

Opportunities and challenges associated with emerging carbon finance in forestry and land use

Seminar on country experiences and lessons learned

Issue Brief 3

Private sector and projects – How can governments use carbon finance to enable private sector action in forests and land use?

This issue brief was developed based on the background paper for the third session in a four-session seminar on country experiences and lessons learned on the **opportunities and challenges associated with emerging carbon finance in forestry and land use**. The paper was discussed at the event and received input from participants. This third session addressed the question how governments can incentivize private sector action through projects and climate finance. It included a deeper look into the processes and institutional arrangements associated with various modalities to enable private sector projects.

The role of governments vis-à-vis private sector projects in REDD+

Government action certainly plays a central role in addressing many of the drivers of forest loss, such as effective regulation and enforcement of land use and tenure rights, in addition to being able to support forest owners and communities to sustainably manage their forests and landscapes. However, government action at large scale can also be complemented by more local and context specific opportunities to reduce forest related emissions, which projects can identify and seize.

Incorporating decentralized action by projects and enabling landowners and stewards to design and access rewards for more appropriate land use decisions and management practices can complement and accelerate the positive impact of government REDD action at national and subnational levels. At the same time, projects and local actions alone cannot address relevant drivers of deforestation on their own, nor address them at the scale needed, thus requiring that projects are adequately integrated into larger processes. The challenge is how to integrate local actions and investments in a way that they can contribute to the country's development and mitigation goals. In the context of climate finance opportunities, this also links local action to measurable performance.

As projects and jurisdictional initiatives have increased in recent years, they serve as a source of practical experience on the ways in which such integration can be done in various policy contexts¹. This seminar session takes country experiences that deliberately attempt to integrate projects, to various

¹ By 2018, the International Database on REDD+ projects and programs (ID-RECCO database-<http://www.reddprojectsdatabase.org/>), included 226 REDD projects with a full or predominant goal of avoided deforestation or forest degradation at the jurisdictional or project scales, of which about half were interested in selling carbon¹. Between 2017 and 2019, an estimated 104 MtCO_{2e} in voluntary carbon offsets related to forestry and land use were transacted,¹ certified under a variety of standards.

degrees, as a starting point and explores the considerations and potential elements for countries to take into account if they chose to advance in the integration of projects and the mobilization of private sector action through carbon finance mechanisms.

Defining the incentives for private sector projects

The two core elements to define the role of private sector projects relate to how the performance of those projects would be assessed and how they would be rewarded.

In terms of assessment of performance, governments could allow projects to measure their performance by using their own measurement, verification and reporting (MRV), by requiring the use of some nationally determined components (e.g. baselines, monitoring and verification systems) or by using non-carbon proxy measures defined by governments. These options involve different degrees of complexity and are critical to ensuring that projects are designed and implemented in alignment with broader climate and development objectives.

In terms of the mechanisms to reward project performance through carbon finance, countries also face a range of options. Access to carbon finance for projects, whether international and/or domestic, could be enabled either directly by the private sector or indirectly through jurisdictions or governments. The direct access option would involve projects to be allowed to own and transact emission reduction credits, while the second one would grant them rewards proportional to their performance according to rules set out in the benefit sharing arrangements of the country or jurisdiction. There is also the possibility to combine these options and effectively create hybrid systems. Table 1 illustrates the combinations of performance and reward mechanisms that countries could consider.

Table 1. Modalities that countries can enable on the role of private sector projects in their national REDD architecture.

	Direct access to carbon finance (domestic and/or international)	Indirect access through benefit sharing arrangements or incentives
Independent MRV systems / standards (bottom up)	Projects can certify and trade emission reductions directly.	No direct trading by projects, but can access finance.
Regulated MRV provisions connected to national systems (top-down)	Projects can trade directly but ERs must use centrally defined MRV such as baseline allocation mechanisms or using data or emission factors from national MRV systems.	Projects are awarded finance indirectly linked to GHG performance. e.g. New Amazon fund
Top down but using non-carbon proxies	Not possible to access carbon finance mechanisms directly	Finance is indirectly linked to carbon performance. e.g. distribution of carbon finance through conditional payments such as schemes of payment for ecosystem services.

