LSE CMIA IETA Workshop on REDD+

April 3, 2014

London School of Economics

Workshop report

Disclaimer:

The following views reflect the opinions expressed at the workshop on April 3 2014, and reflect the broad consensus of the discussions rather than the views of any one participant.

Introduction

Overall project background

REDD+ is at a crossroads - discussions have advanced in the UNFCCC negotiations and readiness efforts are progressing with public financing but private capital is largely on the sidelines. A lack of demand is coupled with uncertainty and risks that hinder the implementation and development of supply. On the other hand regulated companies potentially face large carbon price uncertainty, generating significant risk. Options on REDD+ that give the buyer the right, but not the obligation to buy or sell REDD+ credits at a specified price, such as minimum guaranteed price contracts could provide a mechanism to mobilize private capital in the near and medium terms while offering business and governments a tangible hedging tool in today's uncertain policy environment. NORAD is funding the Environmental Defense Fund, in collaboration with the LSE, IIASA and the Mercator Research Institute on Global Commons and Climate Change to undertake a project to develop an Options Market and Complementary Financial Structures to Mobilize Private Capital for REDD+ and Manage Climate Policy Risks.

Project Outcomes

The project aims to produce research papers and modeling tools to support REDD+ options transactions and other risk-management mechanisms, along with communications and policy advocacy documents for non-technical audiences. The ultimate aim of the project is to facilitate at least one pilot transaction that demonstrates the options approach to REDD+ financing between private investors (possibly along with a public institution) and a REDD+ jurisdiction.

Workshop Objectives

LSE's role in the project is to help to understand the current REDD+ demand context, and the future prospects for any REDD+ market. To facilitate this understanding LSE is engaging with a number of different actors involved in REDD+ and carbon markets. As part of this engagement LSE approached both CMIA and IETA for their assistance. The result was a workshop held with members of both CMIA's REDD+ Working Group and IETA's Land/Use Forestry Working Group at LSE on Thursday April 3 2014, from 12:30pm until 3:30pm.

The workshop had two main objectives: the first to canvass the expertise and experience of the members of the groups in answering the following questions:

- What are the prospects of REDD+ playing a role in compliance markets?
- What are the prospects for increasing non-compliance REDD+ demand?
- What have been the motivations of existing REDD+ purchasers?
- What have been the key lessons from the experiences of these existing purchasers?
- What are the main barriers to engaging private sector finance in REDD+?
- What are the main buyer, supplier and intermediary risks facing REDD+ today?

The second objective was to present initial thinking from LSE and the wider project regarding the use of options and other financial tools to reduce risks to both REDD+ sellers and REDD+ buyers and how they may increase demand and/or mitigate risk.

The workshop was based around three sessions introduced by an LSE member of staff to outline the scope of the session before opening up to open discussions:

- ***Session 1 – Where does REDD+ stand today?*** (Tim Laing)
  - Prospects for Compliance/Non-compliance
  - Motivations for current purchasers
  - Lessons from previous experience
  - Jurisdictional v Project based approaches
- ***Session 2 – Barriers and Risks to REDD+*** (Luca Taschini)
  - Main barriers to engaging private sector
  - Main risks facing buyers, suppliers and intermediaries
- ***Session 3- The Future for REDD+*** (Charles Palmer)
  - Options and other tools to reduce risk
  - Actions to enable interim financing
  - California possibilities
  - Post 2020 Prospects

The following sections summarise the key discussions in each of the sessions.

Session 1: Where does REDD+ today?

Key questions:

- What are the prospects of REDD+ playing a role in compliance markets?
- What are the prospects for increasing non-compliance REDD+ demand?
- What have been the motivations of existing REDD+ purchasers?
- What have been the key lessons from the experience of these existing producers?

Key discussions

Demand is not zero

- There are pockets of demand but no consistent sector or geography. Demand can often be found in unusual places – charitable donations, part of wider corporate social responsibility strategies, donation for tax exemption status, on top of the a-typical purchaser for carbon reduction/neutrality goals.
- Demand also comes from firms who need to meet sustainability indicators for indices such as Dow Jones and Bank lending indices.
  - Experience of companies in the extractive industry (oil and gas) using REDD+ to obtain better loan rates.
  - Criteria are becoming increasingly important, for example HSBC now require 70% FSC certification for lending to forest projects.
    → market actors involved in actions which self-reinforce demand for REDD+, e.g. lenders, market indices, etc., with little or no regulation from government.
- Demand is changing somewhat – away from pure offsets

    - More towards adding revenue streams to other activities for example agro-forestry.
- Demand for REDD+ is not necessarily ‘new’ offset demand; instead it is ‘poached’ from other classes of offset. This is a fundamental challenge to the sustainability of the voluntary market.
- REDD+ was emerging as a potential new asset class 2-4 years ago – firms looking to engage to gain experience – interest has fallen away somewhat as prospects for entry into compliance look more unlikely.

Who is the decision-maker for the purchase of REDD+ credits?
- Differs from company to company
        - Often the CSR department, but can go all the way up to the CEO, this is often dependent on the size of the company.
        - For some entities, such as in the extractive industries, the decision sometimes lies with the risk desk and thus time horizons differ depending on the risk being hedged
- Time horizons are short for voluntary purchasers – not more than 5 years, and often shorter –most clients are 1-3 years.
- For projects which offer investors commodities plus carbon benefits time horizons are longer.

