



Developing the voluntary carbon market in uncertain policy landscapes

A practical guide to political and policy risks | February 2023

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Opening remarks

One message came out loud and clear from COP 27 in Sharm El-Sheikh. We have a large climate investment gap and the private sector can play a big role in closing it. The Rockefeller Foundation¹ estimates that only 16% of the financing necessary to address climate change is currently being met and approximately \$3.8 trillion in annual investment flows will be needed through 2025.

The voluntary carbon market (VCM) can be an effective vehicle for urgently unlocking climate finance from the private sector, while enabling businesses and investors to tackle their hard to abate emissions and reach their net zero and nature positive targets.

Yet, those looking to finance the development of carbon projects face an unprecedented level of risks as a result of emerging governmental climate and carbon policies.

Most governments worldwide are still discovering how they will achieve their climate goals and what policy mechanisms they will leverage, including emission trading systems, carbon taxes or international carbon trading. The policy landscape is highly fragmented with very few countries taking the same approach to the VCM, leaving market participants to analyse changing regulatory landscapes on a country-by-country basis. This uncertainty poses significant risks to projects in the VCM and could limit the acceleration of financing for impactful projects. In this context of high policy uncertainty, this paper has three main goals:

- 1. Define how policy uncertainty translates into risks for the VCM**
- 2. Offer a framework to assess the identified risks**
- 3. Outline existing and emerging risk mitigation options**

¹ [What Gets Measured Gets Financed: Climate Finance Funding Flows and Opportunities](#)

Opportunities to invest in high quality carbon projects or to back projects in exchange for discounts on carbon prices exist today. Abatable estimates that over [\\$10bn worth of transactions](#) were announced into carbon credit generation in 2022 alone, most of which were investments within emerging and frontier markets.

Investments in emerging economies are often perceived as higher risk by institutional investors, due to a historically higher degree of political instability and macroeconomic volatility. What is clear is that carbon project investments may bear an even larger level of risk on top of the risks inherent in investing in emerging markets, because of changing carbon legislations and the operationalisation of Article 6.²

Given the urgency of tackling the investment gap for emission avoidance, reduction and removals, we believe that increasing investors and corporates understanding of carbon-specific political and policy risks as well as how to mitigate them, will allow more climate finance to be channelled into impactful projects through the VCM.

We hope this white paper serves as a useful guide in driving carbon-related investment and corporate procurement decisions.

² See [“Useful vocabulary and concepts”](#) section for a detailed explanation of Article 6.



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Image provided by Sunculture

Article 6 of the Paris Agreement



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What is Article 6?

One of the most important recent policy developments for international carbon markets was the finalisation of Article 6 of the Paris Agreement in 2021. The premise of Article 6 is that trading carbon emission reduction and removal assets across borders could reduce the cost of fighting climate change and therefore raise international climate ambition, as long as there is no double counting. For Article 6 to be effective, climate negotiators agreed on the concept of “corresponding adjustments (CA)”. CAs require that if a credit is internationally transferred to another country or any other entity, it must be deducted from the host country’s Nationally Determined Contributions (NDC), and appropriately accounted for in the national registry of the receiving country.

Article 6 sets two international carbon mechanisms regulated by the UNFCCC:

Carbon trading under Article 6

Article 6.2

This is a country-to-country carbon transfer and trading mechanism. The transferred carbon emission reduction and removal assets are called Internationally Transferred Mitigation Outcomes (ITMO). Some of the pioneers in the implementation of Article 6.2 include Switzerland and Morocco.

Article 6.4

Establishes a market where public and private actors participate in countries' reduction efforts by financing projects. This is where we expect a lot of convergence with the voluntary carbon market, especially in methodology alignment and VCM project developers opting to register their projects under the Article 6.4 mechanism.

Authorised credits (ITMOs and 6.4)

Credits which the host country agrees to transfer internationally using corresponding adjustments. These credits can be either bought by other governments to meet their NDCs or by private entities to meet compliance or voluntary offsetting requirements (e.g. CORSIA).

Mitigation contribution credits

Mitigation contribution credits are credits the host country does not authorise for international transfer. These were previously known as "unauthorised credits" and in principle could be used by companies to make contributions to a country's NDC. The rules and scope of mitigation contribution credits require further work.

Corresponding adjustment is applied

No corresponding adjustment is applied

Buying country's NDC

Other mitigation purposes

Contributes to host country's NDC

The operationalisation of Article 6.4 largely relies on the work of its Supervisory Body³, and it is expected that the mechanism will be able to operational by late 2024 or early 2025. We expect it will take another 9-12 month to see the first issuances after its operationalisation.

It remains unclear whether registries operating in the VCM will be allowed to transfer to the Article 6.4 mechanism. We are nevertheless already seeing interactions between VCM programmes and the Paris Agreement with independent registries certifying Article 6.2 deals.

At the national level, governments have the option of leveraging the Article 6 mechanisms as either buyers or sellers. If they decide to leverage them as sellers, they will have to develop the necessary national accounting infrastructure and processes and decide which sectors will be covered and authorised for international export. Implementation at the national level will take time and likely be different for every country. This creates a high degree of uncertainty for a market that needs to scale fast and deliver on global climate ambitions.

³ The Supervisory Body consists of twelve members nominated from various countries. Their mandate includes deciding what will be traded - i.e. including assessing and approving methodologies - and how it will be traded.