The modalities described in the table above are not mutually exclusive, for instance, countries may allow projects to directly transact in markets while conditioning part of the emission reductions to be sold to the government under predefined benefit sharing arrangements.

These modalities largely depend on the definition of carbon rights and benefit sharing arrangements in a given country, and on the methods used to reconcile carbon accounting across scales; and, have implications on the complexity and other technical challenges of the ultimate system. They also affect the degree of certainty and control that private actors have over a proposed activity and ultimately over the incentives for them to invest in projects and perform. While direct crediting for stand-alone projects

would grant most control and potential incentives for private actors, they also present the most technical challenges to ensure environmental integrity.

Policies and institutional arrangements to enable projects

To incentivize private sector action, governments can set up regulations, procedures and institutional arrangements. The regulations and processes established by countries to address issues related to nesting of projects can be broadly classified around six elements: benefit sharing and carbon right provisions, project approval processes, project and emission registries, baseline allocation mechanisms, risk mitigation mechanism and MRV requirements. Figure 1 illustrates these elements. Some of these elements will be more critical depending on the specific option that the country wishes to enable, and are not intended to be prescriptive, but as a potential taxonomy of elements for countries to consider.

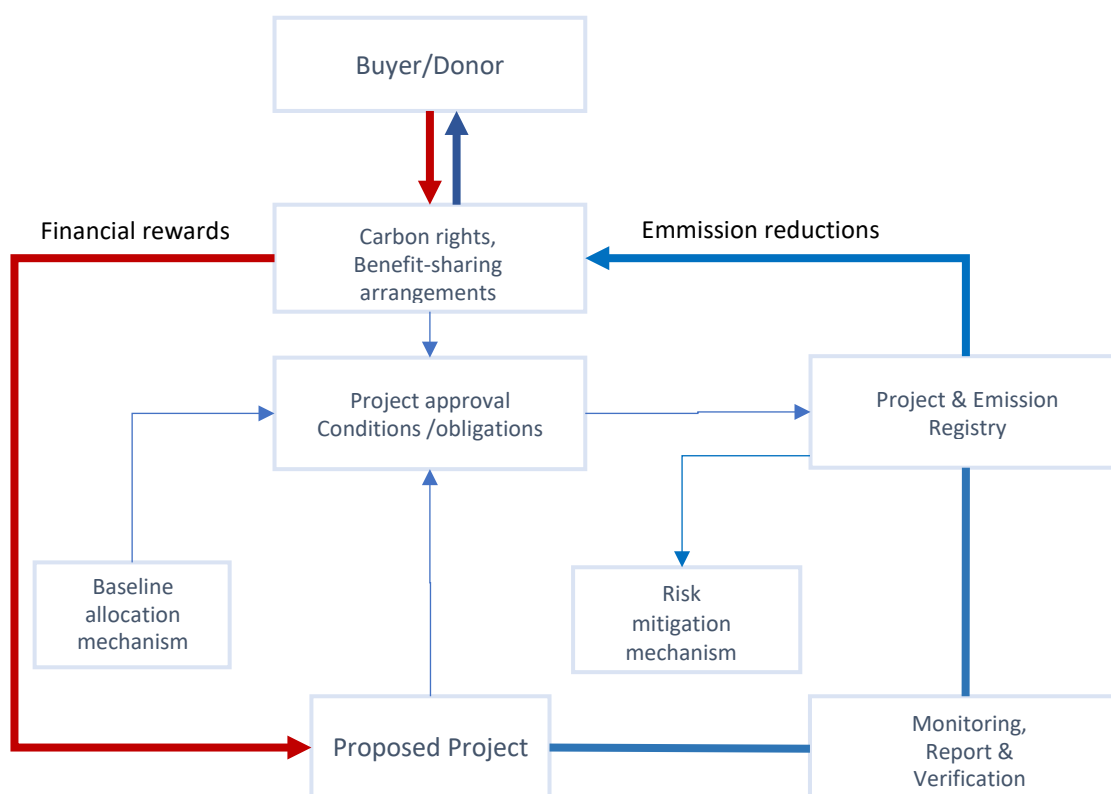


Figure 1. Elements of procedures and arrangements for nesting projects

Benefit-sharing and carbon rights arrangements include the establishment of the rules and mechanisms that define the way in which projects can be rewarded for their actions/performance. Depending on the carbon rights and other arrangements, this may be either in the form of ex-ante or ex-post financing or in the form of emission reductions. This may also include provisions on whether and how projects could engage in carbon transactions with domestic or foreign buyers/donors.

Project approval processes are the core mechanisms by which countries are able to identify, assess, track, and set conditions and obligations for projects. Establishment of these mechanisms enables countries to ensure that any new project proposal or vintage project can be assessed against nationally determined guidelines and criteria in both carbon and non-carbon components (i.e. safeguards), determine overlaps across projects and programs (location, timeframes and scope – activities, pools and GHGs), and assess additionality. They can also serve to trigger other conditions and requirements, such as establishing reporting mechanisms, allocating baselines or contributions to the system operation and risk mechanisms.

Baseline allocation mechanism. To ensure that the baseline used to measure performance of a specific project is consistent with national accounting, countries may establish rules on the baselines that projects can use. For example, countries may allocate a baseline to projects, on the basis of project area and deforestation rates in the region, in a way that the sum of disaggregated baselines does not exceed the national or subnational reference level. However, countries have also used this mechanism to provide additional incentives to certain areas or activities, for example, by weighing the baselines with other environmental value proxies such as biodiversity importance.

Project and emission registry. Registries involve having a mechanism to keeping a record of mitigation actions at multiple levels, emission reductions (verified emission reductions) as well as transactions (claims and use of ERs). It is essential to track status and compliance with nesting rules. Effective operation requires that governments develop the necessary regulation and administrative processes to mandate and operate registries, such as project approval requirements. Registries are also a way to ensure that reporting at the national level, such as National Determined Contributions (NDCs) accounting, is able to identify potential need for adjustments. The registry may also be linked or integrated with a registry for other sectors. The registry is also an important mechanism to keep track of other elements, such as buffer accounts to address non-permanence and leakage, as well as preventing double claims. Registries impose additional costs and data management complexities for countries.

MRV requirements. Aligning MRV approaches across scales is important in order to enable comparability of effort and results. This set of procedures and requirements sets the methods, data, reporting and verification approaches that projects must use. In the case of decentralized systems, this may involve integrating data from individual projects into the national forest monitoring system, while in more centralized ones, this may require projects to use elements of the national MRV system.

Risk mitigation mechanism. Leakage and non-permanence risks can be mitigated through a variety of mechanisms, including project design, buffers insurance, or guarantees can also be used to address residual risks. The risks mitigation mechanism includes the rules for projects to share the risks with jurisdictional/national levels. In the case of buffers, this may need to be inscribed in the registry.

