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MEETING REPORT

Financing Tropical Forest Protection and Sustainable Development in the Amazon: Principles for Investment Mechanisms

Session 2: Brazil-US Dialogue on Sustainability and Climate Change

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This publication is part of the Brazil-U.S. Dialogue on Sustainability and Climate Change. The Brazil-U.S. Dialogue, organized by the Wilson Center's Brazil Institute in partnership with Uma Concertação Pela Amazônia, aims to foster sustained society-to-society dialogue between Brazil and the United States, through convening high-level non-governmental stakeholders interested in making a difference through collaboration on innovative and forward-looking solutions.

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Executive Summary

As COP-26 demonstrated, interest in sustainable investment is growing by leaps and bounds and mobilizing capital at scale to protect and restore tropical forests is an increasingly critical piece of the puzzle in addressing climate change and developing sustainable and resilient economic value chains. However, there is a gap between investor interest and actual investment in the Amazon Basin. Although 25 percent of the world's Nationally Determined Contributions (NDCs) coming out of COP-26 rely on forest conservation or restoration, just 3 percent of climate mitigation finance is spent on forests. Resolving this mismatch by developing mechanisms for channeling capital effectively to support low carbon development and conservation in the Amazon is essential to addressing deforestation and its implications for the planet. In conjunction, investors and the international community must also work with local stakeholders to ensure they have access to these new funding sources, as well as enough capacity to absorb and use new resources effectively.

1. **When it comes to financing through carbon market mechanisms, project-based credits need to be appropriately nested within jurisdictional accounting frameworks to avoid some of the worst concerns regarding risks such as leakage and additionality.** Financing for forests has traditionally existed in two separate universes: one in which project-scale credit is available through voluntary private markets; and another with jurisdictional programming financed through public sector funding. To take advantage of corporate interest and the significant amount of capital present in the private sector, it is urgent that policymakers reconcile these two universes in a way that leverages the positive features of each in order to attract finance at scale.

2. **International funding for forests requires an integrated, layered approach that combines multiple types of capital with innovative tools and new mechanisms to evaluate and aggregate small projects into "large-enough" investment opportunities.**

3. **There needs to be significant attention given to "last-mile" readiness to ensure that local communities and local governments most impacted by forest degradation have access to financing and credit.**

Meeting Report

There is an urgent need for rapid progress and large-scale solutions in the Amazon. Protecting and restoring tropical forests can contribute up to "one third of the climate results the world needs over the next two decades, representing a gigaton-scale mitigation opportunity."[1] Put simply, achieving the world's Paris Agreement targets is virtually impossible without massive action to safeguard the world's tropical forests and the window of opportunity for action is now.

Fortunately, interest in sustainable investment is growing by leaps and bounds. Corporations and investors are ready to invest in sustainability at a scale previously unseen. A number of multinational companies have committed to becoming climate positive, which requires reducing their own emissions, as well as those produced throughout their supply chains, and investing in external emissions reduction programs. This commitment is driving capital towards forests as mobilizing capital at scale to protect and restore tropical forests is a meaningful way for investors and companies to "address climate change, protect nature and create jobs, in a single intervention."[2]

When it comes to the Amazon Basin, however, there is fundamental mismatch between investor interest and actual investment. A credibility gap exists: despite promising rhetoric, there exists legitimate concern about whether the international community is serious about committing funds at the scale needed to transform the Amazon economy. Although 25 percent of NDCs rely on forest conservation or restoration, just 3 percent of climate mitigation finance is spent on forests. Although COP-26 strove to address this issue through initiatives like the U.S.-led Forest Investor Club, much more in particular must be done to ensure that investment reaches local communities—including Indigenous communities—in the worlds' tropical forests to incentivize results-based action to eliminate deforestation and degradation.

The Amazon receives a notable paucity of global impact investment, despite rising attention and growth in sustainability entrepreneurship and innovation in the region. Although 2020 saw a record high in terms of venture capital (VC) and private equity (PE) investment in Brazil, none of it went to the Amazon region, only 4 percent went to agricultural technology, and just 2 percent to food technology. According to a 2020 Aspen Network of Development

[1] Architecture for REDD+ Transactions (ART), https://www.artredd.org/.
[2] World Economic Forum, "3 reasons companies are investing in forest conservation and restoration, and how they do it," https://www.weforum.org/agenda/2021/06/3-reasons-companies-are-investing-in-forest-conservation-and-restoration-and-how-they-do-it/.

