

# **The Tropical Forests Forever Facility: A Proposed Multilateral Investment Fund to Reward Tropical Forest Conservation and Restoration**

*Introduction and Summary, 26 April 2024*

*Disclaimer: The concept presented herein is based on extensive analysis and modelling and is financially feasible as set out. However, this concept note should nevertheless be regarded as work-in-progress, as details will evolve with partners and sponsors providing feedback over the next weeks and months.*

## **1. Background**

At COP28 in Dubai Brazil introduced to the global community a proposal to establish a multilateral investment fund to incentivise tropical forest nations to slow and reverse deforestation and forest degradation - thus contributing to the global goal of reaching zero net deforestation and degradation of tropical forests. This proposal builds on the earlier work led by the World Bank, the Center for Global Development and the Rockefeller Foundation.

Loss and degradation of forests – especially in the tropics – contribute to more annual CO<sub>2</sub> emissions in the atmosphere than any human activity other than energy production and consumption.

The Tropical Forest Forever Facility (TFFF) would reward tropical forest countries for protecting the natural tropical forests that provide enormous development benefits and are a critical part of humanity's effort to combat climate change. By providing an explicit payment for conservation and restoration of tropical forests, the facility would help to address a significant market failure, placing a value to the ecosystem services that those forests render to water management, biodiversity preservation, soil protection, nutrient cycling, continental and global climate regulation, and climate resilience. Correcting this market failure will also help reduce poverty and advance economic development, both in forest countries and globally.

As this market failure has gone unaddressed, deforestation and degradation have proceeded unabated in many developing countries as a result of seemingly compelling economic incentives. Existing initiatives and programs have made progress, but they have not proven sufficient to overcome entrenched interests in the business-as-usual drivers of destruction, and reverse global trends in deforestation and degradation of forests. A new large incentive is needed to generate political will, support country ownership of conservation objectives, and draw attention of key decision makers, including heads of state and ministers of finance and planning, to address the governance changes needed.

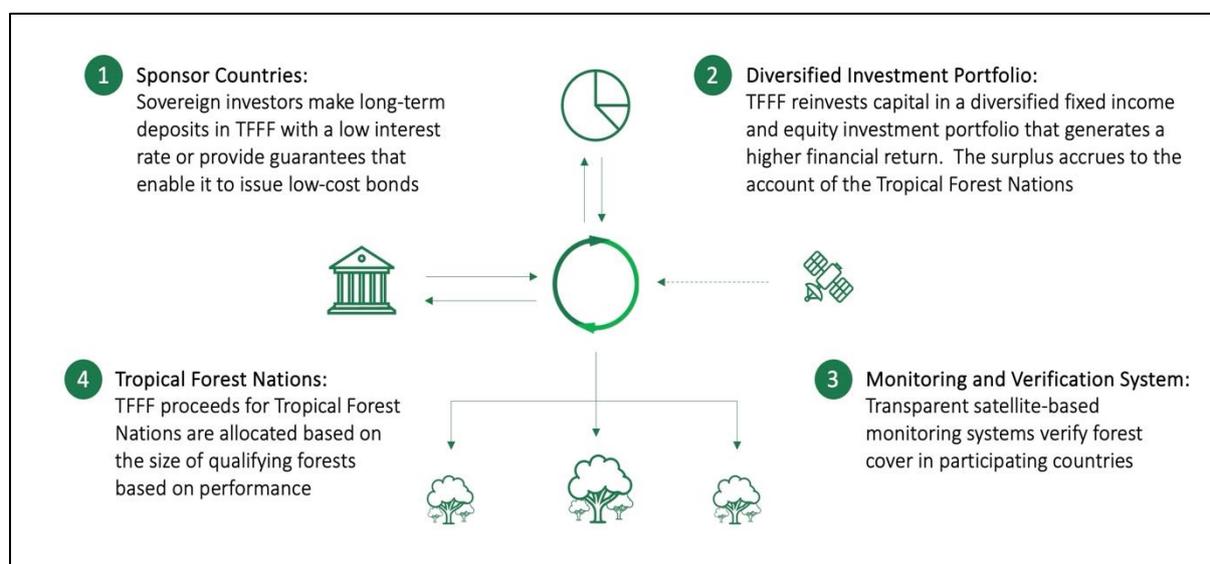
The TFFF will offer a substantial, long-term reward for successfully tackling deforestation. It provides an additional incentive for forest nations to meet this challenge and to seek out and effectively utilize the international community's existing mechanisms, without increasing funding demands on government budgets.. In short, the proposed facility seeks to establish

financial transfers that do not rely on grant contributions strategically designed as conditional incentives for results-based efforts at halting and reversing deforestation and forest degradation. Importantly, while the TFFF would provide a major incentive for forest nations to conserve and enhance these important resources, it is not intended to be the only solution. It would complement, not replace, other policies and initiatives necessary to achieve this key objective, including REDD+ program, development of effective carbon credit markets, and changes in agricultural policies and practices.

## 2. How would the TFFF work?

The TFFF proposes to accomplish the objective just described using well-established financial-market tools. It will generate financial returns for qualifying tropical forest nations by investing low-cost, long-term deposits and other borrowings in a long-dated diversified investment strategy. The TFFF's funding will come from deposits, loans and bonds from advanced-economy sponsors and other investors at a cost materially lower than the returns to be expected from TFFF's investments. Figure 1 provides an overview of the TFFF mechanism.

Figure 1 - Overview of the Tropical Forests Forever Fund



### 2.1. TFFF Finances

#### 2.1.1. TFFF capitalization

**The TFFF aims to assemble a large pool of capital at a low funding cost to be invested in a diversified investment portfolio.**

**The TFFF's capital pool would be borrowed from a range of public and private sponsors providing funding at a cost consistent with that of the borrowings of advanced-economy sovereigns.** It is contemplated that sovereign sponsors would make long-term (20+ year) deposits that would pay an interest rate comparable to their own cost of government debt and be repaid to them at the end of the specified period, and by offering guarantees, which

can be issued bilaterally and/or collateralized by Special Drawing Rights (SDRs). Philanthropies can contribute with grant capital or direct deposits similar to sovereign sponsors. Other sponsors could include a range of institutional and retail investors who would purchase debt issued by the facility to augment its capital base. These investors would benefit from a market rate investment return and the opportunity to participate in a high-impact climate bond.

**The TFFF does not involve outright expenditure or grants by sovereign sponsors.** It is simply a loan or deposit, repaid to them at the end of a specified term and for which they receive interest at their respective government-bond rates. Accordingly, for sovereign sponsors funding their investment in TFFF directly or indirectly through sovereign debt, their investment would be balance-sheet neutral and thus neutral from a fiscal-accounting perspective.

While the TFFF proposal is not linked to or dependent on payments for carbon and biodiversity credits, the possibility of monetizing such additional benefits will be assessed as part of the process.

**Table 1** sets out various options for contributions to the TFFF by a selection of key sponsors and investors.

**Table 1 - TFFF Investor Participation Options**

 <b>Actors</b>	 <b>Investment Options</b>
Sponsor Sovereigns	Direct sovereign deposits Guarantees to support borrowing from others
Philanthropies	Grants Direct deposits
Sovereign Wealth Funds	Deposits and/or other fixed-income investment
MDBs / DFIs	Deposits and/or other fixed-income investment
Other investors	Fixed-income investment

### 2.1.2. TFFF investment

**The TFFF will invest in a diversified portfolio generating a financial return above the cost of the capital provided by sponsors, yielding a substantial net return that can be allocated to tropical forest nations that succeed in conserving and restoring their forests.**

The portfolio would be structured to support periodic cash payouts to qualifying tropical forest nations that elect to receive their returns, while providing enhanced returns for tropical forest nations electing to allow their interest in the TFFF to remain in the portfolio and compound for payout upon dissolution of the TFFF portfolio. Accordingly, the largest asset allocation in

the TFFF portfolio is contemplated to be publicly issued and traded long-dated, high-yield debt, including substantial investment in hard-currency debt of emerging-market sovereigns. The second-largest allocation would be in a global public-equity portfolio, supporting higher returns for qualifying tropical forest nations electing payout upon dissolution.

## **2.2. Rewards for successful tropical forest nations**

Participating tropical forest countries will receive the investment returns on the TFFF investment portfolio (net of the sponsors' cost to fund it) if they succeed in conserving and restoring their forests. Forest countries' initial shares in TFFF's returns will be based on their respective proportions of the total area of qualifying forest covered by TFFF. Participating countries successful in forest conservation and restoration will have the choice of receiving periodic cash payouts or keeping their returns invested in the TFFF portfolio to compound over time. If they elect the first of these options their continuing share in the fund would decline proportionally compared with participating forest countries that reinvest their returns in the portfolio and benefit as it continues to compound.

**The current proposal contemplates that to be eligible a tropical forest nation will be required to keep its deforestation rate below 0.5%, and that its allocation would be reduced by the equivalent of 100 hectares for each 1 hectare deforested or degraded.** Forgone allocations (due to deforestation) will remain in the TFFF, but will accrue to the benefit of the sponsors, but also create a fund to compensate any forest nation that increases its forest cover via reforestation.

**TFFF will keep its verification process as simple as possible.** Satellite monitoring will be the vehicle for doing this.

**TFFF can generate substantial returns for qualifying forest nations.** Based on extensive back-testing and Monte Carlo simulation, successful tropical forest nations could expect to share proportionately in an average annual return of approximately 3.5-4% of the value of the TFFF portfolio. The final size of the portfolio will depend on the amount of eligible forest hectares, with current discussion focused on a USD 100 to 125 bn in size.

