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Understanding the Demand for REDD+ Credits

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1 Summary

2 Reducing emissions from deforestation and forest degradation (REDD+) has emerged as a potentially
3 important component of the global policy-mix to mitigate climate change. Against a background of
4 increasing engagement between private-sector entities and conservation organisations, private
5 sector investment has emerged in REDD+. Despite slow developments at the international scale,
6 there continues to be private sector interest in REDD+, and continued voluntary investments in
7 REDD+ projects and initiatives.

8 In order to better understand possible models for private sector engagement in REDD+, this paper
9 analyses the motivation of private sector stakeholders to engage in REDD+, the perception of the
10 potential of REDD+, the critical obstacles to making REDD+ functional and how actors perceive
11 themselves as part of future REDD+ scenarios.

12 Based on interviews and a workshop with private sector actors, this paper finds that few expect a
13 regulatory market for REDD+ to emerge and that credits from the voluntary market have to be
14 tailored to specific needs. As a carbon offset, REDD+ provides insufficient motivation for investment,
15 particularly if cheaper alternatives exist. Co-benefits such as biodiversity conservation and
16 community development are more important when traditional corporate social responsibility (CSR)
17 motivations play a role.

18 Project scale remains important not only for the fact that smaller projects are viewed as offering
19 more visible benefits to stakeholders but also as a means of having more control over risks on the
20 ground, posing a challenge for the design of jurisdictional REDD+. Moving towards supply chains that
21 are free from deforestation offers an opportunity to tackle commodity-driven deforestation. While
22 questions remain about how such an approach might be integrated into REDD+, it could help
23 address a perceived gap between private sector understanding of the values of REDD+ and the risks
24 associated with these values not arising - termed here as a 'missing middle'.

25 Introduction

26 The private sector has been traditionally viewed as being in conflict with organisations aiming to
27 conserve the environment (Ehrenfeld 2003), but this has shifted with increasing engagement
28 between private sector entities and conservation organisations (Rose & Colchester 2004;
29 Brockington & Duffy 2011). The idea that firms can benefit society and the environment while
30 making profits, has taken root; firms across the economy are being held accountable to this by
31 conservation organisations and consumers (TEEB 2010; Robinson 2012).

32 Such corporate greening (the discovery by business of the cost, innovation and marketing
33 advantages of improving environmental performance, Guziana 2013) has grown hand-in-hand with
34 the development of CSR programmes (Robinson 2012) that emerged as part of the corporate
35 response to the challenges of environmental damage and climate change (Kolk & Pinkse 2004) but
36 are also often viewed as important marketing strategies (McWilliams & Siegel 2001; Kitzmuller *et al.*
37 2012). Multi-national companies in particular have high incentives to engage in CSR as a way to
38 reduce reputational risks (Ruggie 2008), with many seeing CSR programmes as effectively a licence
39 to operate (Earthwatch *et al.* 2002).

40 Beyond CSR, opportunities have been identified for businesses to profit directly from engagement
41 with conservation including the development of new markets for ecosystem services (TEEB 2010).

42 Climate change policy, in particular, has witnessed great change in the 2000s, both with respect to
43 regulations and markets established by governments, as well as voluntary initiatives and largely
44 unregulated carbon offset markets. With tropical deforestation and forest degradation estimated to
45 account for approximately 15% of global anthropogenic greenhouse gas emissions (van der Werf *et*
46 *al.* 2009), stakeholders, ranging from international organisations and national governments to
47 conservation organisations and the private sector, have sought to design strategies and policies for
48 Reducing Emissions from Deforestation and forest Degradation (REDD+).

49 REDD+ was first termed by the United Nations Framework on Climate Change (UNFCCC), with
50 member countries initially focusing on it as an essential and time-limited contribution to mitigate
51 the impacts of climate change. In its simplest form, governments and firms would reward tropical
52 countries for reducing deforestation rates, receiving carbon credits in return. Cap-and-trade
53 schemes like the European Union's Emissions Trading System (EU ETS) were touted as a way of
54 establishing a price for forest carbon stocks. Since 2005, and in spite of initial high motivation and
55 commitment from many stakeholders, including national governments, local communities,
56 conservationist NGOs and the private sector (Palmer & Engel 2009; Nhantumbo 2011), progress in
57 REDD+ has been slow.

58 In mid-2015, the final framework for REDD+ suggested broad agreement in its overall scope,
59 objectives and monitoring, reporting and verification (MRV) (Meyer 2015). The scope of REDD+ has,
60 however, increased dramatically from early proposals for a tool targeting reduced deforestation at
61 project scale, funded by firms purchasing carbon credits, to potentially nation-wide programmes
62 targeting deforestation, degradation and re-forestation, known as 'Jurisdictional and Nested REDD+'
63 (JNR). Between 2005 and 2015, many policy initiatives and experiments have claimed the mantle of
64 REDD+, at all scales, involving a range of stakeholders, from Norway's investments in national
65 programmes in Indonesia (Lee & Pistorius 2015), to Bosques Amazonicos (a Peruvian company)
66 supporting organic certification of Brazil nuts in Madre de Dios (Peru) to encourage illegal gold

67 miners to switch activities (IGES 2013). The critical need to stem tropical deforestation, whether for
68 climate reasons or otherwise, is generally agreed upon, but concerns have been raised regarding the
69 potential efficacy of REDD+ to reduce deforestation, including doubts over cost (Gregersen *et al.*
70 2010), infringements on local community rights (Larson 2011), and debates about how permanent
71 reductions in deforestation might be achieved (Palmer 2011). This last issue is partially related to
72 how REDD+ might be implemented on the ground, in terms of the policies, and extent to which
73 these address underlying drivers of deforestation (see Angelsen 2010).