Entrepreneurs survey, 30% of impact investors indicated that biodiversity and conservation were priority issues, but less than 2 percent of assets under management in Brazil from 2018-2019 were focused in biodiversity.

Resolving this mismatch—developing mechanisms for channeling capital effectively to support low carbon development and conservation in the Amazon—is critical to addressing deforestation and its implications for the planet. As part of this effort, however, investors and the international community must also work with local stakeholders to ensure they have access to these new funding sources and enough capacity to absorb and use it effectively.

On September 15, 2021, the Wilson Center, in partnership with Uma Concertação Pela Amazônia hosted a bilateral discussion focused on principles for sustainable investment within the lens of Brazil-U.S. cooperation. As part of this meeting, we were honored to have opening presentations from Nigel Purvis, President and CEO, Climate Advisors; Frances Seymour, Distinguished Senior Fellow, World Resources Institute; Juliana Santiago, Managing Director of Fund Control, Emergent; and Alan Batista, Investment Analyst, Mirova Natural Capital. We were also fortunate to have former Brazilian Minister of Finance Joaquim Levy moderate a subsequent conversation.

The event was part of a larger initiative: The Brazil-U.S. Dialogue on Sustainability and Climate Change. The Dialogue convenes a diverse group of U.S. and Brazilian stakeholders—scientists, business leaders, civil society, and former government officials—for an open, bilateral debate on what is possible and what will be effective in terms of low-carbon development and environment conservation in Brazil, and how the United States can be a partner in this effort.

Over the course of the September 15 session, the participants identified the following three recommendations as critical to bolstering bilateral and international cooperation for forest investment in the Amazon region. Critically, when it comes to deforestation and land-use change, the sustainable investment challenge is one of coordination, including: reconciling individual projects with jurisdictional approaches; integrating different types of capital and connecting investors with investment-ready opportunities; and ensuring that financing is reaching local stakeholders such as Indigenous communities.

1. **When it comes to financing through carbon market mechanisms, project-based credits need to be appropriately nested within jurisdictional accounting**

frameworks to avoid some of the worst concerns regarding leakage, additionality, and other potential risks.

Voluntary carbon markets have emerged as an important mechanism for channeling financing for sustainability projects, including in the Amazon. There is growing global consensus that this forest investment needs to be done in a way that raises climate ambition and environmental integrity while also providing resources for Indigenous peoples and other local communities. The challenge, however, lies in implementation of this consensus.

Traditionally, large-scale opportunities for private sector investment have been limited. UNFCC negotiations envision national-level implementation with national-level baselines and strategies. Moreover, multilateral organizations and national governments have traditionally taken the lead at the jurisdictional level when it comes to managing and financing REDD+ projects, with limited participation opportunities for the private sector. The now-dormant Amazon Fund, a REDD+ mechanism managed by the Brazilian Development Bank (BNDES) with funding from Germany and Norway, is a well-known example of this model. In contrast, the private sector has invested more heavily in individual projects and through voluntary carbon markets at a project-based scale. This is inherently a more limited form of investment.

The end result is two separate universes: one in which project-scale credit is available through voluntary private markets; and another with jurisdictional programming financed through public sector funding. To take advantage of corporate interest and the significant amount of capital present in the private sector, it is urgent that policymakers reconcile these two universes in a way that leverages the positive features of each in order to attract finance at scale.

One way of doing this is to allow national governments and subnational jurisdictions to access private credit through voluntary carbon markets for results-based payments that reward reduced emissions or enhanced carbon removal in forests. This pathway is embodied by the LEAF Coalition, which seeks to create a mechanism for large-scale financial flows into tropical forests for conservation and sustainable development, including the Amazon. The LEAF Coalition is different from previous efforts in that it offers the private sector a way to invest at the jurisdictional level and thus invest at a much larger scale.

The LEAF Coalition

Initiatives such as the LEAF Coalition provide an example of how multi-stakeholder coordination for financing forest protection and sustainable development can work in practice, and ideally raise the bar for future efforts. The LEAF initiative is a jurisdictional REDD+ financing mechanism built around six fundamental elements: working at scale, robust social safeguards, raising climate ambition, environmental integrity, results-based finance, and mobilizing private-sector capital. LEAF launched in April 2021 with 10 participating companies and US$1 billion pledged, representing a potential scale previously unheard of in forest finance.