Image by Eutah Mizushima | www.unsplash.com

The growing interest by governments in carbon markets

Figure 1: The VCM is maturing from a policy, quality and claims perspective

	Past	Present	Future?
Quality of carbon projects	Unclear definition of quality, open to interpretation	Working on consensus on what high quality methodologies look like	High quality credits are easy to identify, with the potential emergence of a prime and subprime market
Corporate claims	No guidance on claims, leading to greenwashing practices	Emerging clarity on corporate claims and reporting requirements (VCM)	Established governance on corporate claims
Policy and regulation	<p>Limited host country engagement and oversight of projects</p> <p>VCM separate to national NDC efforts</p> <p>VCM acting almost as a supranational market, above any laws or rules</p>	<p>Uncertainty over how to regulate the VCM, with some governments blocking issuances</p> <p>Governments building national markets</p> <p>Governments working on Article 6 and role of VCM</p>	<p>National rules may differ from country to country</p> <p>Clearly defined role of carbon markets in each NDC</p> <p>Revenue sharing with host country governments and communities</p>

Source: Abatable analysis, 2023

National and sub-national governments are taking a very keen interest in carbon markets. We have identified three reasons why:

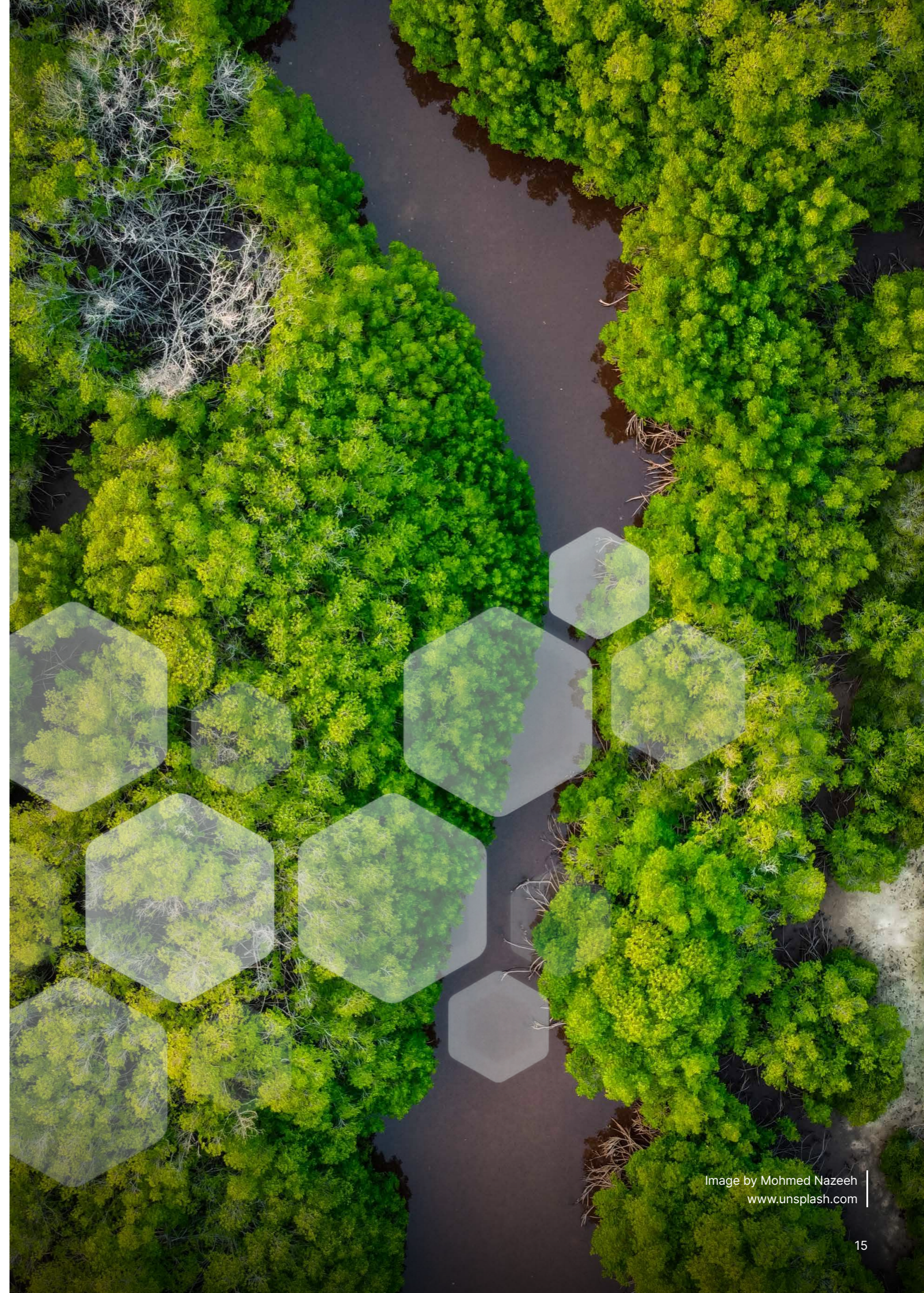
- 1. Governments are worried that credits being exported via the VCM are the “low hanging fruits”, and that their export will make it harder for the country to meet its Paris Agreement targets** (see Figure 1). Some governments are exploring restricting which project types can transfer carbon credits outside of a national carbon system as well as taking a percentage cut from issuances.
- 2. The climate emergency has highlighted the critical importance of carbon sinks as a key natural resource on which a carbon price can be assigned**, particularly in the context of international trading systems. Such a valuable national asset can be a geopolitical tool in international cooperation, with some

countries such as Brazil, Indonesia and the Democratic Republic of Congo (DRC) working to become the “OPEC of forests”.

3. Governments are seeing profits made by international players who back carbon projects in the host country and may want to govern and oversee such flow of foreign direct investments by taking a share of proceeds on credits transferred outside of the country’s national registries. Governments may also want to regulate projects to mitigate the negative environmental and social impact, ensuring carbon projects follow national safeguards and create sustainable livelihoods for local stakeholders.

Whilst policy and regulation can help scale the VCM by providing investment certainty, the current policy landscape related to carbon is highly complex to navigate.

In the next section, we discuss how this uncertainty translates into a set of concrete risks.



Defining host country risks

Since the finalisation of the Article 6 rulebook in 2021, carbon market regulation is still a top item of the negotiation agenda at COPs.

Policy risks are only one of the risks that can affect carbon projects in the VCM. Counterparty risks, physical risks such as extreme weather events or changes in VCM supply & demand dynamics can also damage the returns of carbon projects. Yet, national policy development activities pose an unprecedentedly higher risk level for investors, developers and corporate buyers looking at the VCM space.