74 Many scholars and practitioners nevertheless agree that to work in practice, REDD+ needs to be
75 implemented at a scale that includes as much of the world's tropical forest as possible in order to
76 prevent 'leakage', defined as reductions of carbon emissions in one place causing emissions in
77 another (Atmadja & Verchot 2011). Such scale would require a huge level of financing yet UNFCCC
78 negotiations have failed to resolve the financing issue due to continuing disagreements among
79 countries about who should pay and how (Leonard 2015). To date, finance flowing into REDD+ has
80 been dominated by public funding from richer countries, significantly through Norway's agreements
81 with Brazil, Indonesia and Guyana. The private sector has engaged with REDD+ for a wide range of
82 voluntary reasons including offsetting of emissions, greening of supply-chains and counterbalancing
83 potential future risk (Corbera & Schroeder 2011). Opportunities to profit have also arisen, for
84 example from trading in REDD+ credits.

85 Private sector commitment to REDD+ has been strengthened through the New York Declaration on
86 Forests, signed by 53 multinational companies and 37 governments, that pledges to halve
87 deforestation by 2020 and end it by 2030 (UN 2014). A number of multi-nationals have recently
88 committed to the goal of zero net deforestation, for example, Procter and Gamble have committed
89 to eliminating deforestation across its palm oil supply chain by 2020 (Shankleman 2014).

90 Existing literature on private sector involvement in REDD+ frames the issue as a mismatch between
91 supply and demand. Conservation International (2013) (CI) estimated that REDD+ projects in
92 existence represent more than three times current voluntary market demand, while the Global
93 Canopy Programme (GCP) *et al.* (2014) estimate demand for REDD+ could be as little as 3% of supply
94 between 2015 and 2020. Despite the continued absence of REDD+ from existing regulatory schemes
95 such as the EU ETS, the fact that the private sector continues to invest in REDD+ raises the question
96 of what motivates them to do so.

97 The term 'REDD+' is nebulous and has been used to cover a range of activities concerning forests. Its
98 scope has grown in the official UNFCCC proceedings from Reducing Emissions from Deforestation
99 (RED) to include degradation (REDD) and then conservation of standing forests and reforestation
100 (REDD+). REDD+ is, however, generally used as a catch-all term for projects and policies that are
101 intended to avoid and reduce deforestation and forest degradation and contribute to regrowth of
102 new forests. Since it has also grown in scale, initially focusing on project-based approaches before
103 encompassing jurisdictional approaches at a regional or national scale, this paper adopts a broad
104 definition, i.e., including projects and policies that fall both inside and outside the official UNFCCC
105 process, and activities implemented at project and jurisdictional scales, funded both under
106 regulatory schemes and through voluntary markets (Supplementary Material S1).

107 Drawing on data from interviews and a workshop with private sector actors, this paper has a number
108 of key objectives: it examines motivations of firms engaging in REDD+ for their investments and
109 purchases of credits; decision-making procedures of those currently engaging in REDD+; barriers and
110 risks that have prevented additional investors from engaging with REDD+; and, how private-sector
111 stakeholders perceive REDD+ in the future.

112 Methodology

113 Views of private sector stakeholders participating in REDD+ were evaluated in a two-step process. In
114 the first, semi-structured one-to-one interviews, following interview guides (Supplementary Material
115 S2), were conducted with fourteen individuals. An initial mapping exercise was undertaken of key
116 organisations involved in REDD+ located in Europe. The exercise focused on firms currently investing
117 in REDD+, those investing in other types of carbon offsets, associations representing emitting
118 industries and REDD+ investors, commodity purchasers and carbon-market traders. Contact was
119 made with firms, organisations and individuals and interviews were scheduled. Further contacts
120 were made and interviewed via snowball sampling.

121 Interviews were conducted between December 2013 and June 2014 at the London School of
122 Economics (LSE) and across London. Four participants were not available to meet in person so phone
123 and Skype interviews were conducted.

124 The focus was on firms that had either provided investment into REDD+ projects or purchased
125 REDD+ credits, rather than project developers. Motivations and risks associated with developers are
126 different from those of middle-men looking to purchase credits and sell them on, and different again
127 from those looking to directly invest in REDD+ projects or purchase credits emanating from such
128 projects. Therefore, unless explicitly stated the firms, or entities, referred to here are those investing
129 in REDD+ or purchasing credits.

130 Questions focused on the potential interest of purchasers in REDD+, motivations of existing REDD+
131 purchasers, key decision-makers regarding offsetting in firms, time horizons of firms engaging (or
132 not) in REDD+ and main barriers for engaging private sector finance in REDD+ (Supplementary
133 material S2).

134 In a second step a workshop was held under Chatham House rules at LSE in April 2014. Nineteen
135 participants were involved, drawn from the REDD+ working groups of the Carbon Market Investors

136 Association (CMIA) and the International Emissions Trading Association (IETA). They included
137 representatives of project developers, investors, international donors and a range of companies who
138 provided legal and institutional support to REDD+ projects. While they shared a background similar
139 to those selected for interview, they were mutually exclusive, in order to allow us to check the
140 validity of hypotheses developed on the basis of interviews.

141 The workshop was structured around three main sessions focusing on: where does REDD+ stand
142 today; barriers and risks for REDD+; and the future for REDD+ (Supplementary Material S3). Each
143 session started with a brief presentation that raised findings from interviews, followed by open
144 discussion to validate findings and raise fresh perspectives.