To be eligible to receive part of the US$1 billion pledged this year through the LEAF Coalition, jurisdictions—entire countries or large states and provinces—must demonstrate that they are reducing emissions from deforestation and degradation (REDD+) as well as ensure the "full and effective" participation of traditional communities. Payments will be based on emissions reductions linked to programs that reduce deforestation and degradation from 2022-2026. Jurisdictions must show that deforestation has fallen across the entire territory to receive financing. The initial LEAF financing submission round called for project proposals that begin in 2022, with credits issued in 2023 at the earliest.

These reductions at the jurisdictional level, through national or subnational forest protection programs, are verified according to The Architecture for REDD+ Transactions (ART) under The REDD+ Environmental Excellence Standard (TREES), which includes environmental and social safeguards. The TREES standard incorporates UNFCCC decisions and, critically, it standardizes credits for reductions and removals so that these credits are comparable across jurisdictions and sectors. These resulting high-quality credits can be sold to participating companies, to help offset their emissions.

LEAF is characterized by a high standard both in measuring emissions reductions and in the way it governs how companies can supplement their own internal emissions cuts by investing in tropical forest conservation projects. The initiative requires companies to commit to science- based methods to measure carbon emissions, and also requires participating companies to reduce as well as offset—with external reporting and auditing requirements to verify compliance.

More broadly, there are efforts underway to develop frameworks for nesting projects within a jurisdictional accounting framework for several reasons.[3] First, ending illegal deforestation requires actions that only governments can undertake, such as enforcing laws, regulating extractive industries, and upholding Indigenous rights. Jurisdictional-level programming can help incentivize governments to take these actions by providing financing for REDD+ and sustainable development activities. Second, operating at the jurisdictional scale reduces

[3] https://www.artredd.org/wp-content/uploads/2021/07/Nesting-under-ART-final-July-2021.pdf

some of the bigger challenges in terms of enforcement and accountability. With larger areas, for example, it is easier to control leakage and address concerns over additionality (see our first meeting report on "The Road to COP-26" for further discussion of project-based vs. jurisdictional programs). Appropriately nesting project-scale accrediting within jurisdictional programs allows for more robust accounting and integrity, while still providing ready mechanisms for investment through a voluntary carbon market.

A fundamental part of nesting projects within jurisdictional accounting frameworks is the application of a standard sufficiently robust to generate the types of fundable credits needed for voluntary markets as well as compliance regimes. There is no single "right" way to do this, but participants did examine the Architecture for REDD+ Transactions (ART) and the REDD+ Environmental Excellence Standard (TREES), including TREES 2.0, and its selection as the standard applied by the LEAF Coalition.

The TREES 2.0 Standard

The REDD+ Environmental Excellence Standard (TREES), released in 2020, specifies requirements for the quantification, monitoring, reporting and verification of emissions reductions and removals from REDD+ activities at a jurisdictional (and national) scale, consistent with UNFCCC decisions such as the Paris Agreement. Perhaps most importantly, it standardizes the credits issued for reductions and removals so that these credits are comparable across jurisdictions and sectors—a key issue for scaling up carbon market mechanisms.

In 2021, the ART Board released TREES 2.0, which has a more expansive scope that includes a broader range of actions and stakeholders. In particular, TREES 2.0 includes innovative mechanisms for crediting carbon removals associated with reforestation as well as new methodology for generating credits for jurisdictions that qualify as High Forest, Low Deforestation (HFLD) jurisdictions.[4] The revised standard also provides a pathway for Indigenous territories to aggregate in order to quality as a "large enough" jurisdiction.[5]

2. International funding for forests requires an integrated, layered approach that combines multiple types of capital, with innovative tools and new mechanisms to evaluate and aggregate small projects into "large-enough" investment opportunities.

[4] https://www.artredd.org/wp-content/uploads/2021/08/ART-HFLD-Primer.pdf
[5] https://www.artredd.org/wp-content/uploads/2021/08/ART-IP-in-ART-Primer.pdf

Translating a temperature target—or any other sustainability metric—into an investment strategy is inherently complex. It requires not only a shift from focusing on purely financial returns to integrated value creation but also the development of new tools and standards to assess risks, results (carbon and non-carbon benefits) and returns.

A significant issue that local stakeholders, from small farmers to Indigenous communities, face is the often-small scale nature of their projects because international investors are generally looking for large-scale investments that are relatively easy to evaluate and valuate. As a result, it can be hard to raise capital for Amazon forest projects. For investors accustomed to traditional metrics regarding rate of return and revenue streams, assessing the value and potential of a forest project is much harder and not necessarily worth the effort involved unless the value of the project hits a certain threshold. This is why initiatives such as the LEAF Coalition are attractive to investors: it takes out the guesswork, as companies are able to purchase already-verified emissions credits.

