Environmental Finance

Scaling up conservation finance (part two)

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In the second and final part of this roundtable discussion on conservation finance, participants focussed on how conservation projects could be scaled up and what lessons could be learned from the carbon markets.

Clockwise from bottom left: Lisa Wong, Herbert Lust, Daniel Rossetto, Phil Cottle, Joe Walsh, Lisa Walker, Edit Kiss, Agustin Silvani, Abyd Karmali, Tulio Andrade, Richard BurrettClockwise from bottom left: Lisa Wong, Herbert Lust, Daniel Rossetto, Phil Cottle, Joe Walsh, Lisa Walker, Edit Kiss, Agustin Silvani, Abyd Karmali, Tulio Andrade, Richard Burrett

Participants

Graham Cooper – Editorial consultant, ***Environmental Finance***
Paul Herbertson – Director, **Fauna & Flora International**
Rupesh Madlani – CEO, **Global Sustainable Capital Management**
Lisa Wong – Head of impact, **Affirmative Investment Management**
Herbert Lust – Vice-president, **Conservation International Europe**
Daniel Rossetto – Managing director, **Climate Mundial**
Joe Walsh – Staff writer, **Environmental Finance**
Lisa Walker – CEO, **Ecosphere+**
Agustin Silvani – Vice-president, **Conservation International**
Abyd Karmali – Managing director, climate finance, **Bank of America Merrill Lynch**
Tulio Andrade – Diplomat, **Embassy of Brazil**

Richard Burrett – Partner, **Earth Capital Partners**
Lisa Genasci – CEO, **ADM Capital Foundation**
Edit Kiss – Director of business development & operations, **Althelia**
Phil Cottle – Head of agriculture, **Pardus Underwriting**

[Read part one of this roundtable here]

Lisa Wong: I think when we are talking about conservation finance, there is no one size that fits all. There are some projects that, for one reason or another, will stay small. We want to build a healthy conservation investment market that supports different types of projects and initiatives in different phases of their life, as in traditional markets.

Abyd Karmali, Managing director, climate finance, Bank of America Merrill LynchAbyd Karmali, Managing director, climate finance, Bank of America Merrill Lynch

Richard Burrett: You are right. I think there are a whole range of things that we have to do, if we are going to deliver the scale. What is still missing are the price signals that cause us to stop doing certain things and start financing others.

When we were trying to do forest bonds in the past, the cost signals were just not there. So we jumped on carbon because at least it gave us some assistance – revenue streams that people were prepared to make an investment in.

Abyd Karmali: At this stage of the market's development, I think we have to look at blended capital. This is the rationale for the Catalytic Finance Initiative BAML launched in 2014. The virtue of the blended capital model is that you allow different partners to come in. We now have commercial banks, development finance institutions, investors and philanthropies all involved.

This means that we can look at deal opportunities where one of them can provide a first-loss guarantee, which is crucial for some investors. You can look at opportunities where you need to aggregate lots of smaller opportunities, which is why I think it is a good fit for some of the smallholder farming opportunities that we have discussed. You are basically aligning the mission of the public capital with the scale of the private capital, and the patience of the philanthropic capital.

Rupesh Madlani: We do not hate first-loss but, as investors, when there is an 85% chance we are going to call the first loss, that is not a business case, for us. We want to try and back people to make money rather than call on the first loss.

Phil Cottle: I think it is a key point for anybody involving forestry in their projects that we insurers have a very good understanding of the discount rate for forestry risk, but I am not sure investors

do.
Secondly, I do not think there is going to be any amalgamation of funding sources any time soon. There are too many organisations with different agendas.
But if I have a portfolio of thousands of little forests around the world and each produces an income, perhaps from different sources, and even if some are 20 years away from being bankable in the bond sense – is that not a model for development?