145 Results

146 *Motivations of private sector stakeholders*

147 *Preparatory and pre-regulatory demand*

148 A key question asked of interviewees was their perception of motivations of existing REDD+
149 purchasers. Responses varied, but a conclusion from all interviewees was a dichotomy between
150 those investing for purely voluntary reasons, and those anticipating REDD+ being used in regulatory
151 markets. Interviews with two REDD+ market experts (and validated at the workshop) led to the
152 determination of two different categories of investors in the latter area. The first were those who
153 faced potential future regulatory obligations and were looking to engage with REDD+ in order to gain
154 experience. It was the consensus of participants to the workshop that this type of demand had
155 declined recently due to declining prospects for REDD+ in regulatory markets. It was raised, both in
156 interviews with emitting industry associations and at the workshop, that for entities looking to meet
157 regulatory targets, the main factor determining whether they should engage in offsetting or not was
158 minimising costs.

159 The second category of investors identified were those companies motivated by resale opportunities
160 that investing in REDD+ might bring. A workshop participant suggested that this type of investor had
161 also declined, not only due to the reduced short-term prospects for REDD+ in regulatory markets,
162 but also due to the experiences of early investors in projects that were perceived to have failed.

163 *Corporate social responsibility and offsetting*

164 For those companies looking to engage in REDD+ for voluntary reasons the motivations discussed by
165 REDD+ purchasing interviewees and at the workshop were markedly different from those of pre-
166 regulatory entities. Discussions at the workshop can be succinctly summed up by the phrase used by
167 a workshop participant when discussing the motivations for financing REDD+: 'it's all about the
168 story', suggesting that what was crucial was the message that could be communicated to
169 stakeholders. A workshop attendee with experience in marketing REDD+ credits however, raised the
170 cogent point that to a number of companies the story of REDD+ was currently unattractive. REDD+
171 was predominantly viewed as actors being paid to stop cutting down the rainforest. In the
172 workshop, this prompted the question raised by one participant of 'why should I pay someone to
173 stop doing something?' In the discussions that followed participants reached the consensus that the
174 idea of paying for something tangible, like building an eco-lodge, was more attractive. This moves
175 away from the idea of REDD+ as an 'emission reduction story' - the traditional view as observed by a
176 workshop participant, where REDD+ is perceived merely as a tool to offset emissions - towards the
177 role of co-benefits, for example, biodiversity protection. While such co-benefits were initially viewed
178 as 'the cherry on the top for REDD+' by workshop participants, i.e. as an additional benefit above
179 and beyond the planned objective, the discussion concluded that they should now be seen as
180 playing a central role in investment decisions.

181 An existing REDD+ purchaser interviewee highlighted that for firms looking to engage as part of their
182 CSR programmes, the relevance of projects to their overall strategic direction was also important,
183 and it was this relevance that had helped determine the decision to invest in REDD+ in their

184 organisation. Such firms looked to projects that offered wide benefits, and fitted within their
185 corporate strategies, including a consideration of their customers. For example, a key business
186 sustainability leader interviewee revealed that REDD+ was of particular relevance to firms with
187 supply chains extending into forest landscapes.

188 A more hands-on approach to REDD+, where investors engage directly with the project on the
189 ground, was reported by two interviewees to have not only helped make REDD+ attractive but also
190 enabled greater control over risk. For one interviewee, such an approach was motivating firms to
191 make direct investments in organisations that developed REDD+ initiatives and projects. An example
192 of this approach is Kering, a luxury goods company, investing into Wildlife Works, a REDD+ project
193 developer, (Supplementary Material S4).

194 With regard to the price sensitivity of CSR investors, in analysing interviews and results of the
195 workshop, it became useful to differentiate between those seeking to use REDD+ credits for CSR
196 only and those seeking to use it for carbon-neutral CSR (i.e. voluntarily offsetting a company's
197 emissions). When the question regarding price sensitivity was raised at the workshop it was the
198 consensus that prices did not seem to be important for the former, who were reported to often view
199 the purchase of REDD+ credits, as described by one participant, as a 'charitable donation'. The latter
200 group, however, tended to care more about prices; with the overall aim of offsetting their emissions
201 as cheap as possible. They were only willing to pay higher prices if projects were charismatic and
202 generated wider public relations (PR) benefits. Such firms, one interviewee ventured, often
203 purchased large volumes of cheap offsets in order to cover the majority of emissions (e.g. renewable
204 energy or industrial gas destruction), and a small volume of relatively more expensive REDD+ offsets
205 with co-benefits.

206 *Other potential sources of demand*

207 New pockets of demand have begun to emerge with little or no regulation from government.
208 Instead, they have developed as a result of direct or indirect action in the private sector, responding
209 either to internal drivers, such as the desire to move towards green supply chains, or external
210 private sector-led drivers, such as through sustainability indices.

211 Charitable donations were identified at the workshop as being targeted by REDD+ project
212 developers. A number of large philanthropic foundations have already been active including the
213 MacArthur Foundation and the Clinton Foundation (PwC *et al.* 2011). For example, the latter has
214 supported carbon monitoring in countries such as Guyana, while the MacArthur Foundation has a
215 dedicated programme aiming to minimise deforestation in countries like the Democratic Republic of
216 Congo.

217 Other sources of demand for REDD+ identified by participants included incentives provided by
218 sustainability targets, such as the Dow Jones Sustainability Index (DJSI), that evaluates the
219 sustainability performance of the largest 2,500 companies listed on the Dow Jones Global Total
220 Stock Market Index.

221 In a discussion at the workshop a participant with experience in seeking new markets for REDD+
222 reported that they were investigating demand from companies potentially exposed to significant risk
223 from their investments in carbon-intensive assets that could become stranded if climate or energy
224 regulation is tightened ('stranded assets'). The Generation Foundation (2013) identified market
225 forces and socio-political pressure, along with regulation, as risks that could lead to significant
226 stranding of fossil-fuel intensive assets. Thus, large institutional investors, such as pension funds,
227 could potentially diversify their portfolio away from companies holding potentially stranded assets,
228 towards less-risky opportunities that might thrive in a low-carbon future. The extent to which such
229 opportunities might include REDD+ would depend on the barriers and risks encountered.

