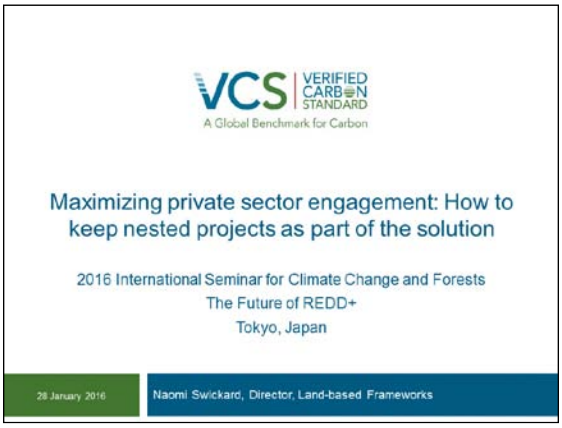
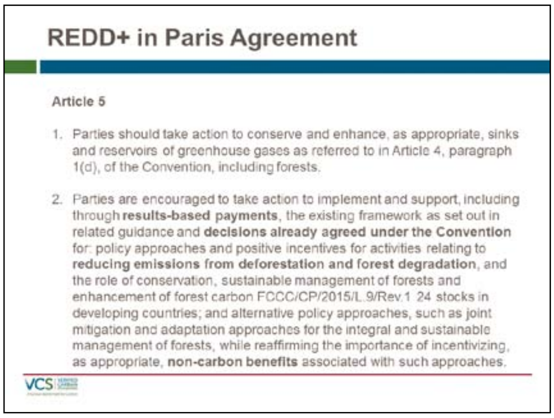
Maximizing Private Sector Engagement: How to keep nested projects as part of the solution[1]

Naomi Swickard (Verified Carbon Standard)



Thank you very much to FFPRI for inviting me to this session for putting on a great event again this year. I am going to focus on two main components: what is the role of the private sector in the post-Paris world and how do we keep private sector engaged, particularly in terms of how we make that work at a project level? I am focusing on that nested architecture because the theme of the seminar here is reference levels, but I do want to be clear that we definitely agree that the private sector can be engaged in REDD in a much broader number of ways and different types of financing arrangements, and that this is one aspect of potential solutions.

Emerging REDD+ Market Opportunities



The first thing I want to start with is looking at some of the emerging REDD market opportunities.

To put this in the context of the Paris agreement, I want to call out three key elements. One is that there is strong language on REDD bringing that into the Paris agreement and recognizing the

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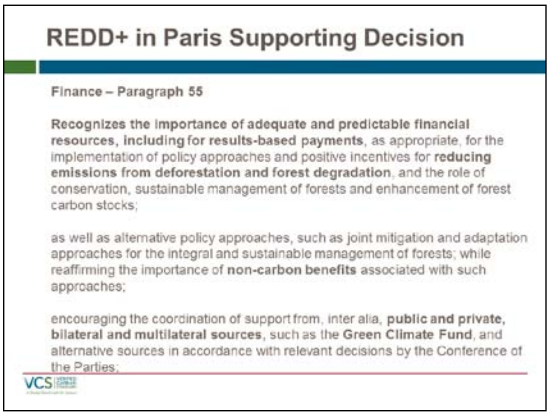
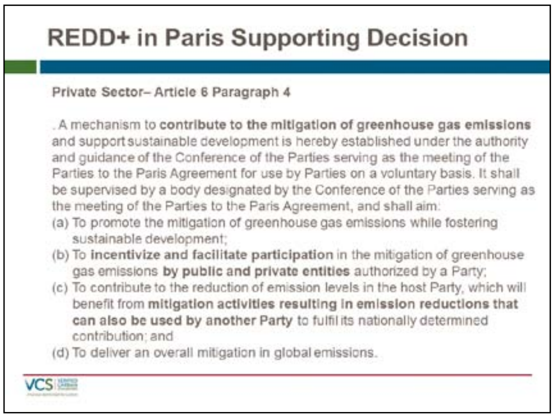
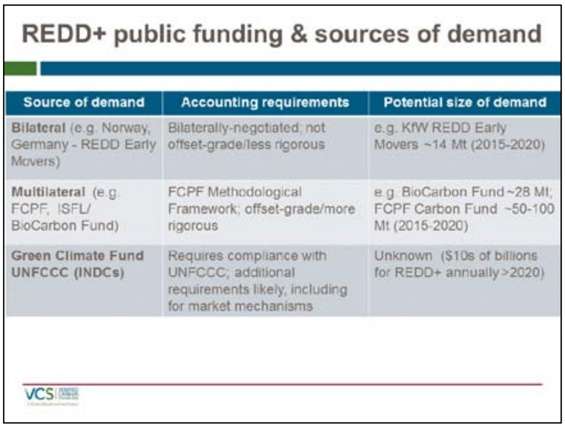
previous decisions.





