the authority to generate and sell carbon credits.

b. Challenges and opportunities

The primary threat to the project site is large-scale ‘planned’ conversion of the area to industrial plantations. Typically this would mean plantations of the non-native *Acacia mangium*, grown for harvesting in 5-10 year cycles to supply the pulp and paper industry, or oil palm. The process of conversion of peat forest to plantation includes complete clearance of existing forest cover and the creation of extensive deep drainage canals. A direct consequence is the oxidation of peat, the emission

of huge amounts of previously stored carbon, and a massively increased fire risk. If this would happen, such a 'business as usual' scenario would lead to carbon emissions on a huge scale, catastrophic effects on biodiversity and severe adverse effects on local livelihoods, health and traditions. Fires from neighboring areas have caused health problems over a wide area and the particularly memorable great Asian smoke cloud of 1998, which extended as far north as Hong Kong.

Fortunately, the government of Indonesia recognizes the need for the preservation of vital ecosystem services associated with its forests and has begun a process of promoting greater use of the Ecosystem Restoration Concession licenses. This project now serves as a model to encourage further expansion of such licenses and is giving further momentum to a process of policy formation that supports green growth planning throughout Indonesia. By acting as a 'real' case study (as compared to the many desktop conceptual case studies) it is also driving the development of similar projects on state-managed land through public private partnerships and on commercially managed land by traditional logging companies.

c. Markets and finance

Long-term success, and the multiplier effect that will bring meaningful change, will depend on finding purchasers of the verified carbon credits generated from this and similar projects. For this project, our current expectation is that project partnership will enter into long-duration contracts to sell most if not all of the credits to one or more governments. An advantage of our approach is the scale of the projects, which means tremendous volume of carbon credits along with substantial co-benefits, including the kind of biodiversity preservation that cannot be ensured with smaller projects. We have good reason to believe that this volume, which limits ongoing transaction costs for large purchasers, and other aspects of the project, including the substantial co-benefits, will make the project appealing to a number of developed country governments that have made scale a prerequisite to investment or purchase. Negotiations with several direct government purchasers are underway.

The risks associated with developing this project have been high and underscore the challenges of operating in a space of uncertain market development and substantial buyer search costs. However, we believe that the opportunity to demonstrate that forests can be protected and restored at scale through the mechanism of carbon credit sales, and in particular the opportunity to save this important Indonesian forest, was a commercial risk worth taking. We also think that, ultimately, such development risks can only be taken on by commercial ventures.

As is typical with projects in this uncertain environment, PT. RMU began development of Katingan by relying on a variety of grants from foundations and other institutions, and in-kind contributions from local stakeholders. The uncertainty increased financing costs and slowed project development. The partnership with Permian Global helped bring patient capital to this process, which has in turn allowed the team to focus on acquisition and development of the ERC license.

We have been fortunate to be able to convince our investors of the need for such patience in the investment process in part by pointing to the positive market signals represented by the commitments to forests made by corporates and governments, including the government of Norway. More patient and catalytic capital is required, but we firmly believe this capital will be rewarded. The work of the SCF

should give more confidence to forest protection investors, and we encourage the SCF and its members to be vocal, visible, and action-oriented in their activities this year and in the future.