

## **UNEP Finance Initiative's submission on: 'relevant information/case studies to inform the working paper on coherence and coordination for financing for forests'**

UNEP Finance Initiative (UNEP FI) is grateful for the opportunity to respond to the call of the Standing Committee on Finance (SCF) of the UNFCCC for inputs to the working paper on coherence and coordination for financing for forests. For the purpose of this submission, we assume 'finance for forests' to include financial transactions and services related to both forests and the sustainable production of agricultural commodities in forest landscapes. We would encourage the development of a more robust definition of the term 'financing for forests', with clearly defined parameters to assist discussions in the future.

We would like to make three general observations related to clarifying the role of the private sector in providing financing for forests. These observations are made in the context of the key role of private finance for REDD+ implementation and results-based REDD+ activities that are highlighted in Annex II of the background paper and which are also covered in a UN-REDD Programme Policy Brief on the same subject.<sup>1</sup> These observations are intended to complement the submission by the UN-REDD Programme on this topic.<sup>2</sup>

- 1) It is generally accepted that finance is a fundamental component of forest and agricultural production systems and that adequate finance and investment in different forms will be required to transition to climate compatible growth trajectories. However, it is clear that sufficient finance alone will not guarantee that this transition is made.
- 2) It is important to note that there is a fundamental distinction between private finance – which is often commercial in nature – and public finance, which is often non-commercial. The commercial finance system is neither homogeneous nor simple. It is a complex ecosystem comprising a multitude of different mediums, channels, instruments and actors across different jurisdictions. However, despite the complexity, a unifying characteristic of private finance is that most providers of private capital will require appropriate risk-adjusted returns, and that the greater the perceived risk of an investment, the greater the required return will be.
- 3) The required pools of capital already exist in the global financial system – an estimated US\$ 225 trillion is currently allocated through the world's capital markets. However, it should be stressed that reallocating a portion of this to forest finance is not a simple task of matching financial resources with expenditure needs. In particular, the vast pools of private finance will generally require a public policy lever to unlock them by creating a financial framework that creates long-term, clear and credible policy signals. This framework is essential if responsible managers of private capital are going to consider reallocating capital under their management towards forest-related activities.

Furthermore, despite 'pockets of leadership' in the context of forest finance, the reality today is that the bulk of financial markets remain unaligned with the needs of forests specifically, and a non-extractive, low-carbon and climate-resilient economy more generally. For private finance to play a more important role in the full implementation of REDD+ activities it is necessary that, i) in the

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<sup>1</sup> UN-REDD (2013) *The Role of the Private Sector in REDD+: the Case for Engagement and Options for Intervention.* Online at: [http://www.unredd.net/index.php?option=com\\_docman&task=doc\\_download&gid=10509&Itemid=53](http://www.unredd.net/index.php?option=com_docman&task=doc_download&gid=10509&Itemid=53)

<sup>2</sup> Submission to the SCF by the Food and Agriculture Organization, United Nations Development Programme and the United Nations Environment Programme to support the REDD+ Activities through the UN-REDD Programme

short- to medium-term there is a better understanding of what is the most effective and efficient way to strategically deploy limited public funds available through different financial mechanisms, amongst them the Green Climate Fund, to crowd in private financing for forests; and, ii) in the long-term to reform financial markets so that they become enablers and catalysts of forest finance.

### **Crowding in private financing for forests**

If financial mechanisms are to 'crowd-in' private sector financing for forests, there is a need for a private climate finance agenda that focuses on a 'bottom-up' analysis of the key activities in developing countries that can lead to REDD+ results. Specifically, there is a need for an agenda that promotes a better and more nuanced understanding amongst policy makers of: i) private sector activities that contribute to generating REDD+ results in a given country context and barriers to implementation; ii) whether those activities – or the actors implementing them – require private finance and investment; iii) what type of private finance would facilitate the implementation of activities (e.g., equity or debt, tenor); and iv) how can existing financial instruments be utilized to crowd in private financing for forests.<sup>3</sup> Only once this information is gathered will it be possible to make informed decisions regarding the best interventions to leverage private financing for forests.

However, it should also be noted that the provision of rural finance has historically been challenging due to high transaction costs and information asymmetries. These can be caused by factors that include covariant risks, low population densities in rural areas and the low appetite financial institutions often have for rural assets – such remote and often small parcels of land – for use as collateral. Certain types of activities – such as the growing of tree crops – can also require relatively long loan maturities with irregular repayment schedules that increase the potential risk a financial institution faces compared to other potential uses of their funds. These factors contribute to a gradient of access to capital that is often observed amongst rural communities, where wealthier customers are able to access capital more readily than poorer customers. These barriers may be overcome through structures such as public-private partnerships that enable risks and responsibilities, resources, competences and benefits to be shared between public and private actors.

Moreover, although behaviour and activities in a forest landscape can be influenced by the availability and cost of capital, this is a necessary but not sufficient requirement of the financial needs of forest stakeholders. The provision of insurance products is challenging in many rural areas but suitable products (e.g., crop and property insurance) can all make a considerable difference to the livelihoods and behaviour of some rural communities. Well-designed savings products are also an important financial service required by rural populations. Savings can help finance the capital expenditure gap between the loan amounts available, and the sum required to make investments in productive assets such as better storage facilities or machinery. Lastly, services such as financial remittance products can be a valuable financial service, especially for communities where family members have travelled large distances to find work, often in cities.

### **Policy makers and regulators:**

It should also be noted that reforming financial markets and institutions is part of the longer-term solution to scaling-up private capital for forest finance. This can involve looking at the financial policies, regulations, incentives, standards and norms – and how they can contribute to expand financial resources for forests and sustainable development more broadly.

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<sup>3</sup> Based on UNEP FI (2014) *Demystifying Private Climate Finance*.

Such actions can complement smart policy in the 'real economy', where policy and regulatory interventions are more established and better understood. Unlike real economy policy and regulatory interventions, which have a direct impact on behaviour and activities, financial policy and regulation works indirectly by shifting the financing behaviour of financial institutions. UNEP's Inquiry on the Design of a Sustainable Financial System is at the centre of a knowledge network of over 40 institutions investigating what is currently working in terms of financial system reform, what might work in the future, and how successful interventions might be scaled up or work elsewhere.<sup>4</sup>

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<sup>4</sup> More on the *UNEP Inquiry: Design of a Sustainable Financial System* online at: [www.unep.org/greeneconomy/financialinquiry/](http://www.unep.org/greeneconomy/financialinquiry/)