There is recognition of the importance of adequate and predictable finance. Called out specifically in this is the need for both public and private sources of finance. We are going to need to continue with the diversity of finance sources. We are not going to have going forward a singular financing mechanism, which means we have a fairly diverse portfolio of finance options which may have different requirements.

Finally, there will be a mechanism contributing to greenhouse gas emission reductions and sustainable development. That needs to incentivize and facilitate participation by both public and private entities. The critical component here is that it includes the opportunity to contribute emission reductions between parties. In other words, there is an opportunity for trading of emission reductions among countries in order to meet INDC commitments.



What we have here is a future that looks bright in some ways in terms of being clear that market mechanisms can be a part of the solution. We know that, given the finance needs for REDD, we need to go beyond donor sources of finance to include the private sector. That goes both ways. We need both of them to cover different elements. We will see a future that includes a variety of these mechanisms that may have different accounting requirements. I just want to point out primarily that, in some cases where you have sort of bilateral negotiated efforts that are fund based, we see a system of accounting which may be less vigorous or may be more streamlined, easier to meet at an earlier stage phase, whereas some of the emerging sources of demand are going to need something that remains more rigorous in terms of how you set the reference level and how you integrate different scales.

An interesting one to point to here is the Green Climate Fund[2], which will have a significant contribution to REDD expected, but in our discussions with the Green Climate Fund, it is clear that what is being submitted to the UNFCCC so far in terms of reference levels from countries are not very comparable. They have concerns about making payments based only on that when it is meant to be a results based mechanism that has some fairness in terms of how payments are made and volumes that are paid for, prices, and etcetera. Therefore, they think they may need some sort of additional parameters or guidance that will allow the unlocking of that results-based finance.

REDD+ private finance & market demand

Source of demand	Accounting requirements	Potential size of demand
Private funds (e.g. Althelia, Permian)	Typically offset-grade required; rigorous	Several hundred million dollars (2015-2020)
International voluntary market	Offset-grade required; rigorous (e.g. VCS, Gold Standard)	~87 Mt (2013-2017)
Domestic voluntary markets (e.g. Costa Rica, Chile, Colombia…)	Varies by country; typically rigorous	Unclear
Regulatory markets (e.g. CA, Japan, South Africa…)	Offset-grade required; rigorous (e.g. California Offset Credits)	e.g. CA ~30-40 Mt (2018-2020)
Aviation sector / ICAO	Likely market-based mechanism, including REDD+ (project and/or jurisdictional); rigorous	~8-10 Bt (2020-2050)

Focusing more on the private sector, we also see a variety and a potentially growing area of need for private and market demand within the REDD space. This ranges from private funds and voluntary markets to a number of emerging opportunities, including domestic markets like international regulatory markets like Japan and California, as well as the aviation sector. I want to focus on two of these briefly.

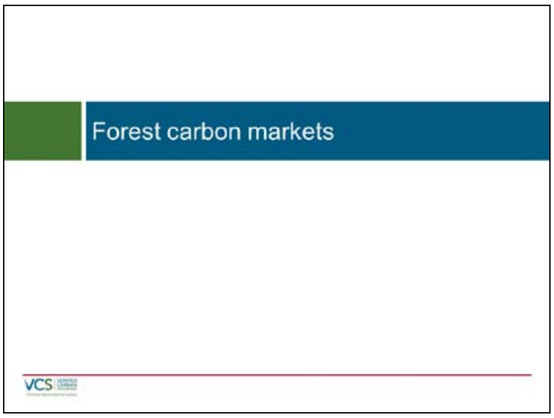
In terms of regulatory markets, California for example is moving forward to incorporate REDD in that market. They are looking to leverage existing frameworks that countries can use to produce offset-grade emission reductions into that market. They are expected to move into rule-making in the next year and bring those tons in California starting in around 2018.

