Natural Climate Solutions Alliance

Natural Climate Solutions for the Voluntary Carbon Market: **An Investor Guide for Companies and Financial Institutions**

Executive Summary

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Executive Summary

Nature plays a central role in the fight against climate change, as improved stewardship of nature can reduce greenhouse gas emissions and increase carbon sequestration as well as maintain and build resilience of ecosystem functions. In this context, a healthy and dynamic market for natural climate solutions (NCS), a subset of nature-based solutions (NbS) that improve the management, restoration, and protection of nature to mitigate climate change while also delivering biodiversity and social benefits, is essential.

Despite this critical role, a significant nature financing gap exists, and increasing private investment flows into NCS will be vital to help realize their full potential to address global climate, biodiversity, and land degradation challenges. In turn, high-integrity NCS projects can offer investors the opportunity to earn financial returns derived from the sale of carbon credits, or secure reliable sources of carbon credits for themselves.

NCS projects offer returns based on the carbon credits they generate, and continued demand for these credits is essential for increasing the flow of private investment. A significant source of demand for carbon credits from NCS comes from the voluntary carbon market (VCM), driven by companies seeking the credits as part of their voluntary net zero and other climate commitments. NCS can offer many advantages over other climate mitigation solutions, as they are immediately available, scalable, affordable, and create additional environmental, social, and economic impacts.

While the VCM has grown significantly over the past few years, 2023 represented a market adjustment, as renewed scrutiny highlighted the challenges of carbon accounting and other ways carbon projects may fail to meet standards of high-integrity. Nevertheless, new market infrastructure, technologies, standards, and methodologies designed to enable higher integrity and greater transparency of both claims (from the demand side) and credits (from the supply side) stand to bolster confidence in NCS procurement. Unwavering and continuous focus by VCM players on high-integrity projects will continue to be needed to help reinforce confidence and demand for NCS-generated carbon credits that can in turn maintain and strengthen the business case for investment in NCS.

Investors considering investing in carbon credit-generating NCS projects have an opportunity to accelerate this trend by setting and promoting rigorous guidelines for investment and strictly selecting high-integrity projects. That way, they not only avoid risks but also send market signals that elevate the quality standards and reputation of NCS projects, the credits they generate, and the markets where many of the credits will be traded.

This guide, co-produced by ERM, its Sustainability Institute and WBCSD's Natural Climate Solutions Alliance (NCSA) and Forest Investor Club (FIC), provides insights to investors on how to identify high-integrity NCS projects, understand best practices for due diligence, and design and implement effective investment mechanisms – all with the goal of demystifying and de-risking NCS investments. It includes insights gathered from a working group of NCS investors and other stakeholders, a market participant survey, interviews, and extensive secondary research.

Key Insights from the Report

- **NCS projects can be complex; plan accordingly.** High-integrity NCS projects not only deliver carbon credits but also offer additional ecological and socio-economic benefits. The highest-potential geographies for NCS are often in rural areas of the Global South, where land tenure rights may be ill-defined, and local stakeholders and working environments may be unfamiliar to investors. As a result, every project has a unique mix of stakeholders, ecosystems, local regulations and laws, and financial structures. For carbon credit generation, each will also need its own system of agreements and verification methods. Topic-specific sections of this guide provide recommendations on how to help navigate the complexities of NCS investments.

- **Match your investment plan with your risk profile and preferences.** Investors should start with a robust investment plan aligned with their goals, risk profile, and the nature of their strategy. Much depends on the trade-offs between risk, control, and financial upside investors are comfortable with. For example, getting in at an early project stage may raise potential returns and give investors more control over the financial structure and deliverables, which can be attractive if reputational risk is a primary concern, but would mean investors would take on more project execution and delivery risk.

- **Conduct thorough and context-specific due diligence.** Given each NCS project's unique profile, robust due diligence is a must to not only understand a project's basic financials and capabilities of the team, but also to evaluate positive and negative impacts on climate, nature, and people. Investors need to scrutinize the risks and merits of individual NCS projects along four pillars: commercial, reputational, regulatory, and operational. Doing so not only helps investors anticipate financial risks and maximize returns, but can also boost the integrity of NCS as part of their impact portfolios, and trust in the VCM and NCS as an asset class as a whole.