230 ***Decision procedures, barriers and risks***

231 *Different decision-making procedures and time horizons*

232 Participants were asked who the key REDD+ decision-makers were in their respective firms. For
233 those engaged in purchasing for CSR, decision-making generally lay with the CSR department,
234 although in some instances decision-making went all the way to the CEO. Decision-making within
235 CSR departments implies that finance for REDD+ comes out of general CSR budgets, and workshop
236 participants highlighted the implications for the time horizon of those investments. With CSR
237 budgets generally decided annually, investments often fluctuate from year-to-year. One participant
238 responded (and there was general agreement subsequently) that, for voluntary purchases for CSR,
239 horizons were not more than five years and often much shorter, suggesting a severe disconnect
240 between financing for REDD+ and the typically longer timeframe of many REDD+ projects - rates of
241 carbon sequestration determine that newly-planted forests take decades to reach maturity.

242 A new type of REDD+ project from which investors receive not only REDD+ credits but also
243 sustainably-sourced commodities was identified as a key potential future source of demand by a
244 participant involved in developing projects, with longer time horizons than for CSR projects.

245 *Barriers, obstacles and risks*

246 ***Preparatory and pre-compliance market demand***

247 Initially raised by an emitting industry association interviewee, and validated at the workshop, was
248 the perception that many stakeholders, especially those anticipating regulatory markets, view a lack
249 of regulatory frameworks and a lack of clarity regarding future regulations as a major barrier to
250 investing in REDD+. Concerns were also raised by both potential purchasers (through emitting
251 industry associations) and suppliers (through project developers at the workshop) over actual
252 emergence of regulatory markets and REDD+'s eligibility into such markets. Emerging pilot
253 institutions and procedures to register projects were perceived by project developers as being too

254 bureaucratic, with a lack of clarity regarding the types of projects that would be allowed to generate
255 credits and conditions under which they might be created.

256 In addition, these investors were deemed by a project developer to be the most price-sensitive and
257 were also concerned with technical risks relating to REDD+ such as additionality, leakage and
258 permanence (see Palmer & Engel 2009; Palmer 2011). It was the view of the same project developer
259 that these risks were likely to be incorporated into criteria that would allow entry of REDD+ into
260 regulatory markets and thus are likely to form part of the risk-assessment of any regulatory
261 purchasers.

262 ***Voluntary demand***

263 Risks related to investments in the voluntary market were perceived, by both interviewees and at
264 the workshop, to be different from regulatory investments. A major barrier, identified by a
265 participant marketing REDD+ projects, was the current low profitability and expectations of future
266 low profitability of REDD+ projects that generate revenues from the sale of credits. Price was
267 deemed, in interviews with market experts, to be less important to investors with more general CSR
268 motivations.

269 Project failure has great potential to damage the reputations of stakeholders involved, and has been
270 a common theme of many REDD+ projects to date, for example the Ulu Masen REDD+
271 demonstration project in Aceh (Indonesia) (Supplementary Material S5). However, the private sector
272 faces a challenge in measuring, quantifying and understanding reputational risks associated with
273 REDD+, particularly given the range of activities, initiatives, countries and contexts. Reducing
274 reputational risk, or at least helping companies understand and quantify the risk could, in the view
275 of participants, provide further impetus for companies to scale-up investment in REDD+. There are
276 private sector institutions that already perform this role to some extent in the form of standards (for
277 example The Verified Carbon Standard). However, at present these standards are extremely

278 stringent, require huge effort and finance, and were highlighted by project developers, as a major
279 barrier of entry to the market.

280 ***Supply chain greening risks***

281 The potential for REDD+ to find investment from companies looking to improve environmental
282 performance in supply chains, and promote sustainable agricultural activities, was raised by a
283 commodity trader interviewee and repeated by others including existing REDD+ purchasers. A
284 commodity market expert interviewee proposed a mechanism for firms to certify commodities as
285 being 'deforestation-free' via a trading mechanism with other firms, when zero deforestation
286 sourcing is not possible within their own supply-chains. At the workshop a REDD+ market expert
287 participant reported that there have been some moves toward such tools through initiatives such as
288 the Round Table on Sustainable Palm Oil. These, however, have encountered heavy criticism with
289 accusations of weak standards and continued deforestation in members' concessions (Greenpeace
290 2013). The same market expert commented that more research was required to exploit the
291 potentially large synergy between REDD+ and the move toward sustainable supply chains.

292 REDD+'s missing middle: The difficulty for private sector stakeholders to
293 understand the complexity of REDD+

294 The workshop set out to understand two key aspects of the current market: the value or services
295 that private sector actors obtain from REDD+, and, the risks that these values or services may fail to
296 emerge. Although participants recognised the importance of both, discussions also raised a further
297 dimension: a broad lack of understanding of REDD+ in the private sector inclusive of its values and
298 risks, characterised here as REDD+'s 'missing middle'.

299 Informed by discussions at the workshop this missing middle is conceptualised as consisting of three
300 elements: a lack of understanding of the values that REDD+ can bring to the private sector
301 (highlighted above with regard to the lack of an attractive story for REDD+); a lack of understanding

302 of the risks associated with REDD+ (demonstrated above in the discussion regarding difficulties in
303 understanding and valuing reputational risks); and, a lack of understanding regarding the mapping of
304 risks on to values.

305 Future scenarios for private sector involvement into REDD+

306 In a discussion on the relative attractiveness of different scales of REDD+ projects a participant with
307 experience of marketing REDD+ commented that CSR purchasers preferred ‘small, nice, cuddly’
308 projects, and the ownership, control and PR benefits these can offer in contrast to JNR. In the
309 discussion that followed a market expert raised the perception that there were fears from some
310 buyers of working too closely with national or regional governments due to issues of corruption,
311 further reducing the attractiveness of JNR vis-à-vis project-scale. Countering this, however, was the
312 opinion raised by a project developer that firms wanted projects to be embedded in overall JNR
313 frameworks, as these were more likely to reduce technical issues such as leakage.

314 Participants of the workshop were almost equally split over the future of REDD+. The first camp held
315 that under clarified institutional settings and rules, REDD+ could eventually re-gain momentum,
316 while the second expressed high uncertainty in this regard. Unless a robust framework for regulatory
317 markets emerges, for instance through JNR, it was the perception of a market expert that private
318 sector stakeholders preferred to participate in efforts to reduce emissions from deforestation and
319 forest degradation in a narrower context. A point of consensus across the workshop, and also seen
320 in interviews with market experts, is the likely move away from REDD+ being the focal point of
321 projects and activities, in the sense that the main motivation of firms investing was carbon credits.
322 Instead, firms are looking for wider benefits from their investment, with multiple sources of income.
323 There is an increasing focus on other benefits that arise from projects that aim to reduce
324 deforestation and generate a return in other ways, such as agro-forestry.

325 **Discussion and Conclusion**

326 REDD+'s brief history has been marked by periods of optimism and pessimism. The current mood in
327 the private sector is generally pessimistic, with doubts over the emergence of regulatory demand
328 and supply of credits outstripping demand, reported both by participants and in the literature (CI
329 2013; GCP *et al.* 2014; Forest Trends 2014). While reportedly in decline, the finding that resale
330 opportunities from investing in REDD+ remain is mirrored by Forest Trends (2012), which found that
331 almost half of buyers of forest carbon credits (including Afforestation and Reforestation credits
332 through the CDM) were motivated by either resale or investment or for regulatory or pre-regulatory
333 reasons. In the voluntary market, recent commitments by companies to reduce deforestation in
334 supply chains (UN 2014) and innovative moves to market REDD+ as a tool to reduce investment-risk
335 offer potential. These voluntary actions raise the interesting proposition that at least some
336 investment can be built on self-reinforcing action from within the private sector, with little or no
337 government involvement.

338 Consistent with Corbera and Schroeder (2011) this paper finds that investors in REDD+ have
339 different motivations, from pre-regulatory purchasers to those looking to voluntarily offset
340 emissions, to those looking to reduce deforestation in supply chains. Firms seeking regulatory credits
341 (or pre-regulatory experience) were more interested in obtaining low-cost options, whilst those
342 purchasing for CSR were more interested in co-benefits (see also Forest Trends 2014), and the
343 associated PR. Differentiated motivations for investing in REDD+ imply policymakers in REDD+
344 jurisdictions and project developers need to offer a range of different products, or at least to better
345 understand the differentiated market.

346 A good understanding of the aims and function of REDD+, along with its values and risks, is lacking
347 among many private sector investors. Both values and risks differ depending on motivations. But
348 even where there is an awareness of risks, the private sector is unable to measure and quantify

349 these. REDD+ lies outside the main activities of most firms, and if they are unable to understand or
350 quantify specific risks of a particular project or initiative, they may be reluctant to invest. Improved
351 understanding of the risks involved in different projects and initiatives might help direct capital to
352 those with a better chance of reaching their aims. This could benefit REDD+ by helping to reduce
353 demand for riskier projects and initiatives.

354 This lack of understanding regarding REDD+ (the 'missing middle') needs to be overcome if markets
355 are to develop further. Helping to bridge this missing middle, aiding the private sector to understand
356 the value that may arise from investing in REDD+ (and the positive impacts that REDD+ may bring to
357 the environment and also to a company's image), and to understand (and quantify) the risks that
358 may be encountered through such investment, could boost private sector investment. Given the
359 multiplicity of REDD+ projects and initiatives, workshop participants unanimously agreed that there
360 needs to be movement towards creating unified packages of information regarding REDD+.

361 In general, one of the greatest obstacles to innovation, especially in finance, is investors' natural
362 resistance to change and new products often fail because investors are reluctant to shift strategy.
363 This challenge has been met by other products in the environmental sphere such as Green Bonds
364 (Climate Bonds Initiative 2015). Aversion to change can be even greater when investors are required
365 to assess new products on the market themselves. Providing suitable, reliable and comparable
366 information might remove at least one obstacle to greater engagement of private sector finance
367 with REDD+.

368 Streamlining standards and the variety of certificates on offer could also reduce complexity for
369 private sector decision-makers and might even help secure senior corporate backing. The recent
370 growth in REDD+ standards and certificates mirrors the growth in certification schemes and eco-
371 labels for timber that occurred in the 1990s. Indeed, some of the arguments for standardising timber
372 eco-labels and certification schemes, for instance, that the diversity of labels can be confusing for

373 consumers (making it difficult to compare products' attributes) and weaken labels' credibility (see
374 Fischer *et al.* 2005), can also be applied to REDD+. Some degree of standardisation, under the
375 auspices of the UNFCCC, might help raise understanding of the potential values and benefits of
376 REDD+ and assist in the understanding, measuring and quantification of the risks involved.