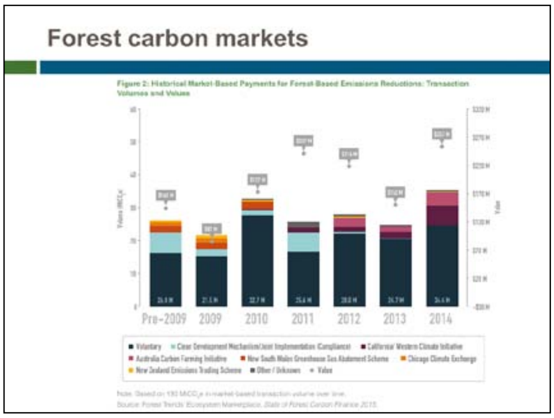
The aviation sector is another area where we see a lot of potential for leveraging markets and potentially using REDD as a part of that mechanism. The aviation sector is expected to use a market-based mechanism to achieve carbon neutral growth from 2020. The organization that manages, the International Civil Aviation Organization[3] (ICAO), is very opaque, so it is hard to get up to date information. However, what we understand from the airlines is that it is likely to be agreed by

[2] http://www.greenclimate.fund/home
[3] http://www.icao.int/Pages/default.aspx

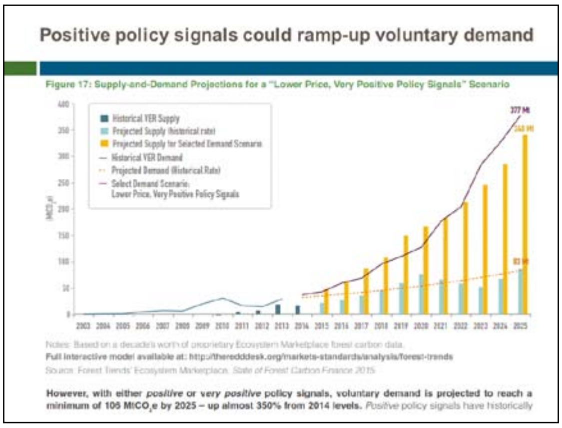
the middle of next year, and that there is a lot of desire from the airlines to bring REDD into that mechanism because they need the scale of emission reductions. They like the diversity of country profiles. They want to be able to purchase tons from the places that they fly, and their interest in the additional social environmental benefits. However, because that is a market mechanism, they are going to be looking for something that has credibility of operating at the level of rigor that would be needed in that mechanism.

Forest Carbon Markets

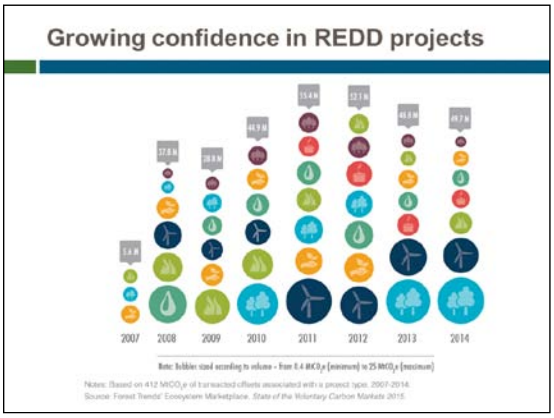


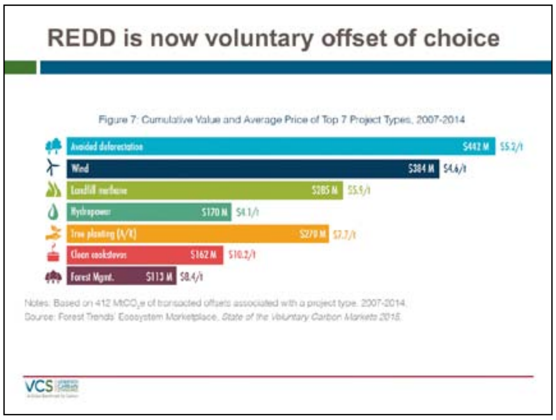


Taking a brief look at where we are at beyond today in terms of market opportunities, we see that forest carbon markets in the voluntary space continued to grow, particularly if you exclude 2010, which was an outlier year in many ways, but we still see steady growth there in terms of forest carbon markets as well as the voluntary market as a whole.



One key component in that sector is the potential that demand could really increase with strong policy signals. Out of the Paris agreement, I think we do have a strong signal that markets will be a part of the solution, but we do not have clear rules on what that will look like, and we do not have clear rules on how it will relate to INDCs and the ability to trade tons outside of countries other than the recognition in the text that it is possible. Therefore, there is still a need, if this is to become a real part of the solution, for clarity on the policy side. ICAO and the aviation sector moving forward with the market based mechanism that includes REDD could be a very strong policy signal.

