Environmental Finance AWARDS 2008

CARBON FINANCE TRANSACTION OF THE YEAR

Ulu Masen avoided deforestation carbon financing

Last year's UN climate change meeting in Bali, Indonesia, saw the issue of deforestation rise up the agenda, because while deforestation is responsible for an estimated 25% of global greenhouse gas emissions, the Kyoto Protocol does not allow carbon credits to be earnt through avoided deforestation projects within its Clean Development Mechanism (CDM). Talks at Bali began the formation of a new framework for reducing emissions from deforestation and degradation (REDD), but still left these projects out of the CDM – for now.

Enter the voluntary market. Avoided deforestation (AD) projects have been taken on by the voluntary sector, in the absence of demand from compliance markets. And while the Ulu Masen rainforest preservation project in Indonesia's Aceh province is not the first AD project, it is the first to achieve certification from the Climate, Community and Biodiversity Alliance (CCBA). This certification, awarded for the environmental and social benefits of the project, led to US investment bank Merrill Lynch ploughing $9 million into the 750,000 hectare project – with an option to add millions of dollars more.

The project is an effort between UK-based NGO Flora and Fauna International (FFI), Australia's Carbon Conservation and the governor of Aceh, Irwandi Yusef – a former project manager with FFI. The key to ensuring success of AD projects is to offer the local community an alternative revenue stream, and this is where the carbon finance comes in.

"Avoided deforestation creates a pool of money, which ensures communities develop … they can use it how they want. It's about empowering communities," explains Joe Heffernan, of FFI Australia.

Carbon Conservation teamed up with FFI to get the project certified and then brought Merrill Lynch on board to buy the resultant voluntary emission reduction (VER) credits; the project is expected to yield 100 million tonnes of VERs over its 30-year lifetime.

Abyd Karmali, Merrill Lynch: engaging Wall Street with avoided deforestation

Abyd Karmali, global head of carbon emissions at Merrill Lynch, says the CCBA certification – awarded in February – addressed any lingering concerns the bank had about getting involved. "One of the reasons to get involved is that the statistics are so alarming," Karmali says. "Thirteen million hectares per year [are cut down], which is equivalent to carbon dioxide emissions of 1.5 times the EU utility sector."

The project's first VERs are expected to be available next year – an ambitious schedule, he acknowledges. However, the bank has seen interest in the credits from other investment banks, energy firms that offer 'green' tariffs and its wealth management clients. Karmali adds that recent moves in the US, which suggest AD credits may be valid in a future federal cap-and-trade system, offer "significant upside for all parties".

Karmali adds that leakage – where the deforestation activities move elsewhere – is a more pressing problem than permanence, and says this is why it's so important that a form of REDD is included in a new climate change agreement.

"One of the reasons for getting involved – and potentially putting our neck on the line – is that it's a high-risk, high-return project," he says, adding that it could help shape the nascent REDD mechanism. He notes that a mistake made by financial institutions once the Kyoto Protocol was signed in 1997 was not to get involved in the market until the rules for the CDM and Joint Implementation were in place, meaning that they had no say on the structure of the mechanisms.

"For a Wall Street bank to be out in front on this type of issue is very important," Karmali says. "It's important to have representation from a broad mix of stakeholders." EF