377 Given the scale of tropical deforestation, the current level of public and private investment to
378 reduce it is tiny compared to what is required (CI 2013; GCP *et al* 2014). This is the case irrespective
379 of whether REDD+ is implemented in the form of positive incentives (like payments for
380 environmental services) or reducing deforestation in supply chains so that inputs to production can
381 be certified as being 'deforestation free'. Yet, at the scale of individual projects or jurisdictions such
382 as Acre in Brazil (Climate Focus 2013), the private sector can potentially make a difference (see
383 Edwards *et al.* 2014). Indeed, where the private sector is part of the problem, in the sense of
384 supplying commodities that drive forest conversion, it can be argued that it should, as quoted by a
385 workshop participant, 'pay someone to stop doing something', becoming part of the solution. Supply
386 chains that are free of deforestation would be a step in this direction and efforts should be made to
387 integrate these with JNR.

388 For firms with operations not directly involved in deforestation, the problem with JNR is whether it
389 will be sufficiently attractive and offer enough of a communicable storyline while providing sufficient
390 finance to make it work. An institutional structure could be created that attracts a (capped) number
391 of private sector partners to pool resources, at a size that allows each partner to obtain CSR benefits
392 and retain sufficient ownership and control. Yet, the extent to which the private sector would be
393 willing to get involved with a jurisdiction such as Acre in Brazil, whether individually or as part of a
394 'club', remains to be seen. It may require the incorporation of the benefits of REDD+ that appear to
395 make it attractive to the voluntary market, such as co-benefits and associated PR. But then REDD+
396 policy would need to be designed to tackle multiple objectives - likely to be more challenging than
397 tackling the single objective of reducing emissions from deforestation and forest degradation.

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1 **Supplementary Material**

2 **S1: REDD+ market context**

3 In the 2000s, private sector finance for REDD+ was expected to be predominantly generated from
4 entities regulated under emissions trading schemes, with mandated emissions reductions partially
5 met via the purchase of 'offset' credits from REDD+ projects (Clements 2010; Agrawal et al 2011;
6 Phelps *et al.* 2011). For example, firms facing obligations under the European Union's Emissions
7 Trading Scheme (EU ETS) can use credits from Clean Development Mechanism (CDM) and Joint
8 Implementation (JI) projects. The peak of private sector interest in REDD+ as a potential new
9 investable asset class was just prior to 2009 (Forest Trends 2014), when the demand from regulatory
10 markets was projected to rise in the near future. Investors saw opportunities to profit by selling on
11 REDD+ credits to entities with potential future compliance needs under regulated emissions trading
12 schemes, despite continued uncertainty over the future eligibility of REDD+ in the EU ETS.

13 At present, only credits from the Clean Development Mechanism (CDM) and Joint Implementation
14 (JI) are eligible for use by EU ETS installations and although there has been some discussion
15 regarding the inclusion of REDD+ in the CDM, this is unlikely to occur in the short-term. A general
16 scepticism regarding future REDD+ compliance demand in Europe (communicated to the authors by
17 a carbon market expert), and a move away from offsetting in the EU ETS, has been compounded by a
18 lack of new carbon trading schemes to emerge since the EU ETS. Perhaps most significantly, the
19 Waxman-Markey Bill in the USA proposed a national level cap-and-trade scheme that would have
20 allowed between 500 million to 1 billion tonnes of REDD+ credit purchases by participating firms per
21 year (Open Congress 2009). Credits would have been sourced from eligible projects and countries,
22 with a gradual movement towards a fully national-level approach, with purchases made directly
23 from governments. The failure of the passage of the bill in the US Senate in 2009 reduced short-term
24 expectations of the return from REDD+ investments, and removed the immediate prospects of
25 national-level demand for REDD+ from the US.

26 Further damage to potential compliance demand for REDD+ came with the repeal of the Australian
27 Carbon Pricing Mechanism in 2014. Although the Australian scheme had not yet granted eligibility to
28 REDD+ credits it did represent a potential future source of demand, especially given close relations
29 between Australia and Indonesia on REDD+, through the Indonesia-Australia Forest Carbon
30 partnership that ran between 2009 and 2014.

31 California is the only jurisdiction that has made concrete moves towards the inclusion of REDD+
32 offsets in a jurisdiction-scale climate policy framework. It implemented a state-level cap-and-trade
33 scheme in the absence of US national policy in January 2013, initially only allowing domestic offsets.
34 Each regulated entity can use such offset credits to meet 8% of their annual emissions, with the use
35 of international credits initially capped at 2%, before rising to 4%. Eligible REDD+ credits are likely to
36 come initially from two jurisdictions, also States: Chiapas in Mexico and Acre in Brazil. Given that
37 REDD+ is yet to enter into the Californian scheme, the future potential scale of investment remains
38 speculative. GCP estimate that up to 80 million tonnes of REDD+ credits could be purchased by
39 Californian regulated entities by 2020, about 70% of the proposed emission reductions in Acre,
40 between 2015 and 2020 (GCP *et al.* 2014).

41 Beyond the regulatory market, a market for those looking to voluntarily purchase REDD+ credits has
42 emerged. This market is relatively small, especially in comparison to the potential REDD+ supply
43 pipeline with an estimated 28 million tonnes of REDD+ credits purchased by a variety of different
44 types of companies for voluntary reasons in 2012, for a total value of US\$216 million, slightly less
45 than the previous year (GCP *et al.* 2014). This demand is exceeded by the supply of credits generated
46 by all current projects (GCP *et al.* 2014). In 2012 30 million tonnes of REDD+ credits from existing
47 projects remained unsold, over 50% of the total supply in the pipeline for that year (Forest Trends
48 2012). The implication of this unsold surplus can be seen in the reported prices for REDD+ credits,
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50

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59

60

61 **S2: Interview Guides**

62 ***Questions for entities focused on offsetting for compliance***

- 63 - What are the prospects of REDD+ playing a role in compliance markets?
- 64 ○ Do you think there is potential interest from compliance buyers for REDD+ options?
- 65 ○ On what time horizon do you sense that compliance purchasers are making decision
66 regarding offset purchases?
- 67 ○ What have been the main reasons why compliance entities have made decisions
68 between different offsets?
- 69 ▪ How large a role has price vs other factors played in decision-making?
- 70 ○ Who have been the key people in the organization regarding compliance purchases?