Phil Cottle, Head of agriculture, Pardus UnderwritingPhil Cottle, Head of agriculture, Pardus Underwriting

Graham Cooper: Is that not what was done in the CDM by aggregating small-scale projects?
Daniel Rossetto: Absolutely. In the early years, the CDM was very much a project-by-project based mechanism. About three quarters of the credits were coming from about 20 very large industrial gas projects in two or three countries. However later, arrangements were put in place for what we now call programmes of activity (PoA).
The advantage of the PoA is you put into place a programme, which is approved at UN level and host country level and, so long as you bring along projects that meet the eligibility criteria of the programme, they can be added without limit. That is a scaling-up mechanism in its purest form. However, unfortunately, the arrival of PoAs coincided with the complete erosion of the carbon price, so we have not yet seen demonstration of the full potential.
PoA projects do not generate REDD+ credits, but certified emission reductions (CERs) under the UNFCCC. A carbon price will therefore lead people to stop the logging activities and start doing other activities that we know generate mitigation and other co-benefits, including conservation.
So I would put forward the thesis that we already have a mechanism in place for scaling-up. What we do not have is a critical mass of policy-makers and members of civil society who understand that.

Daniel Rossetto, Managing director, Climate MundialDaniel Rossetto, Managing director, Climate Mundial

Agustin Silvani: Understanding or willingness? I think there are a lot of lessons to be learned from the CDM, but conservation is at an early stage. We are where renewables were 15-20 years ago. There was a patchwork of investments, some specialised funds and some success stories. What can we learn from that experience? How did that scale-up?
If institutional investors are saying deals have to be triple-A rated and yield market returns, maybe we should not be targeting such investors. When we talk to the mainstream, our

biggest successes are when we do not mention conservation or carbon. For example, we work with local banks in Latin America and we say, 'If you lend to environmentally sustainable businesses, it is just a better credit risk and we have the data to prove it.' That gets people's attention.

Edit Kiss: But today we are not on a level playing field. Subsidies make the unsustainable commodities so profitable that it is hard to make projects both sustainable and more profitable, that is why we need to put a price on forest carbon which could be achieved through various ways such as REDD+ markets, export/import tariffs or premiums for sustainable commodities to make the playing field more even.

Rupesh Madlani, CEO, Global Sustainable Capital ManagementRupesh Madlani, CEO, Global Sustainable Capital Management

Of course REDD+ is not a panacea and will not work in every case and against all types of deforestation pressure, but it can be still used as a catalytic source of finance for achieving real transformation on the ground from unsustainable to sustainable land use. The real challenge is to ensure that the carbon price is channelled to the local communities, farmers on the ground.

Tulio Andrade: We have to remind ourselves that we are at the beginning of a new phase. The Paris Agreement was established in 2015 and the Green Climate Fund has just become fully operational. We have a whole new set of policies in place. Engagement by the private sector, businesses and the financial sector should be coherent with the international climate change regime under the UN Climate Convention, while contributing to its ultimate objective.

Richard Burrett: Yes, Paris is huge. And I think it has moved the mood quite significantly. The question many people still ask is: Will governments actually follow through and deliver on their NDCs? Will those policies and price signals actually be generated?'

Daniel Rossetto: What attracted a lot of banks into the pre-2009 carbon market is that the commodities that were being traded were fungible; that is the certificates could be interchanged without qualitative restriction and used across a variety of countries and regions to meet carbon reduction commitments.

You were able to produce a CER in Burkina Faso, Brazil, China or India – it did not matter. With the exception of, ironically, forestry credits, the EU Emissions Trading System would accept a CER of any kind. As a bank, you could establish a trading desk in one location and then send a team out to originate projects all over the world. You could risk manage your portfolio of credits from London or wherever because of their fungibility.

Carbon reductions were like a currency. You had absolute certainty that there was one body issuing the certificates; that was the UNFCCC.

We could re-engineer that situation very, very quickly. All that is needed is to provide people with clarity that, after 2020, we will recognise all UNFCCC-issued certificates under the Paris Agreement - and that the certificates will be valid to meet the mitigation commitments that

will be in place after that date.
The NDC commitments already in place suggest the world is already 29 billion tonnes short of emission reductions between 2021 and 2030. Therefore this kind of decision coming out under the auspices of the UNFCCC would trigger an automatic rebound in market interest and, by consequence, price.

Abyd Karmali: That is a crucial point. Liquidity is a key investor concern, but currently we have disaggregated, mini carbon markets. Some use taxation, some use trading. By the end of this year at least 60% of global emissions will probably be covered by some form of carbon pricing. The pricing is there, but it is just not liquid.

