

A scenic landscape photograph showing a wide river in the foreground, a dense green forest along the banks, and a range of jagged mountains in the background partially obscured by white mist or clouds. The sky is a clear, pale blue.

# Revolving Seed Capital Fund for Carbon Projects

A financial vehicle to catalyze the development  
of nature-based solution projects

Given the urgent challenge of preventing the increase in global warming and the loss of our biodiversity, voluntary carbon markets (VCM) are emerging as a trading mechanism to reduce or avoid the emission of greenhouse gasses. In 2022 the turnover in the VCM reached ~USD 2 billion and was projected to expand to ~USD 100 billion by 2030<sup>1</sup>.

However, recent controversies regarding its effectiveness have negatively affected the VCM, leading to price fluctuations and devaluations. Several carbon projects have been questioned about the legitimacy of their impact and the real benefit they provide to local stakeholders living in their territories<sup>2</sup>.

In order to restore the confidence in the VCM, several initiatives have been implemented from the offer and the demand side of credits. The Integrity Council for the Voluntary Carbon Market (ICVCM) has published the "Core Carbon Principles (CCP) and Assessment Framework", focused on guaranteeing a high integrity<sup>3</sup> credit standard, which will function as an additional label to the current standards. On the demand side, the Voluntary Carbon Markets Integrity Initiative (VCMI) has published the "Claims Code of Practice" for the corporate sector, which seeks to ensure integrity through specific rules on how to communicate and use high quality credits in the process of "carbon neutrality"<sup>4</sup>.

Peru has an enormous potential to develop carbon projects, mainly Nature Based Solutions (NBS). We are the fourth country with the highest tropical forest cover on the planet and we have a high level of biodiversity. Among the countries of Latin America and the Caribbean (LAC), Brazil has the largest volume of carbon credit emissions in circulation in the region, representing 41.9%, followed by Peru (30.5%), Colombia (7.7%) and Chile (1.6%). Of the total volume emitted in the world, LAC only represents 18.1%<sup>5</sup>.

Of the total volume of credits issued in Peru, 78.2% are NBS, out of which 66.9% are emission avoidance projects and 11.3% are carbon removal projects. NBS projects take advantage of the capacity of ecosystems to absorb atmospheric carbon through forest conservation, reforestation initiatives, wetland restoration, agroforestry practices, and coastal and marine projects.

Despite the existing potential, the Peruvian carbon market consists of a few highly specialized actors that have been promoting initiatives for approximately 20 years. The design and implementation of a project for the emission of carbon credits is complex. It requires a lot of technical knowledge, capital or external investors and collaboration with a diversity of stakeholders during long-term projects.

## Identified challenges in the peruvian ecosystem

<sup>1</sup> Morgan Stanley Research, "Carbon Offsets: Rapid Growth and Product Evolution", February 2023

<sup>2</sup> MCV critic articles: The Guardian, "Revealed: top carbon offset projects may not cut planet-heating emissions", September 2023; The New Yorker, "The Great Cash-for-Carbon Hustle", October 2023

<sup>3</sup> <https://icvcm.org/the-core-carbon-principles/>

<sup>4</sup> <https://vcminegrity.org/vcmi-claims-code-of-practice>

<sup>5</sup> CAF, "Observatorio de la Iniciativa Latinoamericana y del Caribe para el Mercado de Carbono - ILACC", