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Review of the initial modalities of the Private Sector Facility – Addendum V

PSAG recommendations on mobilization of private sector finance to progress the GCF forestry-related results areas

Summary

This document contains the recommendations of the Private Sector Advisory Group to the Board on mobilization of private sector finance to progress the GCF forestry-related results areas. The recommendations are presented in response to a request from the Board, and can be summarised as follows:

(a) Review current pipeline, and projects under implementation by GCF and other entities to identify successful cases/best practice;

(b) Request GCF and invite accredited entities, national designated authorities and other partners to develop innovative approaches to engage private sector in forest-related activities, including all three phases of REDD-plus and funding to implement direct forest-related activities, taking into account all actors and processes involved in the value chain and all the benefits beyond carbon, encouraging also the GCF and partners to address/strengthen (sub) national jurisdictional approaches. Support the countries in the creation of an enabling environment.

I. Introduction

1. The Board of the Green Climate Fund invited the Private Sector Advisory Group (PSAG) to make recommendations on the mobilization of private sector finance to progress the Fund's forestry-related result areas (decision B.12/07, paragraph (f), decision B.14/01, paragraph (a), decision B.BM-2017/02 and decision B.17/01, paragraph (b)(xxi)).

2. The PSAG held meetings on 1 and 2 March in Songdo, South Korea, and 16 and 17 August in New York, United States, to discuss private sector engagement in adaptation and forestry-related investments. The Secretariat prepared presentations and background documents that initiated the discussion. For the New York meeting, forestry experts from World Wildlife Fund (WWF), The Nature Conservancy (TNC) and Conservation International (CI) were also invited as guest speakers to complement the conversation.

3. During the New York meeting, the PSAG heard three tailored presentations from external experts on jurisdictional approaches to zero deforestation, climate-smart forestry, and encouraging private sector investment in forestry, respectively. With takeaways from these sessions and taking into account the GCF operations context, PSAG members considered approaches to mobilizing private finance to progress GCF forestry-related result areas.

4. This paper summarizes major points raised during the discussions and accordingly, elaborates recommendations developed at the meetings, in response to the Board's mandate.

II. Background and context

2.1 The importance of forests in the fight against climate change

5. Agriculture, Forestry and Other Land Use (AFOLU) are responsible for close to a quarter of global greenhouse gas (GHG) emissions: 10–12 GtCO_2e/year. These emissions are predominantly from deforestation and agricultural emissions from livestock, soil and nutrient management, while other land use and land-use changes (e.g. forest degradation and biomass burning) contribute to a smaller degree. Forests are both a source of and a sink for GHG emissions, and are affected by climate change as an ecosystem. According to Global Forest Watch (GFW), tropical forest loss currently represents nearly for 8 per cent of the world's annual CO_2e emissions. If tropical deforestation were compared to a country, it would be the third-biggest emitter globally – ranking below China and the United States and significantly above the European Union.

6. Deforestation as a mitigation measure has commanded substantial attention in the last decade. Gross forest losses are estimated in the region of 13 million hectares a year over the last decade. With afforestation and reforestation factored in, forests account for an estimated 11 to 18 per cent of total GHG emissions (estimates vary substantially depending on modelling assumptions). Nevertheless, reducing emissions from deforestation and forest degradation may account for 24 to 30 per cent of global mitigation potential, and offer a wide array of co-benefits. There is broad consensus that efforts made to reduce deforestation offer greater mitigation potential at a lower cost than afforestation and other forest management interventions.

7. A growing global population is demanding more commodity crops like beef, soy, and palm oil; in the Sub-Saharan Africa this growth means more land is being cleared for subsistence agriculture. Reason why, policies for conservation, afforestation and reforestation must be coordinated with sustainable agriculture practices to increase productivity yield rather than clearing more land for crops.

8. Internationally, the role of forests to mitigate climate change is recognized explicitly in the Paris outcome, mainly through Article 5 of the agreement as also the importance of results-based payments (RBPs) for REDD-plus. Forests are furthermore a key component of strategic and innovative platforms with strong private sector engagement such as the New York Declaration on Forests (NYDF), Tropical Forest Alliance 2020, and United Nations Strategic Plan for Forests (2017-2030).

2.2 Potential of the private sector

9. Private investors are heavily involved in the forest and land use activities, especially those generating revenue, such as agriculture, cattle production and forestry products. There are multiple actors involved, including farmers, small businesses, large corporations, whose sizes, structures, and operations vary widely, ranging from purely local, to national, regional and international in scope. Although private sector actors are significant agents of land use change, engagement with the private sector to slow, halt and reverse forest loss as well as to restore forested landscapes has been limited. For the private sector specifically, the need for financing is huge: while sustainable forest management needs between USD 70 to 160 billion each year, official development assistance to forestry covers only about 1 per cent, and other available public sector financing sources barely double that amount[1].

10. The lack of engagement in forest and land use solutions is due to a number of factors and barriers, that include a lack of regulatory and enabling environments; political, economic and financial risks associated with the long-term investments; lack of adequate incentives to engage in forest conservation (including in value creation); lack of understanding of REDD-plus (Reduction Emissions from Deforestation and Degradation) as an opportunity to attract investments, and uncertainties associated with future carbon markets. In many countries, REDD-plus, such as stated by Brazil regulations, "only eligible Public (National) entities are able to raise payments resulted from REDD+", which clearly creates a barrier for private sector.

III. PSAG recommendations

11. The PSAG, taking into account the inputs by external forestry experts and considering GCF's approach as a financial mechanism to promote climate resilient development, reiterates the importance of simplifying and streamlining processes related to accreditation and no-objection letters (NOLs), as well as transparency around those processes in order to enable and accelerate private sector participation. Particularly, the following recommendations are made to the GCF Board in relation to mobilization of private sector finance to progress GCF forestry-related result areas:

(a) Review current pipeline, and projects under implementation by GCF and other entities to identify successful cases / best practice. GCF also to take a proactive role in business development and generation with private sector entities, countries and accredited entities (AEs).

(b) Prioritize using existing requests for proposals, e.g. MSME, to support forest-related successful cases.

(c) Recommends the GCF to encourage its partners, including countries and AEs to address and/or strengthen (sub) national jurisdictional approaches that allow the private sector

[1] The Program on Forests (PROFOR), *Private Financing for Sustainable Forest Management and Forest Products in Developing Countries—Trends and Drivers*. Available at <https://www.cbd.int/financial/doc/wb-forestprivatefinance2014.pdf>.

to integrate them into national or subnational accounting system, including through readiness and capacity building grants.

(d) Requests the Secretariat and invite AEs, national designated authorities, and other private sector partners to analyse and develop approaches to engage the private sector in all three phases of REDD-plus and other forest related activities, including through funding to implement direct forest related activities.

(e) GCF should encourage AEs and other entities to bring funding proposals that can establish a pool of funding that can be rapidly deployed to support high risk, high potential and innovative ideas that drive strong pipeline in forestry-related activities, including funding non-direct forestry activities, such as sustainable agriculture practices, that favours incremental productivity yield for commodities and crops that are often demanding the clearing of new forest areas.

(f) PSAG recommends that GCF projects take into account all actors and processes involved in the full spectrum of the value chain (timber and non-timber) involved forest-related activities; and take into account all the benefits beyond carbon.

(g) PSAG recommends that forest-related activities should measure not just mitigation result area, but include strong measures to quantify adaptation and resilience co-benefits. In addition, there has to be also a strong physical climate risk assessments (such as fire, draught, land slide and other extreme weather events) in the design of the forestry projects and programs.

(h) **PSAG recommends that GCF support the countries in the creation of an enabling environment including the development of regulatory and policy framework conducive to enhanced private sector operations in forest related activities.** This may include: (i) capacity building in host countries to address policy and regulatory gaps to incentivize private sector participation in forest related activities; and (ii) establishing the necessary policy guidelines that stimulate private sector investment in forest related activities. PSAG also recommends that GCF forest-related activities are consistent with well recognized existing standards, certification and platforms.

IV. Next steps

12. In line with the above recommendations, concrete action points for the Secretariat to implement include the following:

(a) **Simplify/shorten the timeline for private actors seeking accreditation/NOLs**. As an initial step, it is crucial for the Secretariat to Conduct an analysis that would allow identifying the barriers faced by companies involved in deforestation-free supply chains and develop mechanisms that could support overcoming such barriers.

(b) **Develop a menu of options to access to finance that could be channelled to private sector in a more simplified modality**, e.g. by agreeing on pre-set financial structures that have been proven successful in the forestry sector as well as looking for innovative funding modalities used in other sectors, such as ongoing forgiveness of loans related to performance or results-based financing as incentive to reduce deforestation and forest degradation, as well as to promote carbon stock enhancement, conservation and sustainable forest management. In this case loans could be made with predetermined conditions related to achievement of forest and land use climate change outcomes, to be independently audited. Every year in which the conditions are met, that year's loan payment would be forgiven. The loan would thus be converted into a grant, gradually and according to transparent conditions. Similarly, unbundled subsidies can be considered in which a subsidized loan can be offered as a grant and a market rate loan, leaving the recipient free to take the loan only if appropriate. Also, loans combined with output-based grants can be considered. Output-based grant schemes pay grants only on delivery of the desired output which could be linked to reduction of emissions from deforestation and degradation, increased forest cover through reforestation/afforestation, restoration of forest or forest conservation interventions, sustainable forest management and other forest related activities.

(c) **Analyse how new technologies could also be applied to foster actions to reduce or halt deforestation and forest degradation**, as well as to enhance forest carbon stocks, forest conservation, sustainable forest management and other forest related activities**.** For example, blockchain technology, which, in simple terms a means to distribute ledgers, opens up a wide range of possibilities in forestry and land use—especially with regards to traceability systems, land titling, and monitoring sources and uses of funds. In this regard, and in many other ways, the technology could have large implications on carbon markets as well as facilitation of meeting supply chain commitments (amongst other possibilities). Some examples of such instruments include first loss guarantee, carbon market risks guarantee, contingent loans/grants for performance risks, forest bonds, and other types of innovative financial instruments. These products could be offered as off shelf standardized instruments to attract private sector engagement in a more proactive and expedite way. Such innovations of financing instruments could reduce the risk of the GCF portfolio considerably while also reducing the dependency on up front grants for projects.

(d) **Addressing the uncertainties in forest carbon offsetting.** Incentivize private investments on the basis of the REDD-plus results-based payments pilot programme, by reducing the carbon market risk and ensuring that emissions reductions resulting from their investments that comply with the procedures of the pilot programme will be eligible for payments from the GCF in case the carbon market doesn’t absorb the supply. While the current state of the carbon markets is not providing the right signal for private sector actors involved in emission reductions trading, several emerging markets could provide new incentives for forest sector mitigation. Some of these emerging carbon markets include: Domestic emissions trading schemes (ETS), Bilateral international carbon trading, International carbon markets (e.g. Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA)). While many of these markets are still under development, GCF could offer private sector investors an instrument to reduce the uncertainties of the future demand from these and other markets that can emerge in the future.

(e) **Promote and proactively participate in discussion forums with private sector actors to identify business opportunities through GCF modalities for private sector.**

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