- **Recognizing and supporting the rights of Indigenous Peoples and local communities (IPs & LCs) is a must.** Many IPs & LCs have historically faced exploitative practices and poorly managed projects. Acknowledging IP & LC rights, both legal and customary, is crucial for breaking the cycle of exploitation. That is why NCS projects must ensure Free, Prior, and Informed Consent (FPIC) of IPs & LCs, institute proper grievance mechanisms, emphasize their right to give or withhold consent at any time, and seek to maintain not just their consent, but their partnership as key project stakeholders over the entirety of the project's duration. Neglecting this can lead to serious reputational risks, poor project performance, or even project failure given the key role that IPs & LCs can play.

- **Sharing revenue with local communities is vital.** Full and effective participation from IPs & LCs is instrumental to the success of NCS projects, from initial implementation through carbon credit generation and ongoing project maintenance. They are key stakeholders in the project and should be compensated accordingly for their contributions to the project and access to statutory and customary rights. Revenue sharing agreements should be designed to compensate IPs & LCs. In addition to recognizing IPs & LCs as core project partners, fair and equitable revenue sharing agreements help align stakeholder incentives while mitigating risks for the project, investors, and IPs & LCs themselves.

- **High-integrity NCS projects require high-quality monitoring.** What sets high-integrity NCS projects apart is that they generate verifiable climate, biodiversity, and social impacts that can last decades. Well-designed systems of measurement, reporting, and verification (MRV) are crucial to deliver on that promise. Buy- and sell-side carbon credit integrity frameworks have robust MRV requirements, meaning certified NCS projects will typically already have defined MRV requirements depending on the methodology they align with. Investors can leverage the data collected through the MRV process to review and benchmark project performance and impact, and address and mitigate inefficiencies or challenges.

The report examines each stage of the investment process in a dedicated chapter that includes the questions that investors should ask, common challenges, and examples of best practices. Below is a brief summary of recommendations for investors that are examined in much great detail in the report.

Build a business case

- Identify a business case that resonates with your organization's portfolio and investment strategy.
- Consider potential financial, carbon, environmental, social, and reputational benefits.
- Integrate investment timeline considerations into your business case.

Identify the investment type, finance structure, and map stakeholders

- Determine the type of NCS investment you are interested in and the right stage of maturity.
- Identify the investment type and finance structure that align best with your objectives, expectations, and the needs of the project.
- Map priority stakeholders and decide if, when, and how you will engage them.

Conduct due diligence

- Complete preliminary desktop screening to determine whether an NCS investment opportunity is strategically aligned with your objectives.
- Conduct deep technical due diligence to assess commercial, reputational, regulatory, and operational risks. Fill data gaps through field visits and stakeholder interviews.
- Conduct a thorough review of environmental and social issues to ensure that IP & LCs are on board, and the investment generates positive impacts beyond carbon.