Key factors affecting demand
- Price plays a relatively small role in non-compliance demand.
    - In fact given it’s seen on some occasions as a ‘donation’ – in which case why would you want to give less?
    - The importance of price differs from company-to-company with those purchasing for carbon reduction/marginal abatement options more price sensitive.
- Co-benefits are also important
    - Those involved in developing REDD+ activities are showing more interest in developing associated activities, e.g. job creation, rather than focusing on carbon alone; such multi-faceted projects are difficult to set up.
- CSR demand is highly budget dependent – and budgets are often set from year-to-year – giving very short time horizons, and high fluctuations in activity.
    - Quality of credits matter even if purchased for CSR reasons (issue of reputational risk).
- Given governance in tropical nations, concerns raised about corruption and where the money ends up. This is why many corporates like project based offsets.
- The sophistication of buyers is important in determining how much they are aware of issues such as permanence.
    - Some voluntary purchasers do care about permanence but depends on their level of sophistication
    - Co-benefits are more crucial to many buyers where CSR is main driver.

Jurisdiction vs projects
- Projects need to be part of a jurisdictional approach – embedded in overall developments
- However CSR buyers like small, nice cuddly projects

- This is due to less risk, more control, and finance flowing straight to projects
  - 'Newness' of REDD+ makes smaller projects easier to understand
  - Easier to understand what you are purchasing
- Some fears from buyers about working too closely with governments, fears of corruption, etc.

Alternative motivations

- Alternative motivations that could be adopted are horizontal landscape approaches, domestic sources of demand – e.g. Rio city purchasing credits from Acre, aviation, building into investor requirements for REDD+ jurisdictions

Session 2: Barriers and Risks to REDD+

Key questions

- What are the motivations for private sector to get involved in REDD+ (emissions reductions or other services)?
- What are the risks that the private sector stakeholders face when "investing" in REDD+?

Values / Services	***Key risks***
Extractive Industries – Stranded Assets	Market risk / price risk
Requirements for Loans / Stock indices	Political risk
Impact investors / funds - Green bonds	Permanence
	Reputational risk

Compliance

- For compliance entities the main motivation is minimizing costs – therefore price is the major factor (and risk) – as long as credits meet pre-set criteria. Purchasing is mainly undertaken by compliance firms buying as cheap as possible

CSR/Supply-chain

It's 'all about the story'

- And the story for REDD+ is not great at the moment
- Easier to sell paying to do something – something tangible (speaks to importance of more visible 'co-benefits'), rather than paying for stopping doing something (more 'intangible')

Host country role

- Interesting case studies where firms have worked directly with government for example BP's partnership with the Forestry Commission in Scotland to establish the Scottish Forest Alliance on a 100 year contract.
  - Partially due to BP's involvement in Scotland with North Sea Oil
  - Potential to build off companies who have a deep stake in countries

- Also potential to play off power of host countries to impart conditionality on investors following examples in other areas such as for example UAE requirements on access to oil fields

Reputation is key

- Reputational risk – is a crucial component for REDD+ investors – and is very difficult to measure and quantify – making it hard to include in risk assessments
    - Some institution to quantify, or help understand this risk would be beneficial
    - Wouldn't eliminate risk – but could assist understanding
    - Index/rating agency?

- Standards play some role in doing this – but very stringent, difficult with multiple standards
    - Definitely boosts demand
    - Moving towards more validation of co-benefits

- Multiple standards may be a signal to buyers that the market is not yet mature
- To improve senior stakeholder buy-in – reduce complexity for decision-makers – reduce standards, industry associations – create a unified package of information

Session 3: The Future for REDD+

Key questions

- Potential for REDD+ options to reduce risks to buyers and supplying finance to suppliers?
- Can buyers also retain/obtain at least some of the benefits they might obtain from projects financed via non-compliance markets from jurisdictional projects?
- REDD+ options as a 'club good' of REDD+ pioneer buyers?

Key discussion

Potential for options

- Question is does the use of options talk to the fundamental problem with the market?
- Previous use of options in CDM/EU ETS driven by trading desks
    - Authority to pay premium to obtain future results – but not to loan money
    - Similar to loaning but looks and feels different
    - Added on to existing commodity trading
        - Once there is a compliance need then traders just want delivery of the commodity
- May be too early for such an approach – maybe more relevant a couple of years before entities are regulated.
- Why would corporates get involved in this?
- Discounted prices would be very low
- Could be useful to create temporary demand
    - If regulatory signals start to emerge by 2015 then demand for call options may emerge

- Put options may be useful to overcome the lack of current demand with options helping to leverage long-term demand

- Could help to solve the funding gap
    - Very attractive to project developers – allows forward selling and early revenue
- Is there experience from compliance buyers in the pre-EU ETS period that could be looked at?

Experience

- Perhaps look at the current deal between KfW and Acre for results-based payment where 24 million credits were purchased and 11 million cancelled

Alternative approaches

- Can you boost investment in projects in developing countries?
    - Boosting return on debt?
- Jurisdictional approach – public sector finance being used to create incentives for private sector to invest in projects

List of Participants

Name	*Organisation*
Chris Webb	PwC
Christina Elvers	PwC
Darragh Conway	Climate Focus
Edit Kiss	Althelia
Andrew Hedges	Norton Rose
Pieter van Midwoud	Gold Standard
Sophy Greenhalgh	IETA
Samuele Repetto	IETA
Dirk Forrister	IETA
Pamela Brazier	Wildlife Works
Luz Abusaid	US AID
Andrea Abrahams	BP
Olivier Levallois	Carbon Clear
Christian Dannecker	South Pole Carbon
Robert Hume	Carbon Green Africa
Tim Laing	LSE
Charles Palmer	LSE
Luca Taschini	LSE
Pedro Piris Cabezas	EDF