When analysing policy and regulatory risks, our position is that these risks cannot be effectively addressed without discussing the political, economic and institutional environments in which they are developed and implemented.

For that reason, in this paper, we cover two types of host country risks:

Policy and regulatory risks

Policy and regulatory risks in the context of carbon projects emerge as governments start defining and regulating their carbon assets. This can take the form of laws, national strategies, moratoriums, etc.

Political and institutional risks

Political and institutional risks in the context of carbon projects refer to the ability to develop carbon projects given the political stability, economic situation and capacity to implement and enforce regulatory decisions of a country.

We consider that both types of risks are connected. For example, high levels of public sector corruption, which is an institutional risk, can have a strong impact on the operationalisation of a new policy requiring every project to be authorised by a government. It is therefore important to understand and assess both categories of risks in tandem.

Key policy and regulatory risks affecting carbon projects

Government interest in regulating international emission trading can take many forms, from radical measures such as a ban on the export of credits to lighter measures such as taxation. In this table, we outline the key risks associated with rapidly developing policy and regulatory landscapes.



Ban on the export of carbon credits

A ban on the export of carbon credits refers to a government decision to forbid the international sale of carbon credits issued under their jurisdiction.

Several countries like Indonesia and Papua New Guinea have recently imposed moratoriums or “export bans” on VCM issuances of forestry-based carbon credits. These bans can harm a carbon project as without the revenues from the sale of carbon credits, project developers are unable to pay for the mitigating activities happening on the ground. These existing bans are expected to be temporary as host countries define how they will reach their NDCs and what role the VCM can play.



Ban of claims associated with carbon credits

A ban of claims associated with carbon credits refers to governments forbidding buyers of carbon credits from making voluntary claims such as net zero or carbon neutral when using carbon credits from their country.

A new type of credits for host countries was formalised at COP 27: mitigation contributions. Under Article 6.4, *mitigation contributions* allow a developer to sell a credit internationally with no corresponding adjustment. Using these credits, buyers would not be able to make any other claims than having contributed to a country's NDC.



Revocation or dispute over carbon rights

Revocation or dispute over carbon rights refers to governments retroactively voiding the rights of project developers or communities to the benefits arising from selling carbon credits.

Currently, there is no internationally accepted definition of carbon rights, and very few countries have adopted definitions in their national legal systems. As it concerns the right to trade carbon, carbon rights need to be determined by legislative and/or contractual arrangements. This can affect a project as the lack of definition of carbon rights can lead to disputes over who owns them. In some cases, carbon rights are associated with the land, while in others, surface rights and carbon rights are separate to the land. There is also ambiguity for projects for which emission reduction does not occur on land, for example cookstoves or mineralisation of concrete.



New taxes on carbon project development

New taxes on carbon project development: as part of the broader regulation of carbon projects, we are seeing governments tax carbon projects at different stages of their value chain, especially validation and export. The emergence of new taxes can pose a risk to the returns of investors if these are very high.

Tax rebates to support low-carbon solutions: many governments have been actively supporting low-carbon solutions via different financial incentives, including favourable tax regimes. Recently, the United States published the Inflation Reduction Act investing \$369 billion in energy security and climate programs over the next ten years. The development of new financial incentives could render carbon finance less critical, affecting the additionality of a project and the validity of a corporate claim.



International trade sanctions

This arises when one country retaliates against another by raising import tariffs or placing other restrictions on the other country's imports. Trade sanctions are typically related to foreign policy. These could affect a project's ability to sell the carbon credits it generates if the host country becomes subject to sanctions of the nature Russia, Syria, Venezuela or Iran are subject to. Sanctions may be unilateral, imposed by a single country, or multilateral if agreed by multiple nations.



Baseline alignments to national accounting

Baseline alignments to national accounting refers to the process by which projects developed under the VCM need to align their baselines with those developed by the host country, for example a Forest Reference Emissions Level (FRELs) for forestry-related assets. A project will need to review its emission reduction calculations to conform with the jurisdictional program, often including a review of a project's baseline to align with national baselines, which could lead to fewer credits being issued than originally expected.



Changes in local administrative requirements

Changes in local administrative requirements, including those for permits, management plans, reporting, etc. This may impact the operating costs or capital expenditure requirements and/or feasibility of a carbon project.



Image by Ivan Bandura
www.unsplash.com

Key political and institutional risks affecting carbon projects

Political and institutional risks affect most types of investments in emerging and developing countries. In this section, we list and define what those risks are in the context of carbon projects.



Macroeconomic risks

The macroeconomic variables that pose risk include: fluctuations in interest rates and exchange rates, growing unemployment rates, higher price indexes and agricultural exports.

Macroeconomic risks can affect a carbon project if the project relies on the import and export of goods.



Political instability

This is the propensity of a government to collapse either because of conflicts or rampant competition between various political parties.

Political instability can affect a carbon project in several ways, including by preventing the implementation of a project due to conflict or by a new regime revoking authorisations to carry out a project.



Weak rule of law

The rule of law is a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to national laws, which are equally enforced and independently adjudicated (UN definition).

Weak rule of law can affect carbon projects in many ways, including:

- Government breach of contract
- Expropriation of land or carbon rights
- Lack of property ownership enforcement



Public and private sector corruption

Transparency International, a non-profit whose purpose is to take action to combat global corruption, defines corruption as the abuse of entrusted power for private gain. In the context of carbon projects, corruption can take many forms. For example, public servants could demand money or favours in exchange for authorisations.



Expropriation or dispute over property rights to land

Property rights to land refers to the legal ownership of land, by individuals, communities, businesses, and the State. According to a 2019 World Bank study⁴, only 30% of the global population has legally registered rights to their land and homes. Weak property rights to land pose two main risks in the context of carbon projects:

1. Risk of displacement of Indigenous and local communities: only about half of the land held by indigenous and local communities worldwide has been legally recognised by governments. Developing a carbon project in a country where these rights are not well established can lead to disputes over land rights, potentially followed by the displacement of indigenous and local communities.

2. Risk of land expropriation for project developers: almost all governments have the power to seize property when it is required for the public good, as long as just compensation is available to the aggrieved owner. The key risk is what should be considered proper “just compensation” and whether it would cover the expected returns from the carbon project being developed.



Institutional capacity

Refers to the capacity of governments to develop systems and assessments required for the effective functioning of carbon markets. These can include developing a Forest Reference Emissions Level (FREL) or a national registry.

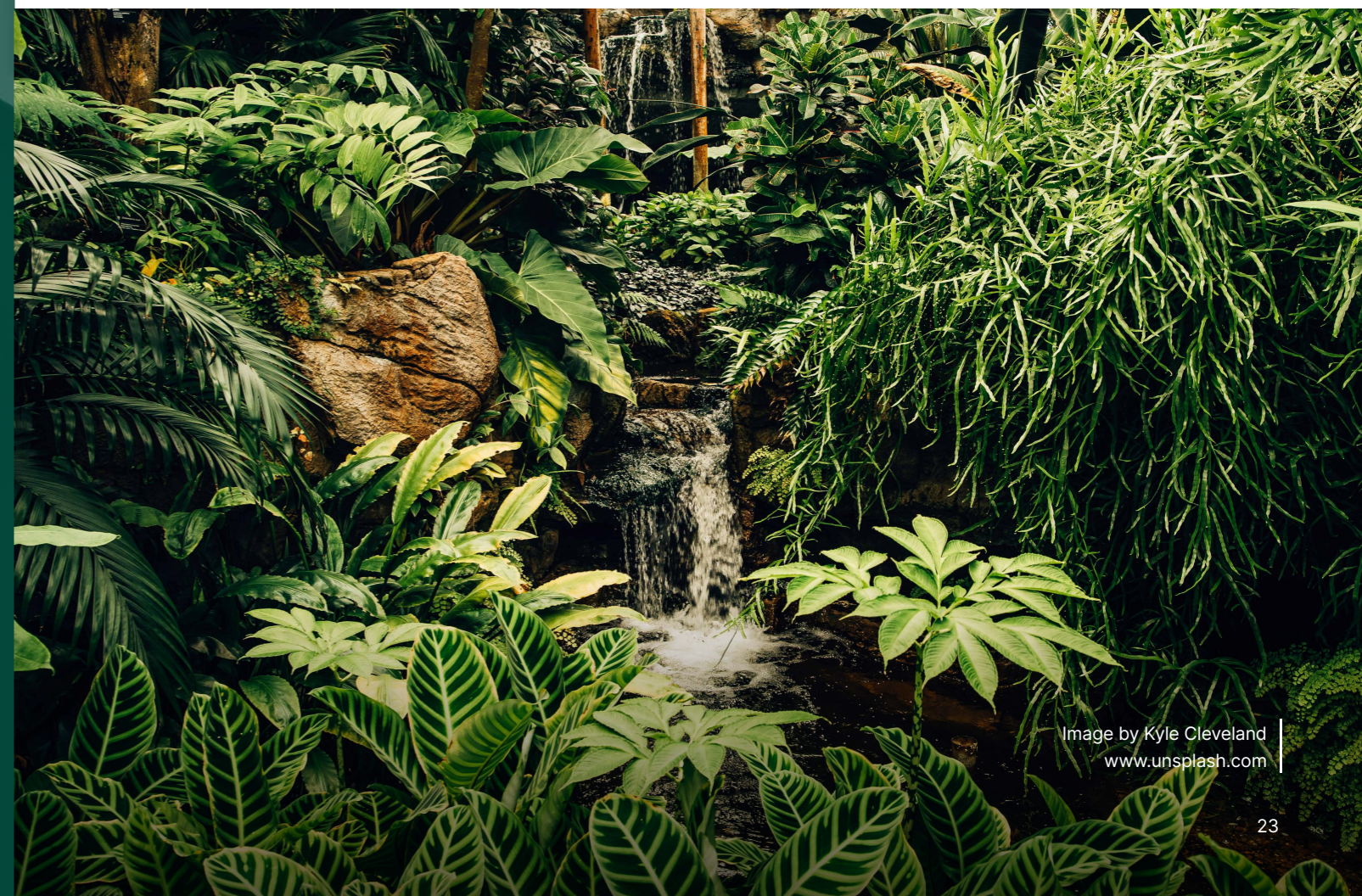
Weak institutional capacity can lead to hold ups in securing land rights from governments, difficulties registering a project in a national registry (if applicable), etc. In turn, this can cause delays in a project’s implementation, validation and distribution.

⁴ <https://blogs.worldbank.org/voices/7-reasons-land-and-property-rights-be-top-global-agenda>

How to conduct a host country risk assessment

Abatable has developed an assessment framework for host country risks. The assessment relies on information which Abatable has reviewed in conjunction with policy and in-country experts. In order to conduct an in-depth assessment, our recommendation is to leverage the five sources of information listed below, making sure to cross-check the insights gathered and accepting the fact that the assessment is likely to evolve. Access to stakeholders and information is key to being able to conduct a comprehensive host country assessment.

- Project developers
- Policymakers and government representatives
- Policy experts such as Abatable
- Local lawyers
- Public indexes and research tools



Each of these resources can help you with a different aspect of your assessment, as shown below:

Indexes and research

Understanding host country historical trends with regards to weak rule of law, risk of instability, indigenous peoples rights, etc

Local lawyers

Assess existing climate and carbon related regulation when developing a project, as well as identifying regulatory gaps

Policy experts

Can leverage their network and provide the “bigger picture” to build a balanced assessment

Project developers

Are likely to be very familiar with the policy developments which could affect their project and provide insights into how material certain risks are

Policymakers

Can provide insights as to how the government is thinking about carbon market policy and the role of VCM

Understanding a host country's track record

Trying to predict the future as best as possible

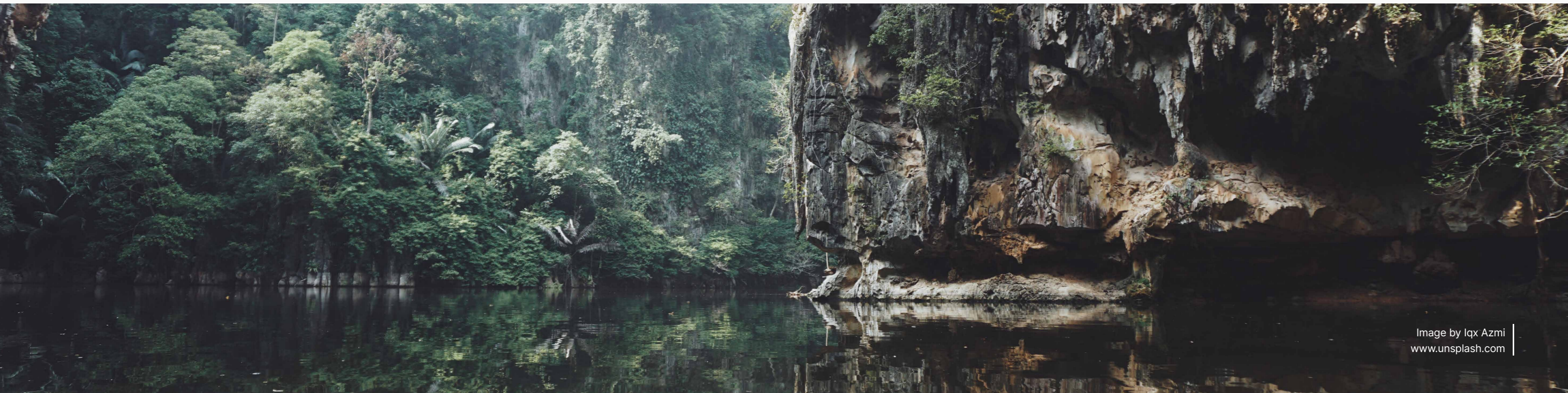


Image by Iqx Azmi | www.unsplash.com

In order to conduct a host country assessment, we turned the risks we identified into a subset of questions, which you can leverage in your own assessment.

Abatable is building a repository of these national assessments, which is regularly updated. If you are interested in accessing them or collaborating, do [get in touch with us](#).

Table 3: Questions to conduct a policy and political risk assessment

	Risk	Assessment questions				Potential sources of information
POLICY AND REGULATORY RISKS	Ban on the export of carbon credits	Is the project type required for the achievement of the host country's NDC?	Has the government expressed intentions to ban certain sectors from exporting credits to meet its NDC?	What are the local and national governments views towards the VCM?	Is the government likely to provide authorisation letters to either carve the project out of the NDC or to ensure participation in Article 6.4?	Project developers Policy experts Research Policymakers and government representatives
	Revocation or dispute over carbon rights	Are carbon rights well defined in the host country? If yes, who has ownership of carbon rights?	Have there been recent carbon rights disputes in the host country?	Is the government currently developing a national carbon market / Article 6 mechanism? If yes, how does it interact with the VCM and existing projects?		Project developers Lawyers
	Ban of claims associated with carbon credits	Has the host government expressed intentions to ban claims associated with VCM carbon credits?		Does the government have views on which type of carbon credits corporates should buy to make net zero or carbon neutral claims?		Policy experts Policymakers and government representatives
	New taxes on carbon project development	What tax regime does the government currently impose on carbon projects?	Are there tax rebates the project could benefit from?	Does the government intend to develop additional taxes on carbon projects? If yes, at which stage of development? If yes, what will the tax be?	Does the government intend to 'tax' credit exports by taking a percentage of exported credits for NDCs?	Project developers Lawyers Policy experts Policymakers and government representatives
	International trade sanctions	Is the host country currently subject to trade sanctions?	Is there a risk that the country may be subject to international trade sanctions? - To promote peaceful transitions	- Deter non-constitutional changes - Constrain terrorism	- Protect human rights - Promote non-proliferation	Project developers Lawyers
	Baseline alignments to national accounting	Is the host country currently developing a Forest Reference Emission Level? - In what stage is it?	Has the government expressed its intentions to include projects in a jurisdictional programme for REDD+?			Project developers Policy experts Policymakers and government representatives
	Changes in local administrative requirements	Has the government expressed any administrative requirements to secure permits, register projects, issue credits or transfer credits?	Given the track record of the country, do you expect these requirements to cause delays? If yes, to what extent do they impact projects?			Project developers Lawyers
POLITICAL RISK	Macroeconomic risks	How have interest rates, exchange rates and GDP recently fluctuated?		Are unemployment rates growing?	Are there any other red flags?	Indexes Policy experts
	Political instability	How stable is the current government?		Are there any risks of terrorism, civil unrest or war with another country?		Indexes Policy experts
	Weak rule of law	How strong is the rule of law in the country?		Are there any concerns to be had about the future of the rule of law in the country?		Indexes Local lawyers
	Public and private sector corruption	What are the levels of public and private corruption in the country?		How does corruption impact carbon projects?		International indexes Local lawyers Project developers
	Expropriation or dispute over property rights to land	Are indigenous peoples land rights recognised by the State and well defined?	What is the government's track record in respecting indigenous peoples rights?	What best practices does the government recommend project developers follow?	Have there been any recent cases of expropriation or disputes over property rights to land?	Policy experts Local lawyers Project developers
	Institutional capacity	Do you believe the government has the institutional capacity to effectively develop and implement its climate and carbon market strategy?			May institutional capacity cause delays?	Policy experts Local lawyers Project developers

Assessing risk levels

Once the risks have been identified, we recommend mapping them by level of likelihood and consequence on financial returns.⁵ These two elements will define the overall risk level (see Figure 2). Risks which are identified to be highly likely and for which consequence on financial performance is the highest should be given priority on due diligence and mitigation measure.

Likelihood refers to the possibility of a risk occurring. In this context, it should be assessed qualitatively (low, medium, high), leveraging historical data and insights from actors on the ground.

Consequence relates to the severity of lost financial returns if a risk occurs. In this case, investors and corporates can set their own boundaries to define what low, medium and high consequence means.

Figure 2: Risk matrix showing the defined risk levels

	Consequence		
Likelihood	Low	Medium	High
Low	Low	Low	Medium
Medium	Low	Medium	High
High	Medium	High	High

⁵Returns in the context of carbon project investment can either be financial or as carbon credits.

As Figure 3 shows, a risk level can be attributed to each risk based on a contextual understanding of how likely the risk is to materialise and the potential consequence.

Figure 3: Example of risk level assessment and implications

Risk	Likelihood	Consequence	Risk Level	Implications
Political instability	High	High	High	Key area of diligence and exploration of mitigation options including insurance
Ban of the export of carbon credits	Low	High	Medium	The risk can be acceptable but it should be monitored and re-assessed on a regular basis
Macroeconomic risk	Low	Medium	Low	Acceptable risk, continue monitoring the risk level

In the absence of established climate legislation and Article 6 strategies, the below policy and regulatory risks could be considered as high likelihood:

1. Ban of the export of carbon credits
2. Revocation or dispute over carbon rights



How to mitigate host country risks

Mitigation solutions have been used by long-time market practitioners, and new solutions in the insurance space are emerging as well.

To date, there are many examples of successful collaborations with governments and communities, as well as the use of blended finance instruments, for the development of successful and long-term carbon offsetting projects. However, blended finance and community engagement solutions may not be enough reassurance for mainstream investors and corporates seeking to invest in carbon projects.

More traditional insurance products can play a key role in unlocking large scale private finance by providing innovative risk transfer solutions for institutional investors. The offering today is limited but we see this as an important area of growth in the months and years to come.

We identify three ways in which investors can work to mitigate host country risks:

1. Working closely with governments and communities
2. Leveraging insurance instruments
3. Sharing the risk through blended finance

1. Government and community engagement as a risk mitigation strategy

In our experience in assessing carbon projects, we see the level of engagement project developers have with communities as well as local and national governments as a key success factor. We found that governments are quite positive about projects which showcase not only carbon and biodiversity benefits but also alternative livelihoods, long term employment and education opportunities.

Concretely, involving communities and different levels of governments in projects can contribute to:

- Reducing the risk of dispute over carbon rights as these are agreed upon together between the project developers, governments and communities. In some cases project developers can work on initiatives for the government to grant official land titles;

- By understanding the project and its benefits, governments tend to be more inclined to provide authorisation letters (see box 1) which provide reassurance to investors and would be covered by a breach of contract insurance policy;
- By working closely with governments, project developers can better foresee risks and understand the direction of policy;
- Project developers can take an active role in shaping rules and regulations and developing best practices by leveraging examples governments are familiar with.

Box 1: Government letters as a risk mitigation solution

One of the key tools we have seen project developers leverage to mitigate export bans and revocation of carbon rights are government authorisation letters. These letters can provide a guarantee against different risks and we are seeing two major trends:

Authorisation letters carving out the project of the host country's NDC

These authorisations exempt project developers from future policies and regulations that would affect their ability to trade credits under the VCM (i.e. export bans or nationalisation of project types). For example, if the host country decides to ban the export of REDD+ credits under the VCM, the project with an authorisation letter could continue its activities and exporting credits. Whether these letters will hold legal grounds and will be respected by future governments is still to be determined.

Authorisation letter guaranteeing the inclusion of the project under the future Article 6.4 mechanism

The idea of these letters is quite different. It is betting on the fact that Article 6.4 will be an attractive opportunity and project developers are seeking a letter which will guarantee the inclusion of the project under the future mechanism, to be traded with corresponding adjustments.

The Chyulu Hills REDD+ project in Kenya is an excellent example of project developer, community and government partnership.



Image provided by Conservation International

CASE STUDY: Chyulu Hills REDD+ in Kenya

The Chyulu Hills REDD+ Project (CHRP) is a multi-partner initiative designed to promote climate change mitigation and adaptation, restore biodiversity and create alternative livelihoods under the United Nations scheme of Reducing Emissions from Deforestation and forest Degradation (REDD+). It is located in the Tsavo-Amboseli ecosystem in Southeastern Kenya and stretches over an area of 410,533.84 hectares.

The Chyulu Hills region, which provides water for nearby communities, livestock and wildlife, has seen deforestation driven largely by slash-and-burn agriculture and charcoal burning for fuelwood. For the past seven years, local communities, the Maasai Wilderness Conservation Trust (MWCT), the private sector and other partners have teamed up with Conservation International to protect and restore the forests and grasslands of this critical landscape.

The CHRP is focused on generating benefits in the areas of climate, community and biodiversity under the Verified Carbon Standard (VCS) and the Climate, Community and Biodiversity (CCB) standards. Its specific climate-related goals are to prevent the emission of 28,122,572 tCO₂e over the Project's 30-year crediting period by stopping deforestation, forest degradation and grassland conversion. The intervention to address the drivers of change within the project area has been clustered into four REDD+ project components: (1) Forest and Wildlife Protection, (2) Livestock and Range Management, (3) Community Engagement and (4) Support and Reforestation and Improved Agriculture

The successes of the project have mainly been achieved by creating alternative income restoration of degraded landscapes, increasing employment

opportunities, and supporting stricter environmental law enforcement among other collaborative actions. Additional programs towards food security, improving health and education facilities, and raising environmental awareness have been implemented. The project will also deliver a suite of biodiversity co-benefits through greater protection of the expansive Chyulu landscape by increasing security, improved monitoring and bolstering wildlife-compensation schemes.

The CHRP's uniqueness lies in its nine constituent partners, each of which contributes specific and invaluable expertise. The nine constituent partners include: Kenya Forest Service, Kenya Wildlife Service, four Maasai Group Ranches (Kuku, Kuku A, Rombo and Imbirikani) and three local NGOs (Maasai Wilderness Conservation Trust, Big Life and Sheldrick Wildlife Trust).