71

72 ***Questions for existing REDD+ purchasers***

73

74 - What have been the motivations of existing REDD+ purchasers?

75 ○ What have been the key lessons from the experience of these existing purchasers?

76 ○ Would jurisdictional REDD+ be as attractive to existing purchasers as project-based
77 credits?

78 ○ How important has price considerations been in non-compliance offset purchasers
79 decision-making?

80 - Who have been the key people in the organization regarding REDD+/offset purchases?

81 - What are the main barriers to engaging private sector finance in REDD+?

82 - What are the prospects for increasing non-compliance REDD+ demand?

83 ○ What tools could be used to boost demand?

84

85 ***Questions for Exchanges involved in carbon trading***

86 - What would be required to catalyse interest in the major exchanges in designing a REDD+ option
87 market?

88 - What would be the steps required to establish a REDD+ options market place? How does this
89 mirror (or differ) the establishment of any other carbon offset market? How would this be
90 different for an options approach?

91

92

93 **S3: Workshop material**

94 ***Developing an Options Market and Complementary Financial Structures to Mobilize Private Capital***
95 ***for REDD+ and Manage Climate Policy Risks (Options Market and Risk-Reduction Tools for REDD+)***

96 ***- LSE – CMIA/IETA workshop – April 3, 2014***

97

98 ***Overall project background***

99 REDD+ is at a crossroads - discussions have advanced in the UNFCCC negotiations and readiness efforts are
100 progressing with public financing but private capital is largely on the sidelines. A lack of demand is coupled
101 with uncertainty and risks that hinder the implementation and development of supply. On the other hand
102 regulated companies potentially face large carbon price uncertainty, generating significant risk. Options on
103 REDD+ could provide a mechanism to mobilize private capital in the near and medium terms while offering
104 business and governments a tangible hedging tool in today's uncertain policy environment. NORAD is funding
105 the Environmental Defense Fund, in collaboration with the LSE, IIASA and the Mercator Research Institute on
106 Global Commons and Climate Change to undertake a project to develop an Options Market and
107 Complementary Financial Structures to Mobilize Private Capital for REDD+ and Manage Climate Policy Risks.

108 ***Project Outcomes***

109 The project aims to produce research papers and modeling tools to support REDD+ options transactions and
110 other risk-management mechanisms, along with communications and policy advocacy documents for non-
111 technical audiences. The ultimate aim of the project is to facilitate at least one pilot transaction that
112 demonstrates the options approach to REDD+ financing between private investors (possibly along with a public
113 institution) and a REDD+ jurisdiction.

114 ***Workshop Objectives***

115 LSE's role in the project is to help to understand the current REDD+ demand context, and the future prospects
116 for any REDD+ market. To facilitate this understanding LSE is engaging with a number of different actors
117 involved in REDD+ and carbon markets. As part of this engagement LSE approached both CMIA and IETA for

118 their assistance. The result has been the proposal for a workshop to be held with members of both CMIA's
119 REDD+ Working Group and IETA's Land/Use Forestry Working Group at LSE on Thursday April 3, from 12:30pm
120 until 3:30pm.

121

122 The workshop has two main objectives: the first is to canvass the expertise and experience of the members of
123 the groups in answering the following questions:

- 124 - What are the prospects of REDD+ playing a role in compliance markets?
- 125 - What are the prospects for increasing non-compliance REDD+ demand?
- 126 - What have been the motivations of existing REDD+ purchasers?
- 127 - What have been the key lessons from the experiences of these existing purchasers?
- 128 - What are the main barriers to engaging private sector finance in REDD+?
- 129 - What are the main buyer, supplier and intermediary risks facing REDD+ today?

130

131 The second objective is to present initial thinking from LSE and the wider project regarding the use of options
132 and other financial tools to reduce risks to both REDD+ sellers and REDD+ buyers and how they may increase
133 demand and/or mitigate risk. It is our hope that the workshop can build relationships that can provide avenues
134 for dissemination of findings from the work of LSE and the wider project.

135 ***Follow-ups and outputs***

136 The aim of the work being undertaken by the LSE is to produce a report outlining the current state of REDD+
137 demand, the perceptions of private sector operators as to the outlook given the current policy conditions and
138 the interest, if any, in risk reduction tools such as options. The report from LSE will be complemented by a
139 similar report from EDF focusing on perceptions in the United States. These reports will be accompanied by a
140 programme of stakeholder engagement focusing on communicating the key messages to policy-makers, and
141 also testing and refining the findings and messages from the study through further engagement with private
142 sector stakeholders.

143

144

Agenda

145 The workshop will be built around three separate sessions. In each an LSE staff member will very
146 briefly outline the topics of interest and our initial findings and thoughts on each topic before
147 starting an open discussion focusing on the key questions within each topic.

148 **12:30pm – 1:00pm** ***Buffet Lunch and Greetings***

149 **1pm – 1:15pm** ***Introduction***

150 **1:15pm – 2:00pm** ***Where does REDD+ stand today?***

151 5 minute presentation followed by open discussion on:

- 152 ○ Prospects for Compliance/Non-compliance
- 153 ○ Motivations for current purchasers
- 154 ○ Lessons from previous experience
- 155 ○ Jurisdictional v Project based approaches

156 **2:00pm – 2:45pm** ***Barriers and Risks to REDD+***

157 5 minute presentation followed by open discussion on:

- 158 ○ Main barriers to engaging private sector
- 159 ○ Main risks facing buyers, suppliers and intermediaries

160 **2:45pm – 3:30pm** ***The Future for REDD+***

161 5 minute presentation followed by open discussion on:

- 162 ○ Options and other tools to reduce risk
- 163 ○ Actions to enable interim financing
- 164 ○ California possibilities
- 165 ○ Post 2020 Prospects

166 Session 1 presentation:

Where does REDD+ stand today?