Graham Cooper, Editorial Consultant, Environmental FinanceGraham Cooper, Editorial Consultant, Environmental Finance

Another potential solution to get us to scale could be green tagging. There has been some discussion of whether we can effectively assign some form of green tag to loans for activities that enhance conservation. If investors believe that there is a positive benefit from these loans, that may result in a premium in the market.

Look at the hunger for green bonds. On average, they are oversubscribed by two to three times and some believe that is leading to price compression.

Lisa Wong: Large investors are very tapped in to broader climate change discussions. But finding appropriate products for them to invest in is a struggle. So we have to be thinking about simple instruments that allow them to allocate their capital today.

This is one of the things about green bonds … they are very simple. It is really a tagging device with greater accountability and greater reporting. And it has helped divert substantial capital into a green market.

Most investors want more information if they can get it. And, regarding the question of whether we should forget about institutional investors because they only want triple-A credits and large projects – I do not think that is quite true.

For example, we recently launched a global climate bond fund with Lombard Odier, in which we have the capacity to purchase sub-investment grade bonds as well. In fact, we will actively seek to invest in underfunded sectors, including adaptation.

This fund is geared to institutional investors and we have not had a single conversation where they said, "Oh, adaptation, should we be looking at that?" It is more, "Oh, finally, thank you." A lot of institutions are thinking about these risks and want to find a solution. But they are slow-moving organisations.

Richard Burrett: There is $80-plus trillion of investments in the global economy. So we have to get some of that capital focused on positive green impact things. And we also have to tilt them away from business as usual. Whether that is through index products that look at low-carbon, greener outcomes, or whatever. Just try and make it easier.

Lisa Walker, CEO, Ecosphere+Lisa Walker, CEO, Ecosphere+

Lisa Walker: It can cost billions of dollars to do a geological carbon capture and storage project, which may have limited environmental and social impact. Imagine channelling that money into forest conservation, biological carbon capture and storage.

We don't necessarily have all of the technical answers with geological carbon capture and storage, yet we invest in it. I think that investors need to start becoming more active on all forms of carbon capture and storage, natural and technological, and really understanding all the levers they have to pull.

Rupesh Madlani: Business-as-usual is a well-oiled machine. Unless you have a big spanner to put in quick, it is going to take a while to move the needle, to move the funding away from stuff that is not great for the environment.

Paul Herbertson: One of the areas that we want to try and move into more is facilitation on the ground; transforming some of the near-bankable projects to make them bankable. And what is actually required to incubate and accelerate some of the projects, whether they are run by conservation organisations, small businesses, landscape initiatives, supply chain interventions, or whatever. What is actually needed to structure those opportunities to something that would be investable by the likes of ADM or others?

Richard Burrett: I think the supply chain is a very viable area to look at. As an example, if you are looking at larger companies that are effectively aggregating smallholders, that is a positive. If you can help finance that, you can actually improve standards down that supply chain.

Paul Herbertson:

The other thing that we are grappling with internally is what is the metric for change on the ground? If it is policies within a large agri-business, is that actually driving performance? You have the compliance issues that are not often tracked in sustainability reporting. How do you measure all of those? How do you try and capture it?

And that comes back to some of the challenges we have seen with REDD+ where measurement has been an obstacle. It has been a challenge to people coming into the market. Whereas on the green bond side, there has been a bit less scrutiny perhaps around how the finance is used.

Paul Herbertson, Director, Fauna & Flora InternationalPaul Herbertson, Director, Fauna & Flora International

Agustin Silvani: We see a lot of conservation projects, be they on supply chains or traditional wildlife protection projects, that could be bankable, but require some help. On the other side, we see some funds that are sitting there looking for projects. So, we plan to launch a fund later this year to try to bridge that gap.

We are targeting $25 million to start and are calling it a pre-investment facility – a revolving facility where people can come to get either the technical support or the financial support needed to make them bankable and link them up to private funds.

Obviously, this is just a drop in the bucket, in terms of what is needed. But I think we could do around 100 projects or so, in three or four years. We are looking initially at the low-hanging fruit. There are some fisheries investments that require support and supply chain projects in coffee, palm oil, or cocoa – that sort of thing. Also ecotourism, which is 'nichey', but still a multibillion-dollar market with lots of potential.