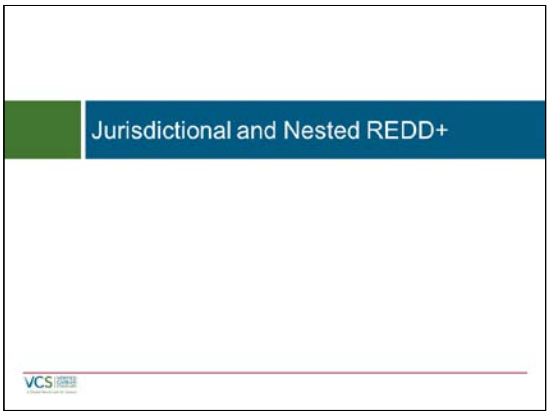


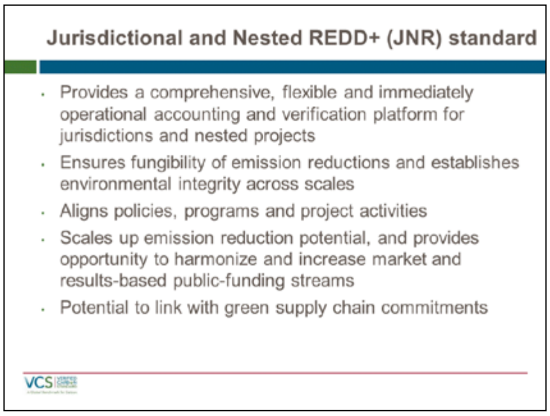


Finally, we also see growing confidence in REDD projects on the ground in terms of the fact that they have become a major source of emission reductions in these markets. You see that with the forest emblems starting to grow throughout the years and becoming the dominant source in 2013 and 2014.

You see that as well in the total cumulative sales where REDD has become this voluntary offset of choice.

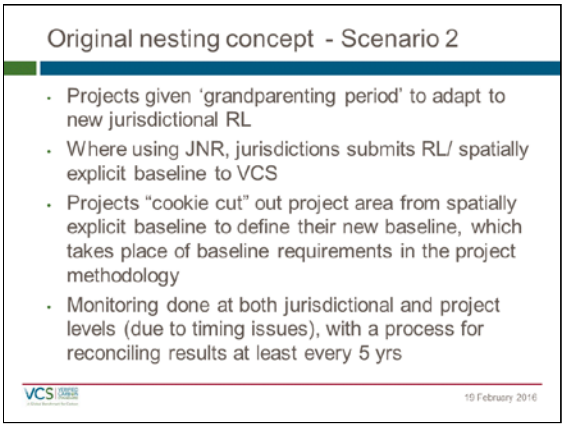
Jurisdictional and Nested REDD+



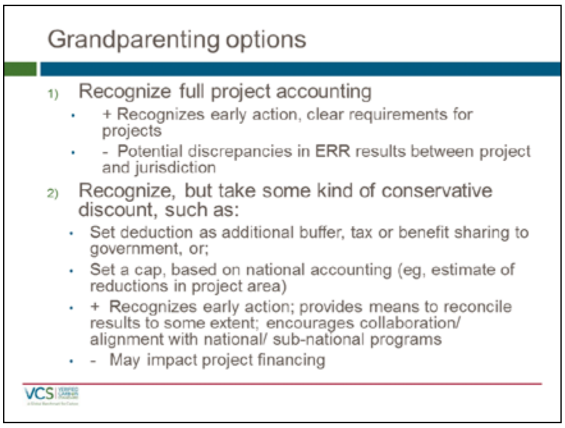


Where does that really leave us? We have within the agreements clear references to REDD and a clear need for private finance. We need mechanisms to ensure that that private finance can continue to operate in this space. In other words, we need to design the mechanisms going forward and elaborate the rules around the use of markets in a way that can incentivize that private sector action. This is only one part of the solution, but I want to focus on this today because I think one of the key things that many of you are thinking about, particularly related to the JCM, is how we incentivize more of this investment at the project scale but make sure that it aligns with what is happening at the higher level; in other words, within national and sub-national accounting.

The VCS has worked for a number of years on a framework called the Jurisdictional and Nested REDD+ standard or framework. It is meant to be a high quality, rigorous, or market-ready mechanism for jurisdictional accounting and nested activities.