167



Our thoughts

- There is no current demand for REDD+
- For REDD+ to enter into compliance markets it needs to be demonstrated
- Non-compliance motivations could assist in boosting interim demand
- Jurisdictional REDD+ may be less attractive to voluntary buyers

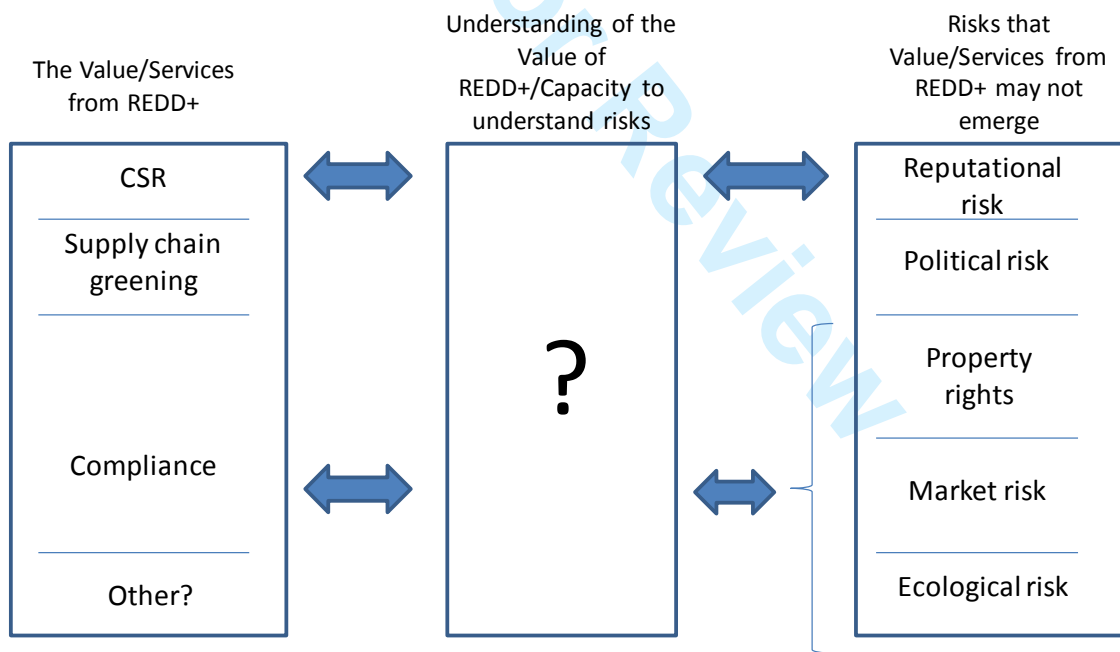
168

What we'd like to know

- What are the prospects of REDD+ playing a role in compliance markets?
- What are the prospects for increasing non-compliance REDD+ demand?
- What have been the motivations of existing REDD+ purchasers?
- What have been the key lessons from the experiences of these existing purchasers?

169

170 Session 2 presentation:



171

172

173

174 **S4: Kering and REDD+**

175 Kering is a French multinational clothing and accessories company controlling global brands such as
176 Puma and Gucci. The firm has a strong commitment to sustainability dating back to an original ethics
177 charter issued in 1996. One of its subsidiaries, Puma, moved to Environmental Profit and Loss
178 Accounting in 2011.

179 As part of its sustainability strategy, Kering has committed to a number of environmental targets
180 with direct or indirect relevance to forests. These include a commitment to offset all its emissions
181 from Scope 1 and 2 activities – using offset programmes that contribute to the welfare of the
182 community and the conservation of biodiversity in its regions of operations.. In order to help achieve
183 this objective in 2012 Kering procured a 5% stake in Wildlife Works, a leading REDD+ project
184 development and management company. This allowed Kering to take a place on the management
185 committee of the company through which it procures the REDD+ credits that it uses to offset all its
186 emissions.

187 Kering's engagement with REDD+, despite its relatively higher price than otherwise offset
188 opportunities, fits within the overall target of its sustainability arm to: 'invest in for-profit businesses
189 that incorporate biodiversity conservation and social concerns into their business model, resulting in
190 net-positive social and environmental impacts.'

191 The multiple benefits that REDD+ offers to Kering may well lie behind the companies large
192 commitment to the asset class. Further REDD+ investments may also prove useful to meet other
193 sustainability targets that Kering has set itself. The company has committed that 100% of the leather
194 used in its products will be from sources that do not result in converting ecosystems into grazing or
195 agricultural lands. REDD+'s potential role in providing green supply chains, along with offsetting
196 carbon emissions may therefore offer strong motivations for companies with multiple sustainability
197 objectives to invest in the asset.

Proof for Review

199 ***S5: Ulu Masen REDD+ demonstration project***

200 The Ulu Masen REDD+ demonstration project, covering around 750,000 hectares in Aceh
201 (Indonesia), was designed by Aceh's Government in combination with the private company 'Carbon
202 Conservation', and with some initial guidance from Flora and Fauna International (Institute for
203 Global Environmental Strategies 2007). Merrill Lynch was reported to have invested US\$9 million
204 into the project in an arrangement that committed the bank to purchase US\$9 million worth of
205 credits with an option to buy further credits (Business Green 2008). The project was validated by the
206 in 2008 but the validation subsequently expired and the project stalled, with no credits issued. Part
207 of the land planned for the project has since been sold to a Canadian mining company (Sydney
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