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Rio +20: Forest Bonds

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Summary

- Forest bonds could play a critical role in filling the need for a long term financing mechanism for sustainable forests.
- Government support and public finance will be needed to catalyse the long term investment of private capital for sustainable ecosystem management.
- Public finance alone cannot provide the levels of funding needed; just a small move from private and institutional investors into forest bonds would make available very significant levels of finance.
- Forest Bonds would be an incentive to long term land use policies which protect and manage forests sustainably as there would be a secure return.
- Demonstration projects should be supported and models of best practice applied to other critical tropical forest areas.

Context

Tropical forests play a critical role in providing ecosystem goods and services, including biodiversity, water, and food, as well as vital global carbon stores. Current rates of deforestation will lead to runaway climate change since forest loss accounts for up to 20% of global anthropogenic carbon emissions¹. Just a 50% reduction in deforestation by 2030 is estimated to require around \$25 billion of investment per year, so it is essential to mobilise private investment. Global bond markets are a potential source for that scale of funding. There is about \$90 trillion of outstanding issuance in global fixed income, which could play a key role in forest finance. Public funding can help catalyse the private market, either through grants or by de-risking bonds for investment by the private sector.

Finance for REDD+ has been focussed around REDD readiness activities, with typically short time frames. At present there are no reliable long or even medium term financing mechanisms to stimulate investment in sustainable forest management. However, long term finance could well provide a greater incentive for a recipient country to put in place strong landuse policies.

¹ UN-DESA Policy brief 16 April 2009

So, once successful pilots are developed and promoted by governments, they can be scaled up to attract private investment to fill this financing void.

Pilot Project: WWF and Global Canopy Programme are piloting a multi-revenue forest finance mechanism in Acre, Brazil. This involves structuring a forest backed security, likely a bond, to raise upfront capital for sustainable forest management that would either be asset backed or asset linked. Interest (and final principal) can be partly repaid to the holders of securities from revenue generated from standing forests and forest commodities. These may include, but are not limited to, environmental, agricultural and timber commodities, such as REDD carbon, brazil nuts, sustainable timber, rubber, etc. Some of the upfront capital will be invested in the local community for sustainable livelihood programmes, and in monitoring and enforcement for conservation. A separate grant-based long term finance mechanism can also be structured, which could be used to earmark funds for sustainable livelihoods and conservation. Another role for governments would be to help de-risk this type of offering for large scale private investors.

Investor Alignment

There has been increasing investor interest in this space. For instance, the rise of green bonds has been steady now with around \$12 billion issued to date. Impact investing has also seen a commensurate rise. With many sovereign countries experiencing financial difficulty and with low yields on US government bonds, interest in other asset classes will only continue to grow. This type of long term financial instrument could be interesting for pension funds, as well as those looking for portfolio diversification. Importantly, correlation amongst traditional investments has increased recently thereby adding to investor risk. Forest bonds may be a way to bring an uncorrelated investment into long term investor portfolios, while also helping to build sustainable environments and ecosystems.

Challenges

There are, of course, challenges with any nascent idea. For forest bonds, these include accounting for political risk, securing multiple revenues, lack of a price signal for carbon, reliable and sufficient demand to make a difference, and verification. We will look at these in detail in our pilot.

Added Potential Benefits

One of the main issues with finance recently has been its decoupling from the real economy. Instead of serving the natural world and the productive economy, finance has been serving itself and chasing short term returns. Extraction of rents from the market for personal gain has gone unchecked. This behaviour has increased systemic risk in the financial system as well as exacerbated market swings and the boom-bust cycle. Forest bonds may be a mechanism that helps realign the financial sector with the real economy and the natural resources that underpins markets. This is an important narrative for the forthcoming Rio Conference and can feed into supporting sustainable jobs and livelihoods. Forest bonds can be a useful tool to help reshape the financial system and lead us closer to a green economy. The concept will need political support to overcome difficulties and solve some of the associated challenges. The potential, though, is exciting and the need is urgent.

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