The governance structure of the project is through The Chyulu Hills Conservation Trust (CHCT) in which each of the nine partners has appointed a board member. This unique partnership formed of public, private sector and local community institutions has received global recognition, good ratings from formal audit reviews by the external validators and verifiers and the buyers. Overall, effective collaboration between governments, private sector and communities in the CHRP can be attributed to strong communication, transparency, and inclusiveness, as well as a commitment to shared goals and benefits by all the partners involved. Read more about the project [here](#).

Case study by George Tarus, Member of Technical Advisory Committee, Plan Vivo

2. The emergence of VCM-specific insurance policies

In 2022, we saw the emergence of VCM-specific insurance with insurance provider Howden and investment firm Respira [launching a policy](#) protecting a buyer in the event of carbon credit invalidation due to fraud or negligence by the project developer. In January of 2023, Kita and Chaucer introduced the [first insurance policy](#) protecting buyers of forward-purchased carbon credits against delivery risk.

We see the development of insurance policies focused on carbon market specific risks as a key growth factor for the VCM. As part of writing this report, we spoke to some key insurance providers about their plans to develop insurance products for the VCM, including MIGA, AON, Howden and Kita.

Box 2: What insurance policies to expect in 2023 and beyond?

1. Policy and political risk insurance: We expect a pioneering policy focused on land expropriation, government breach of contract and revocation of carbon rights to be announced in early 2023. Other policies in development focus on more traditional political risks such as violence or coups.

2. Warranty insurance for VCM transactions: This policy would provide buyers undertaking forward purchase agreements insurance over specific warranties. For example, this could be used if a project hasn't yet gone through a verification process. Given that some project developers may not be able to provide enough collateral, this kind of insurance product would provide additional recourse to buyers. We don't yet have an expected timeline for this type of instrument.

3. Parametric insurance: Parametric insurance describes a type of insurance contract that insures a policyholder against the occurrence of a specific natural event by paying a set amount based on the magnitude of the event, as opposed to the magnitude of the losses in a traditional indemnity policy. An example is a policy that pays \$100,000 if an earthquake with magnitude 5.0 or greater occurs. This would be mainly targeted towards project developers. We don't yet have an expected timeline for this type of instrument.

CASE STUDY:

MIGA as a provider of political risk insurance (PRI) in carbon markets

As part of the development of this paper, we engaged with the Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group. MIGA provides guarantees against non-commercial risks such as currency transfer restrictions, expropriation, breach of contract, and war and civil disturbance.

In 2006, MIGA launched the guarantee for a Clean Development Mechanism project in El Salvador, focused on converting methane gases to less harmful carbon dioxide at a landfill. MIGA supported the project by providing approx. US\$2mn in guarantee coverage (insurance) to Canadian company Biothermica Energy. The guarantee covered the risks of expropriation, war and civil disturbance, and breach of contract, including the breach of the Salvadoran government's commitments under a letter of approval for the carbon emission reductions under the Clean Development Mechanism of the Kyoto Protocol.

How do MIGA's current products apply to carbon projects?

Today, MIGA offers various guarantee products. Although they don't cover all the policy risks we present in this paper, their guarantees do offer relevant coverage, especially when policies and regulations already exist.

1. Breach of contract

MIGA's breach of contract guarantee provides protection against losses arising from a government's breach or repudiation of a contract with an investor. In case of a breach or repudiation, an investor invokes a dispute resolution mechanism (such as an arbitration) set out in the underlying contract. If, after a specified period, the investor is unable to obtain an award because of the government's interference with the dispute resolution mechanism (denial of recourse), or has obtained an award but not received payment (non-payment of an award), MIGA would pay compensation. This

guarantee can be relevant for risks such as a revocation or dispute over carbon rights emerges and export bans. Nonetheless, this guarantee can only be used if a contract is in place between the project developer and a government body explicitly stating who owns the carbon rights or that the project won't be prevented from exporting carbon credits.

2. Expropriation

Expropriation refers to the act of a government taking ownership or control of an investment, without compensation or with inadequate compensation. MIGA's expropriation guarantee provides compensation for losses resulting from expropriatory government actions, including direct and indirect expropriation. While this guarantee may be appropriate if there is a risk of land expropriation, in most cases it may not currently specific cover carbon rights expropriation or revocation. As laws and regulations relating to carbon rights in various countries evolve, this cover may become more relevant.

3. War and civil disturbance

MIGA's war and civil disturbance guarantee protects against losses due to war, civil unrest, and related perils. This includes coverage for losses resulting from armed conflict, revolution, insurgency, coups, and other acts of civil disturbance. This guarantee can be a useful tool to leverage if the political instability risk level is quite high.

What products is MIGA focusing on in a post-Paris era?

Although MIGA's current guarantees do cover some of the risks that carbon projects face today, they don't cover all political risks which may adversely affect carbon projects. MIGA is currently looking at further ways to adapt or tailor its products to carbon markets, including for investor risks related to revocation of Article 6 authorizations. If you would like to know more, get in touch.

3. Risk sharing through blended finance

Investments in carbon projects can be too risky for private finance, especially in host countries which have little to no track record in hosting VCM projects. Blended finance, which combines philanthropic or concessional public funds with commercial funds, can be a powerful means of rebalancing risks and enabling investment.

There are different definitions of blended finance and for the purposes of this paper, we use the OECD definition “blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries.”

By blending public and private funds, blended finance can provide a more favourable risk-return profile for private investors, reducing the risk of investment and increasing the likelihood of success. Examples of blended finance mechanisms include government subsidies, grants, first-loss guarantees, and risk-sharing facilities. Governments and nonprofits can decrease the perceived risks and encourage private sector investment in landscape projects by participating in a blended finance structure or a technical assistance facility.