Summary considerations

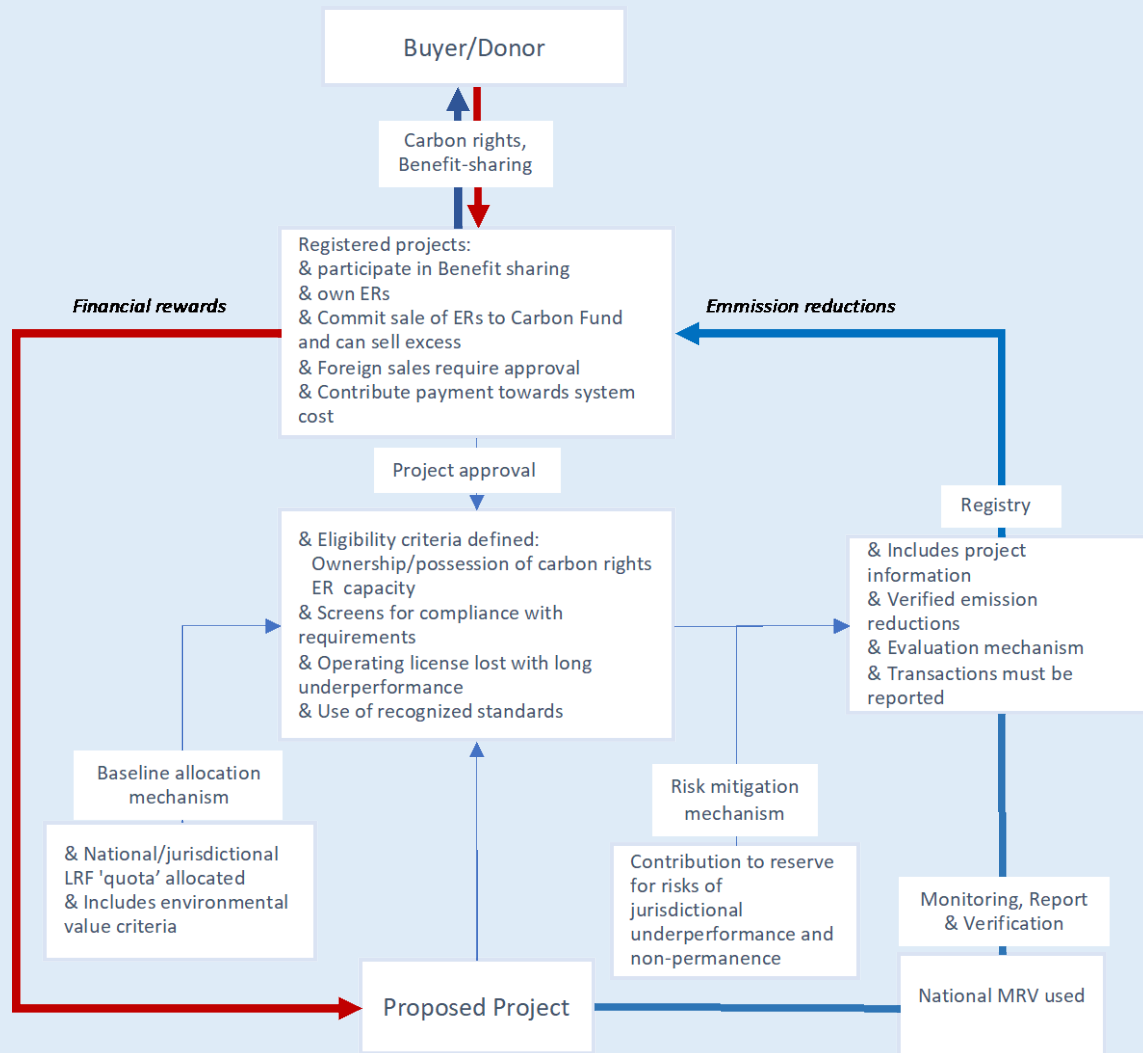
- Governments are mandated to lead country efforts to address the drivers of forest loss. But government action also faces limitations, not just in terms of resources, but also in their capacity to identify more local and context specific opportunities to reduce forest related emissions. Therefore, decentralized action by the private sector and landowners can complement, and accelerate the positive impact of government REDD+ action.
- A number of practical solutions are emerging to show how private sector projects can be enabled to access carbon finance. Rather than a one-fits-all, these models reflect a range of visions and national circumstances.
- A recurrent question in discussions between governments and the private sector is about access to carbon finance, i.e. whether international and/or domestic carbon finance can be accessed directly by the private sector or indirectly through jurisdictions or governments.
- The regulations and processes established by countries to address issues related to nesting of projects can be broadly classified around six elements: benefit sharing and carbon right provisions, project approval processes, project and emission registries, baseline allocation mechanisms, risk mitigation mechanism, and MRV requirements.
- The complexity and cost of *nesting* approaches will vary with the modality chosen by countries, and countries will need to take those into account as well as the contribution that projects can play in addressing the drivers of deforestation and contributing to enhanced jurisdictional or national action.

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Annex 1. Example of Project enabling (*nesting*) in Guatemala

Guatemala has opted for a hybrid mechanism, with project level emission reductions having to sell to the FCPF's Carbon Fund under government agreed terms, while they can sell excess ERs directly. Baselines are centrally allocated (quota) and projects must use national monitoring. Projects also contribute to the cost and benefit sharing mechanism.



Sources: Government of Guatemala. Anexo XI: Approach and Principles of Nesting for REDD+ Initiatives (Projects and Programs) in Guatemala. Guatemala, November 2019.

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