

CLIMATE INVESTMENT FUNDS

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ENGAGEMENT OF THE PRIVATE SECTOR IN THE FIP

Introduction

1. Participation of the private sector¹ is of vital importance to produce favorable forest and climate change mitigation outcomes at scale. Private investments in forest and natural resource operations as well as in forest-based industries dwarf the combined flows from multilateral development banks, donor agencies, civil society organizations and charities. Small and medium scale businesses form the overwhelming majority of forest-related enterprises in developing countries.

2. There are significant opportunities for the FIP to help leverage environmentally and socially sustainable private sector investment in climate relevant operations, such as afforestation, reforestation, restoration of degraded landscapes and sustainable natural forest management. FIP funding can also be instrumental in supporting sound agro-business and bio-energy investments which are climate friendly and socially acceptable by providing incentives for stabilizing forest margins, supporting best practice examples of sustainable management (inclusive of conservation set-asides, buffer zones and more productive use of already cleared forest adjacent land), through involvement of local populations, and through creating company partnerships with forest smallholders. Well targeted support from the FIP can also help to reduce investment risks and market barriers for responsible private operators in regions or countries where national enforcement capacity is weak by addressing forest governance, transparency, sustainable forest management practices, such as certification, forest and chain-of-custody, land tenure and complex social and environmental challenges which are beyond the capacity or appropriate role of such private operators.

3. *Engaging the Private Sector:* This document describes how the FIP, through the private sector arms of the MDBs, could engage the private sector and implement an effective public/private strategy, recognizing that FIP funding arrangements for engaging the private sector will be necessarily different than the arrangements applied for public sector proposal financing in some respects in order to effectively integrate private operators. The processing of FIP programs and projects will follow the MDBs policies and procedures for appraisal, MDB Board approval and supervision.

Private Sector Proposals

4. Consistent with the policies outlined in the FIP Project Design Document, private sector projects and programs would support pilot country REDD efforts by catalyzing on-the-ground investment to address the underlying causes of deforestation and degradation and support afforestation or reforestation and sustainable management practices in support of climate change mitigation. Private sector proposals could be submitted in the form of either individual large-scale projects (“Projects”), or program envelopes which aggregate several small and medium sized projects each utilizing less than \$50 million of FIP funds and all having a shared thematic focus and objective (“Programs”). Proposals would be based on a country investment plan (“Investment Plan”) developed together with the host government, IBRD and relevant regional development bank and would explain how the Projects and Programs are expected to contribute

¹ This could include state-owned companies.

towards the objective of achieving transformational outcomes in a sector, sub-sector, country, sub-national region, sub-region, or region while demonstrating that these outcomes would not be possible without support from the FIP. Investment plans should be derived via a transparent public-private collaboration process which defines respective roles and complementarity of objectives.

Timing, Form and Content of Private Sector Proposals

5. Timing and Form of Private Sector Proposals: Private sector Project or Program proposals in line with an endorsed country Investment Plans would be submitted to the FIP Sub-Committee for consideration in the same way as proposals for the public sector. Such funding proposals would follow the same operational criteria as those for the public sector. When submitting a FIP proposal, each MDB would have to balance the level of detail required to present to the FIP Sub-Committee with the need to manage expectations of the private sector client. Each MDB would need to choose when, within its own internal processes, it submits a proposal for FIP funding; however in all cases, this must be prior to an MDB's final Board approval.

6. Content of Private Sector Proposals: Programs and Projects would be evaluated based on their merits as described in each proposal. Each proposal would include the following information:

a) *Description of the Project or Program*: Private sector proposals should contain the following elements:

- i. For each Project: a description of the project in generic terms and how the FIP funds would be used within the project. Final approvals of FIP financing for Projects would be subject to the internal approval processes of the implementing MDB.
- ii. For each Program: a profile of the types of sub-projects expected to be financed under the Program. Sub-projects within a Program would not require additional FIP approval, unless agreed otherwise by the FIP at the time of approval of the program allocation. Final approval of FIP financing for sub-projects would be subject to the internal approval processes of the implementing MDB.
- iii. All proposals: a description of the elements that go beyond supporting a Project's or Program's financing needs, such as advisory services and knowledge management initiatives should be included. In keeping with MDB private sector practice a proposed Project or Program budget may include initiatives aimed at reducing information barriers or other non-financial barriers to market transformation. These activities may include capacity building for private sector entities, including small- and medium-sized enterprises, and knowledge products/initiatives aimed at expanding good practice via sharing information among private sector entities, public sector organisations, public-private sector entities, financial intermediaries, and on behalf of MDBs, and other relevant development partners.

b) *Strategy for achieving transformational action:* This section would describe how the Project or Program expects to achieve transformational action towards reduced emissions from deforestation and land degradation in the sector, sub-sector, country, sub-national region, sub-region, or regional level. It would discuss how the proposal fits within: a) priority sectors for private sector investments collaboratively identified in the Investment Plan b) already established country objectives and strategies, c) the existing policy and regulatory environment, and d) if relevant, how policy, regulatory and other institutional issues will be addressed to ensure the Project's or Program's success.

Investment Criteria

7. In addition to the operational criteria for FIP investments to be determined by the FIP Sub-Committee, private sector projects would also be assessed against the following criteria:

- (a) Financial Sustainability.
- (b) Effective Utilization of Concessional Finance.
- (c) Mitigation of Market Distortions.
- (d) Risk Reduction.
- (e) Use of market-based standards and third party verification systems for emissions reductions and environmental and social impacts

8. Financial Instruments and Procedures: Concessional FIP resources should only be used if it can be demonstrated that (a) FIP participation leads to barrier removal (b) the use of FIP funds would be limited to a few interventions that would demonstrate the change, remove the barriers and (c) the project is sustainable beyond the planned support. Each proposal should describe, in broad terms, the financing instruments to be utilized, and should justify the use of each instrument in light of the market barrier being addressed and need to avoid or limit market distortions. The Proposal should explain if and how subsidies are limited to specific components, and discuss why this approach would provide significant additionality, i.e. why such projects would not go forward as contemplated without use of FIP funds.

9. FIP financing would not be uniformly offered to all private sector companies. For Program proposals, the amount and terms of the FIP funding offered to an individual sub-project or client would be determined between the MDB and the client on the basis of efficient and effective use of FIP resources. Country, industry, market and individual company dynamics would impact the amount of subsidy that may be required to achieve the desired objective.

10. Modalities for blending with MDB financing: To achieve greater leverage, private sector Projects and Programs would seek to blend FIP financing with MDB financing in the most efficient and effective way possible. Financing proposals offered to end-clients may or may not initially differentiate between funds provided by the FIP and funds provided by the MDB's own account, as highlighting the FIP funds could lead to the private sector entity demanding more subsidy than it otherwise would accept to undertake a given project.

11. Financial Instruments: MDBs could use or create financial instruments as appropriate to meet the needs of their private sector clients and achieve the goals of the Project or Program. Each MDB should explain in the proposal why it believes it can structure and implement the financial instruments proposed for each Project and Program. FIP resources could be combined with other instruments and mechanisms available in the market, such as GEF resources, other donor funds, and/or carbon credits. In the case of such resource pooling and to the extent available at the time of submission, underlying Project and Program proposals might need to explain the particular advantages of combining these tools in the specific circumstances. It would be important to share and build upon lessons learnt through deployment of various financial instruments, and identify opportunities for replication and scale-up as appropriate.

12. Pricing and terms: The pricing and terms of the FIP funds offered to private sector clients would be tailored to address the specific risk, market, and structural aspects of each Project and Program. MDBs would seek to ensure that the subsidized financing minimizes or avoids market distortions.

Results Measurements

13. Proposals would include performance indicators for each Project, Program and the sub-projects within each Program, along with a timeline for such indicators.

Reporting

14. MDBs would report on the progress of all Projects and Programs annually or more frequently if requested by the Trust Fund Committee. To ensure consistency in reporting and evaluation, universal measurement criteria would be developed by the MDB Committee. The measurement criteria would be in line with already existing best practice.