Determine a fair revenue sharing agreement

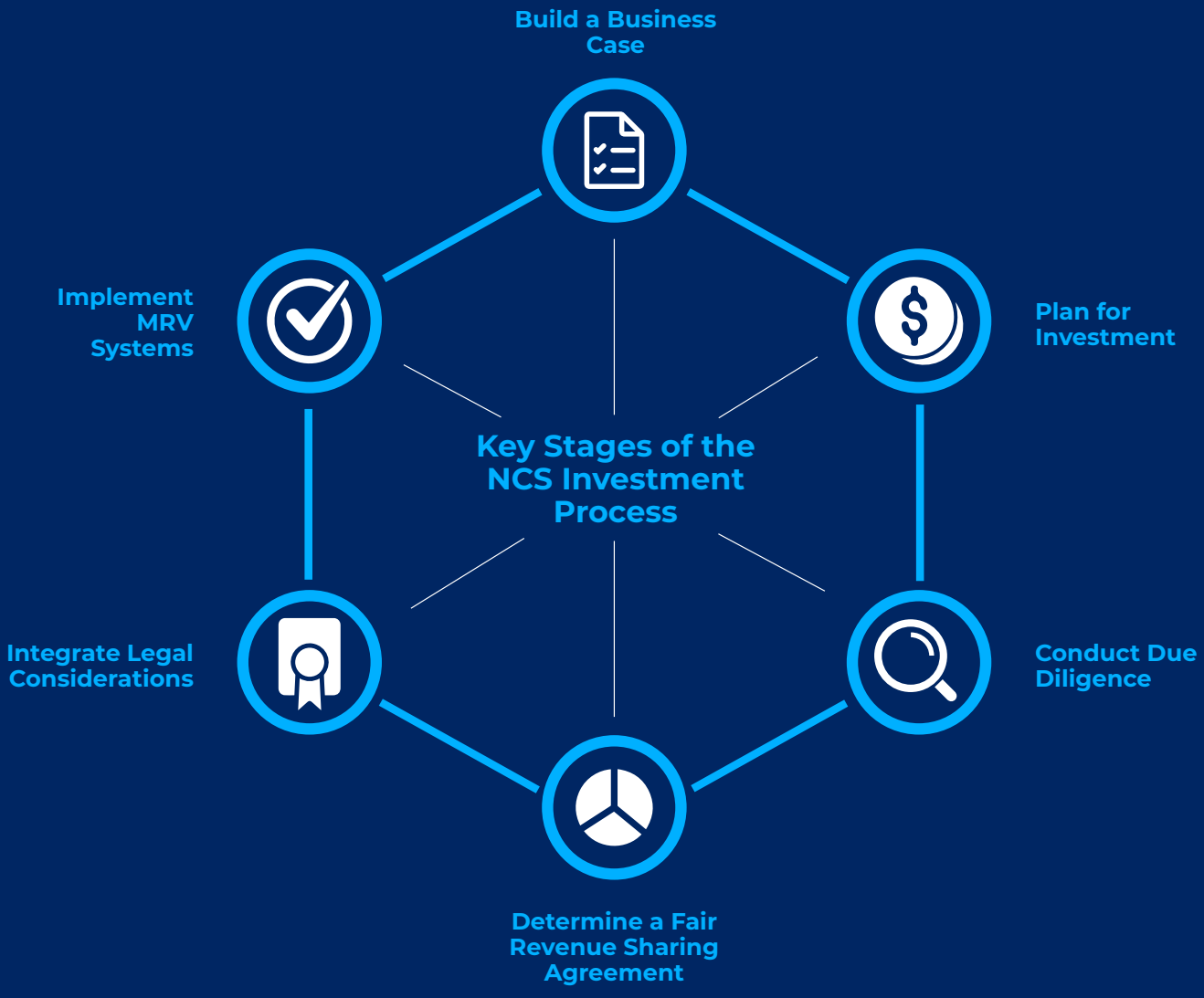
- Determine the status of a potential investment's revenue sharing agreement; if already implemented, determine what parties have been involved in its development.
- Account for all revenue streams generated by the NCS investment and review the agreement for specifications on how the revenue will be distributed.
- Ensure project proponents are regularly engaging with relevant stakeholders and has established independent grievance mechanisms.
- Work with developers and communities to update revenue sharing agreements as needed.

Integrate legal considerations

- Engage international and/or local advisors to ensure that legal and tax due diligence is conducted at an early stage.
- Discuss the risks identified during due diligence with your project counterparties as soon as possible.
- Ensure that risks are allocated appropriately in transaction documentation with the support of international and local advisors.
- Consider the use of additional legal risk management through the deal structure, insurance procurement, additional legal opinions, and so on.

Implement a system for measuring, reporting, and verifying data (MRV)

- Establish internal guidelines and best practices for data collection and reporting; determine if an investment's MRV practices align with internal guidelines.
- Disclose data in line with carbon credit standards and requirements from verification bodies.
- Ensure the collected data and selected metrics directly correlate to claims made on positive climate, biodiversity, and social impacts.
- Leverage data and disclosure findings to review performance and integrate them into project agreements and activities.



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