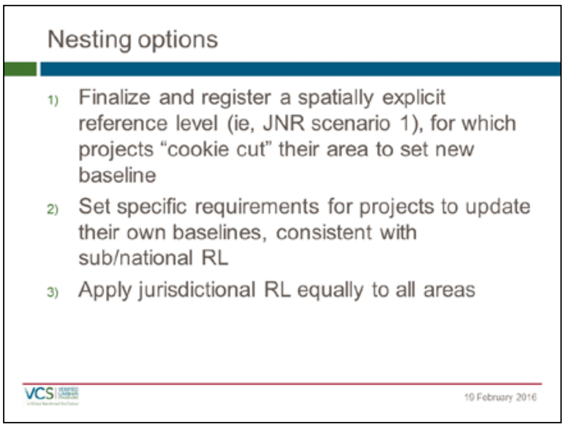
We are working with a number of countries that are using that, particularly those that are trying to access regulatory markets like California. Many others are using it as guidance. When we designed this, the idea at the time was that more momentum would continue around market mechanisms. Because of that, there would have been an incentive for jurisdictions or governments to grow further with reference levels to do something that was spatially explicit. In other words, that it was predicting where and when deforestation would occur in the jurisdiction. If the reference level does that, nesting or making sure that projects are aligned with jurisdictions becomes quite easy. The project can simply draw its area out of the higher reference level and use it, but what we are finding is that in most countries that is not happening, at least not yet in terms of the spatial projection that would predict deforestation across the entire jurisdiction.



How do we deal with this? We see two main timeframes where we need to be able to reconcile what is happening at a project scale and what is happening at a higher scale. The first timeframe is in the grand-parenting period, which is a period of time where projects are using project level reference levels, but we need to make sure there is not a major conflict with the results at a higher level. However, these projects are not yet fully integrated into the higher reference level, which may take time.

There are a number of options where that can be used in the scenario. Governments can decide to recognize full project accounting. In other words, they could recognize the total emission reductions from projects. They would then need to deduct that from the total emission reductions that are at a jurisdictional or national scale to avoid double counting. That would recognize the early action of projects and provide them clear requirements, but it does mean that you could have a discrepancy in results. A lot of that stems from the fact that projects have primarily chosen to operate in areas of high threat. In other words, they have a higher deforestation risk in the project area than the average across the jurisdiction. It can appear that they are sort of carving off more than their share. This has become a problem in countries particularly where there are a higher number of projects.

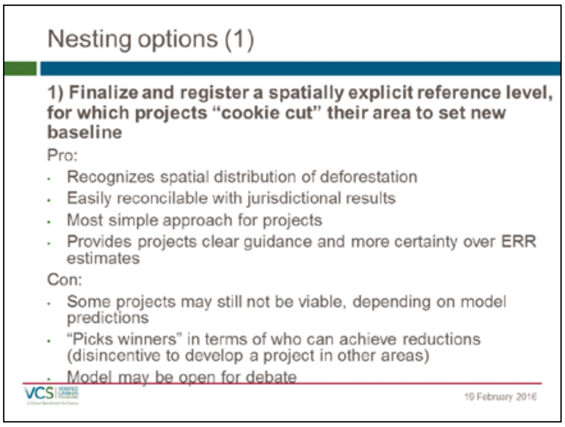
There is a need to reconcile this, so there are other opportunities that could be taken during this period to make sure that you do not have the scale discrepancy. Those could include different kinds of set-asides that take some type of a conservative discount on projects in the early stages to avoid this discrepancy, but that has plusses and minuses as well.



Beyond the grand-parenting period; in other words, once projects become fully nested in a jurisdictional approach, they need to essentially be as harmonized as possible with the higher level reference level or baseline. There are a number of options for that. When we were initially looking at this architecture and nested system, the idea was that a spatially explicit reference level that predicted where and when deforestation would occur at a jurisdictional scale would mean that the project can simply draw out its area. However, that has challenges as well and I will come back to that.