Another solution is to turn to companies that specialize in managing forest carbon investment projects, which are able to assess and aggregate local investment opportunities, as well as raise international capital through targeted investment funds. One example of this model is the Althelia Biodiversity Fund, a blended finance impact fund that invests in sustainable business models in the Amazon. Designed in partnership with USAID, the biodiversity fund offers certain guarantees to lower the risk to investors. It also an example of patient capital as it has an 11-year term for the fund—not uncommon for sustainable impact investment. Perhaps most importantly, the fund provides an exit strategy that allows investors to access their returns and providing small companies in the Amazon with full ownership once they have scaled up.

3. There needs to be significant attention given to “last-mile” readiness and ensuring that local communities and local governments have access to financing and credit.

The counterpart to the need to develop mechanisms for channeling financing for forests is ensuring that local governments and local communities have the tools and capacity required to access and use that financing. Government agencies, particularly at the subnational level, lack the resources and technical capacity to develop and administer the types of rigorous jurisdictional programs needed to tackle the climate challenge. Similarly, local stakeholders often lack the information needed to access capital markets; or their projects may be

considered too small to be of interest to investors. Both of these challenges will need to be resolved if we are to address deforestation in the Amazon.

One key recommendation from participants is to provide separate funding for project development and evaluation, as well as technical and legal advice—something lacking in the LEAF Coalition's design. One benefit of LEAF financing is its flexibility: jurisdictions are able to propose the projects they deem most suited to their local contexts and needs. This design assumes, however, that jurisdictions already have the capacity in place to respond and all they lack is financing for implementation. The challenges with this model were apparent during the initial funding round for LEAF, as interested jurisdictions scrambled to find assistance and advice for their proposals—a challenge exacerbated by a short deadline.

Not all funding mechanisms are built without technical assistance and capacity building. The Amazon Fund, to give one prominent example, was administered through BNDES, which also served as a capacity-building entity. With an initiative like LEAF, however, a third party would be required to step up and fulfill this role because its mandate is solely to match emissions reduction credits with investors' needs for lowered emissions. This third party could be a revitalized Amazon Fund, private consultants, or a combination of experts and organizations.

As one participant noted, the need for a third party to provide technical assistance and support capacity building could prove beneficial. Jurisdictions will need independent advice, especially as additional financing mechanisms develop, so they can evaluate the benefits of joining LEAF or any other initiative from a position of knowledge and make the best decision possible for their stakeholders. There is an inherent conflict of interest if the organization managing a carbon market is also providing advice to potential participants in that market. This holds true not only for jurisdictions, but also for Indigenous communities and other local actors who will need legal and technical advice to access financing on beneficial terms.

Although not addressed in detail at the September 15 meeting, participants also stressed the importance of expanding access to Brazil's rural credit program as well as to small business loans for sustainability entrepreneurship. There is significant space for bilateral and international collaboration in these areas, particularly in supporting the development of new technologies for assessing and distributing credit and other investment programs.

More About Rural Credit

When it comes to sustainable agriculture and land use, technical assistance must also go hand-in-hand with access to rural credit. Access to rural credit is one of the biggest challenges for certain biodiversity value chains, such as cocoa in Brazil. Researchers have found that improvements to the country's rural credit policy—focused on modernization and sustainability—could significantly expand sustainable practices in agriculture, allowing for intensification and higher productivity without further deforestation. These gains are particularly pronounced among small farmers.[6] However, the fragmentation and complexity of the rural credit system makes it difficult for producers to navigate, and small farmers in particular face challenges in securing credit. There is significant opportunity for technological innovation and public-private partnerships to disrupt this space and extend access to credit for small holders and small business owners alike in order to incentivize sustainability.

[6] https://www.climatepolicyinitiative.org/wp-content/uploads/2020/12/REL-Rural-Credit-Policy-in-Brazil.pdf

About the Brazil-U.S. Dialogue on Sustainability and Climate Change

The Brazil-U.S. Dialogue is a multi-year initiative to foster stronger society-to-society collaboration between Brazil and the United States on Amazon deforestation and sustainable development. This includes the creation of a neutral forum for constructive dialogue that brings together many sectors of society and the facilitation of a discussion focused on what is possible and what will be effective in terms of low-carbon development and conservation in Brazil.

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