Image by Joel Vodell
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CASE STUDY: Althelia Climate Fund

Image by Vlad Hilitanu
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The Althelia Climate Fund 1 (now called the Mirova Climate Fund) was established in 2013 as one of the first dedicated funds aimed at addressing climate change through blended finance. The Fund, created by Althelia Ecosphere, was an 8-year investment fund that focused on projects that follow a landscape approach in Africa, Asia, and Latin America. It distinguished itself by generating income from both sustainable commodities (e.g. agroforestry cocoa without deforestation) and ecosystem services (e.g. carbon). This is a unique feature, as most funds only focus on one source of income from the landscape. To mitigate some of the perceived risks of this new strategy, the fund had a 50% portfolio guarantee from USAID. It received investments from AXA, the Church of Sweden, and various Development Finance Institutions.⁶

The Althelia Climate Fund worked on a shared loss guarantee. The fund invested in projects that make income from sustainable commodities and ecosystem services, which presents an attractive risk-reward profile but is also considered untested. To mitigate the risk, USAID offered a 10-year, \$133.8 million loan portfolio guarantee covering 50% of Althelia's investment risk, including carbon price fluctuations and project implementation challenges, which helped attract other investors such as Credit Suisse and various family offices. USAID used these partial guarantees through its Development Credit Authority to mobilise financing in developing countries and had a low cumulative default rate of 1.85% for its supported loans, while mobilising up to \$3.1 billion in private local funds. USAID had also provided a similar guarantee for Althelia's Sustainable Oceans Fund.

The Althelia Climate Fund's success using a 50% portfolio guarantee from USAID to attract private investment shows the effectiveness of this tool. The small chance of the guarantee being used provides assurance to investors, and it is particularly valuable for a first-time fund manager, reducing some perceived risks. A first-loss guarantee can be a more attractive option for private investors, reducing risk on the fund's return profile.

Despite the clear potential of the fund, it faced several challenges in its implementation. One of the main challenges was attracting sufficient private investment to support the fund's goals. This was partly due to the perceived risks associated with investing in the sustainable land use and forestry sector, as well as the limited awareness of the investment opportunities in this area. Another challenge was the difficulty of integrating the social and environmental goals of the fund with traditional financial considerations. This required a significant effort to develop new investment products and approaches that could balance the need for financial returns with the social and environmental impact goals of the fund.

Despite these challenges, The Althelia Climate Fund 1 demonstrated the feasibility of blended finance in the sustainable land use and forestry sector and helped to attract new investment into this area. As the development community continues to explore the use of blended finance to address complex development challenges, the fund provides valuable insights and lessons for future efforts in this area.

⁶ <https://www.blendedfinance.earth/blended-finance-funds/2020/11/16/amazon-biodiversity-fund>

Conclusions & Acknowledgements

As governments develop their climate strategies and laws, carbon market stakeholders face an unprecedented level of uncertainty. Will governments choose to restrict the role of the VCM and limit the export of carbon credits? Or will they embed it into their carbon trading plans and simply regulate it? These are some of the key questions investors and companies looking to support carbon projects face today.

Despite many governments being in the early stages of development of defining the roles of carbon trading in meeting their NDCs, this paper demonstrates that with access to the right sources of information, it is possible to assess policy and regulatory risks and make informed investment decisions. When the risks are high, we highlight the role that different mitigation approaches can provide, from closely collaborating with governments to leveraging insurance products or blended finance.

Given the impact policy can have on carbon projects, Abatable is working on assessing and continuously monitoring national policy and regulatory developments. If you would like to collaborate or learn more, [do get in touch!](#)

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Carbon market vocabulary

Word / phrase	Meaning
Carbon credit	A carbon credit is a tradable certificate or unit. A carbon credit represents GHG emission avoidance, reduction or removal of one tonne of carbon dioxide equivalent from the atmosphere. Carbon credits are often referred to as carbon offsets.
Carbon project	A carbon project refers to a project contributing to reducing or removing carbon dioxide equivalent, which leverages carbon credits as a financial mechanism.
Carbon offsetting or offsetting	Carbon offsetting or simply “offsetting” refers to an organisation purchasing carbon credits to counterbalance their emissions. The expected minimum requirement is that offsetting is done in addition to credible value chain mitigation.
Climate contribution or mitigation contribution	Climate contribution or mitigation contribution refers to an organisation purchasing carbon credits to make a “contribution” claim, meaning that the credits will not go towards achieving a carbon neutral or net zero.
Voluntary carbon market or VCM	The voluntary carbon market is a global market-based mechanism where private actors voluntarily buy and sell carbon credits that represent removals or reductions of carbon dioxide equivalent from the atmosphere. It is referred to in this paper as the VCM.
Project developer or developer	A project developer is an NGO, social enterprise or private, for-profit entity that develops projects to avoid, reduce and remove GHG emissions (measured in carbon dioxide equivalent) from the atmosphere.

Crediting mechanism	A crediting mechanism refers to the system under which a carbon project is registered. It implies following that system’s requirements, crediting guidelines and methodologies to issue carbon credits. They include voluntary registries such as Verra, Gold Standard, Plan Vivo and UN mechanisms like the Clean Development Mechanism and the future Article 6.4 mechanism or local offset mechanisms such as in Alberta (Canada) and California (USA).
Carbon methodology	A carbon methodology refers to requirements each project developer must follow to have their projects registered and validated to issue credits. Hundreds of methodologies with different stringency levels, and are associated with different project types exist currently.
Nationally Determined Contribution or NDC	A Nationally Determined Contribution (NDC) is a national climate action plan to cut emissions and adapt to climate impacts. Each country “Party” to the Paris Agreement is required to establish an NDC and update it every five years. NDCs are not legally binding unless they are transposed into national law.
Corresponding adjustment or CA	A corresponding adjustment is a carbon accounting mechanism by which, when a credit is internationally transferred to another country or other entity to be used in meeting a mitigation pledge, it must be discounted from the host country’s NDC and carbon accounting registries.
Host country	Refers to the country where a carbon project is located.
REDD+	REDD stands for “Reducing Emissions from Deforestation and forest Degradation”; the “+” signifies the role of conservation, sustainable management of forests and enhancement of forest carbon stocks. REDD+ is a framework created by the UNFCCC.