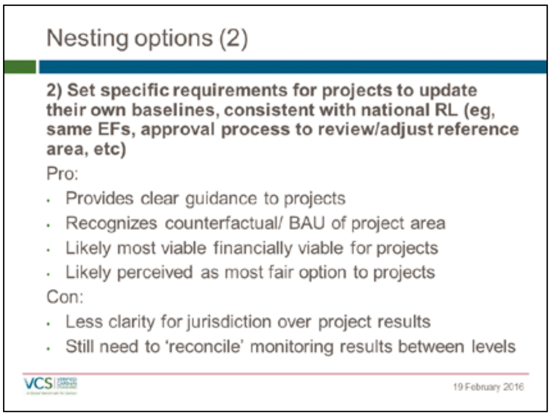
The second option would be for projects to essentially use as much of the higher level reference level as possible while doing the spatial component at the project scale. In other words, they might use the same emission factors as the jurisdiction. Perhaps some of the same activity data, though they may have more fine grained results at a project scale that could be added to that, but then looking at how that impacts within the project area and doing the modeling at a project scale.

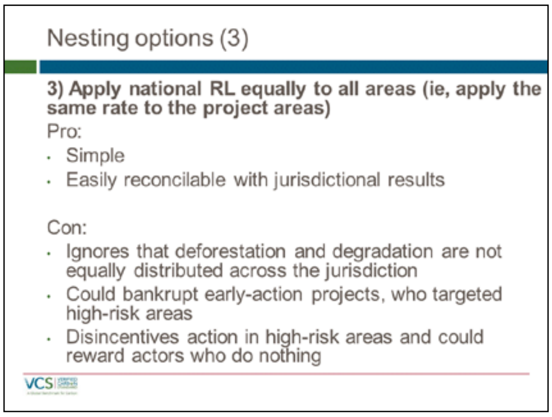
The third option would be something along the lines of applying the jurisdictional reference level equally to all areas of the jurisdiction and just making a policy call that any project that wants to operate can, but it would be tied to essentially the rate of deforestation across the jurisdiction applied to the project area.



These all come with a number of plusses and minuses. I can see wheels turning from some of you involved in projects going, "Hey, wait a minute. What does this due to my baseline, and what is this due to the financial architecture of my project?" It is a risk, but I think we have to recognize that these projects, A, must come into line with higher level of jurisdictional programs, and to be a part of the solution, we need a mechanism that works both for the projects and for the jurisdiction.

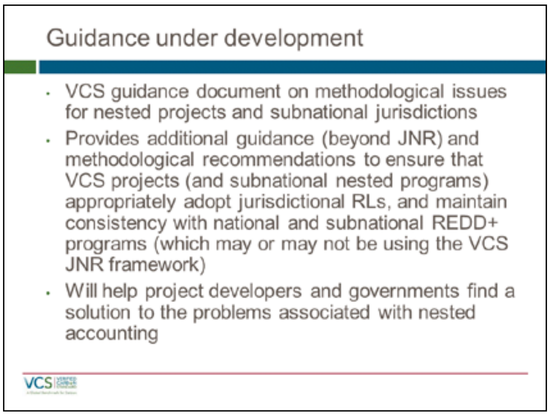
Briefly, some of the opportunities or pros and cons to these different options: if the jurisdiction does a spatially explicit reference level, this would recognize the fact that you have different rates of deforestation across the jurisdiction and that projects are oftentimes located in a high threat area. It is easily reconcilable with jurisdictional results because it would essentially be the same as the higher level of reference level, and would provide clear guidance and certainty to projects. However, it does have some risks that model predictions that would be required to do this are open for debate or could be very complex.

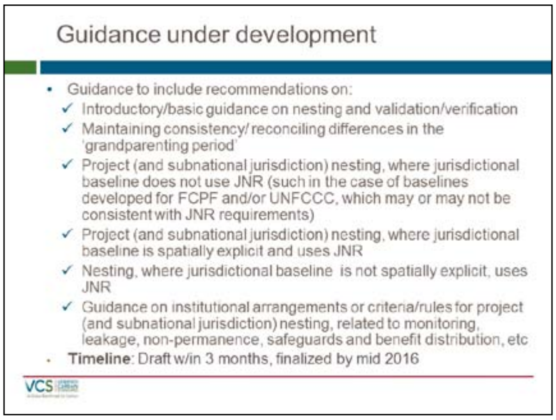




The second option of allowing projects do the spatial component at the project level using as much of the jurisdictional data as possible, it would provide clear guidance to projects and perhaps the most sort of oversight of their own future, but could result in still needing some reconciliation.