Table 2 shows an illustrative example of the mechanism assuming a USD 4 payment per hectare.

**Table 2 - Notional TFFF Allocations**

	Year 0	Year 1 (Scenario 1)	Year 1 (Scenario 2)
Deforestation Rate	N/A	0.4%	0.6%
Standing Forest Area in ha	10,000,000	9,960,000	9,940,000
Deforested Area in ha	N/A	40,000	60,000
TFFF Allocation in USD	40,000,000	23,840,000	0

While the TFFF as designed has a finite life, some or all participating tropical forest nations could choose to keep the fund operational after the maturity and repayment of sponsors' deposits, using accumulated returns as an equity base to support a continued funding program. TFFF thus could become an evergreen facility generating a continuing periodic payout for qualifying tropical forest nations.

### **3. Secretariat and investment services**

The proposal as currently envisioned contemplates that the World Bank or another international institution could support the TFFF's secretariat, provide investment management services for its portfolio and arrange satellite monitoring and verification services. Notably, there is a broad range of capable public and private institutions with long track records that could provide these services.

### **4. Road map and next steps**

At the request of the Government of Brazil, the World Bank is acting as the Government's strategic partner to plan the proposed programme. Discussions with potential sovereign sponsors, institutional investors and other potential partners have shown strong support and willingness to engage in the implementation process to ensure that the initiative aligns with their respective priorities.

On 17 April 2024, the Government of Brazil hosted a working level round table discussion at the WB/IMF Spring Meetings 2024 to present the initiative and clarify technical financial questions of the proposal.

The participants of this round table have been invited to be part of the Working Group that will further develop the concept of the initiative. The process until final operationalisation of the TFFF is divided into three phases: Phase 1 – Design and Validation, Phase 2 – Consultation and refinement, and Phase 3 – Standing-Up.

In the initial Phase 1 from April 2024 to the G20 Ministers of Finance meeting in Brazil in July 2024 the aim is to:

1. Further develop the financial structure, eligibility criteria and incentive structures for forest conservation
2. Clearly define the terms of engagement for sponsors
3. Develop options for (i) governance and (ii) monitoring and verification.

Table 3 sets out the timeline for next steps in detail, while Table 4 provides an overview of the key milestones through the end of 2024.

Table 3 - TFFF Next Steps

 <b>Phase 1: Design &amp; Validation</b> <i>April 2024 - July 2024</i>	 <b>Phase 2: Consultation &amp; Refinement</b> <i>Aug 2024 – Nov 2024</i>	 <b>Phase 3: Standing-Up</b> <i>Dec 2024 – Nov 2025</i>
<ul style="list-style-type: none"> <li>▪ Establishment of TFFF Working Group</li> </ul> <p><i>Validate:</i></p> <ul style="list-style-type: none"> <li>▪ Financial structure and minimum critical specifications</li> <li>▪ Qualifying forest countries and landscapes criteria</li> <li>▪ Incentive potential for successful forest conservation</li> </ul> <p><i>Determine options for:</i></p> <ul style="list-style-type: none"> <li>▪ Governance Structure – Roles &amp; Responsibilities</li> <li>▪ Monitoring and verification</li> </ul>	<p><i>Consult:</i></p> <ul style="list-style-type: none"> <li>▪ Investors on value proposition</li> <li>▪ Tropical forest countries on expectations, performance measurement, and use of proceeds</li> <li>▪ Bilateral/Multilateral institutions and civil society organizations as key supporters</li> </ul> <p><i>Finalize:</i></p> <ul style="list-style-type: none"> <li>▪ Fundraising strategy</li> <li>▪ TFFF design, governance, legal arrangements</li> </ul>	<p><i>Activities to be informed:</i></p> <ul style="list-style-type: none"> <li>▪ Fundraising</li> <li>▪ Institutional set-up</li> <li>▪ Facility launch at COP 30</li> </ul>

Table 4 - TFFF Key Milestones

<i>Phase 1: Design &amp; Validation</i>			<i>Phase 2: Broader Consultation &amp; Refinement</i>		
February 2024	April 2024	May 2024	July 2024	October 2024	October/November 2024
●	●	●	●	●	●
<b>Kick-off Technical Workshop</b> <i>G20 MFCBG Sao Paulo</i>	<b>Kick-off Meeting (Investors)</b> <i>World Bank/IMF Spring Meetings Washington, DC</i>	<b>Kick-off Meeting (Forest countries)</b> <i>UN Forum on Forests Washington, DC</i>	<b>Investor &amp; Forest Country Meeting</b> <i>G20 MFCBG Rio de Janeiro</i>	<b>Investor &amp; Forest Country Meeting</b> <i>World Bank/IMF Annual Meetings Washington, DC</i>	<b>Global Stakeholder Engagements</b> <i>COP 16 / COP29 Colombia &amp; Azerbaijan</i>