

Engaging with the Forest Carbon Partnership Facility: Climate Finance and Banking Sector

The World Bank's Forest Carbon Partnership Facility (FCPF) is a global partnership of governments, businesses, civil society, and Indigenous Peoples focused on reducing emissions from deforestation and forest degradation in developing countries, through the sustainable management of forests and conserving and enhancing forest carbon stocks—activities commonly referred to as REDD+.

The FCPF works with 47 developing countries across Africa, Asia, and Latin America and the Caribbean, along with 17 donors who have made contributions and commitments totaling US\$1.3 billion. Part of the FCPF's support to countries includes strategic engagements with the private sector to crowd in investments, products, and services that benefit the climate, biodiversity, and communities. The FCPF helps countries to become familiar with this kind of private sector investment, and to promote it, by removing barriers, increasing liquidity, diminishing risks, and seeking out innovative entry points for companies to help scale up REDD+ activities.

Why climate finance and banks should engage with the FCPF

- o The FCPF can enable financial entities to increase sustainability in investment practices by improving the regulatory environment while demonstrating innovative financial mechanisms to incentivize market entry.
- o The FCPF provides the opportunity to invest in carbon credits, green bonds, and insurance products through its private sector partners, IBRD, IFC, and others.

How climate finance and banks can engage with the FCPF



Results-based payments: Risk-taking financial investors and companies that implement emission reductions activities can receive monetary and nonmonetary benefits on the basis of verified emission reductions. As risk-adjusted return is a key



consideration, the FCPF will put in place risk-mitigating measures, such as multiyear contracts that recognize the need to share risks, discounting the current market price of carbon such that the investor and the local community or company delivering the results share in the risk (and the rewards) over time.

Loans and loan guarantees: Farmers and smaller enterprises in low-income countries often have difficulty borrowing from formal financial institutions that loan money against payments tied to future production. Loan guarantees are an effective risk-mitigating instrument that can enhance the creditworthiness of farmers and smaller enterprises by providing a part of the collateral. If the borrower fails to repay their loan, the lender can resort to partial repayment from the guarantor under a loan facility set up by the FCPF. In addition, this loan facility could leverage access to credit guarantees and other blended capital to help spread risk.



Green bonds and REDD+ bonds: Private investors can purchase green bonds to provide immediate capital for FCPF emission reductions programs. In return, they will receive the principal and periodic interest by a certain date. As a pioneer in green bonds, and a recognized bond issuer with over \$8.5 billion issued since 2008, the World Bank (IBRD) issues bonds on behalf of the FCPF. The World Bank does this by transferring a portion of bond proceeds to emission

reductions programs to meet financing needs while keeping the remainder as a reserve to meet final redemption obligations. REDD+ enhanced bonds are modified green bonds that aim to integrate up-front donor grants and donor-funded results-based payments into green bond structures to enable larger-scale financing from capital markets.



Blended finance: For private sector investors, blended finance is an attractive option, as the public or philanthropic parties play a big role in improving the risk/return profile so that it can generate a positive financial return while helping to contribute toward sustainable development goals.



Impact investment funds: The private sector can play a role in complementing public and philanthropic resources in addressing sustainable land use development, by using different investment methods including loans, grants, equity investments, and bonds. At present, some of the most significant land use impact investment funds are run by Mirova and Althelia. In this context, one of various strategies available to the FCPF is collaboration with an existing fund (built around emission reductions) to set up a first loss guarantee. This type of guarantee would reassure prospective private sector investors that their investment in emission reduction projects would be secure up to a certain percentage or dollar amount.

CASE STUDY: Green bonds from the International Finance Corporation (IFC)



In October 2016, the World Bank's IFC partnered with the global resource company BHP Billiton to issue an innovative forest bond designed to reduce deforestation and attract private sector investment in low-carbon development. This five-year forest bond valued at \$152 million allows investors to receive coupons in the form of carbon credits generated from deforestation avoided, or cash coupons (or a combination of both). In order to reduce project risks

for investors, this principal-protected fixed income instrument was issued under the IFC AAA-rated program.

BHP Billiton is also providing a price support mechanism that ensures the project can sell a predefined minimum quantity of carbon credits every year until the forest bond matures, whether or not investors choose to receive carbon credit coupons. This IFC forest bond is the first to harness this kind of mechanism to channel private sector investment toward forest protection, climate change mitigation, and low-carbon development.



For additional information: Please visit forestcarbonpartnership.org or email us at fcpfsecretariat@worldbank.org