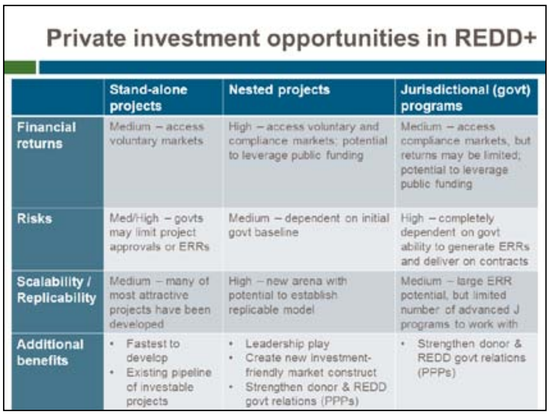
Finally, the third option is easily reconcilable, but could very well bankrupt many projects. That is a major risk, not just for the project, but also for the country, because the failure of projects that have existed for the last number of years could really mean negative perceptions of REDD and failures to deliver to the communities that they made promises to.



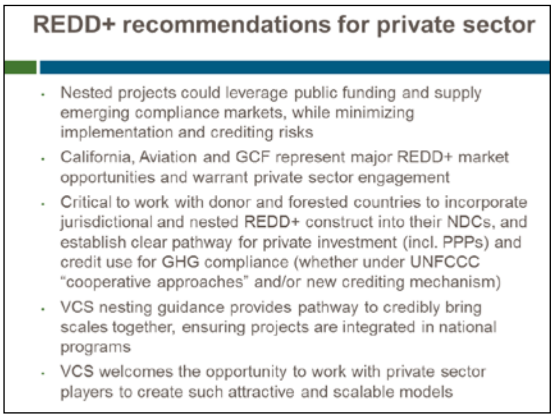


We are working on some guidance to go much deeper on this. What are the actual technical options for reconciling these different scales? We will be sharing that and completing it sometime in the next three months. Hopefully, that will be useful to many of you working at the national and project scale that need to figure these elements out.

Conclusion

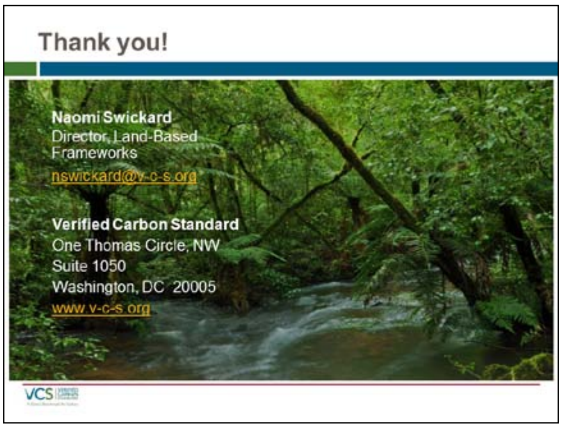


	Stand-alone projects	Nested projects	Jurisdictional (govt) programs
Financial returns	Medium – access voluntary markets	High – access voluntary and compliance markets; potential to leverage public funding	Medium – access compliance markets, but returns may be limited; potential to leverage public funding
Risks	Med/High – govts may limit project approvals or ERRs	Medium – dependent on initial govt baseline	High – completely dependent on govt ability to generate ERRs and deliver on contracts
Scalability / Replicability	Medium – many of most attractive projects have been developed	High – new arena with potential to establish replicable model	Medium – large ERR potential, but limited number of advanced J programs to work with
Additional benefits	• Fastest to develop • Existing pipeline of investable projects	• Leadership play • Create new investment-friendly market construct • Strengthen donor & REDD govt relations (PPPs)	• Strengthen donor & REDD govt relations (PPPs)



Finally, I just want to highlight in terms of going forward the continued role of the private sector in projects. I think we can clearly see the standalone projects that are not integrated in the higher level have a very risky future, and one that is risky to both the project and the jurisdiction. There is a need to integrate those scales, but many in the private sector are very nervous about engaging directly with jurisdictional programs, that there is a high risk of credit delivery and many other issues in terms of interacting at that scale.

Therefore, what we really need is partnerships going forward between the public and the private sector where we can work together to ensure that we create mechanisms that make sense for all of the parties, that we can clarify how this relates to the INDCs, and allows the private sector to do what they can, particularly where they have a strength in forcing change on the ground in specific locations in a way that can tie to a segment of the demand and finance that is needed for REDD, particularly targeting areas where there is a need for those mechanisms, like aviation. I welcome any comments from any of you. These are initial recommendations or thoughts on how this structure can work.



Thank you very much.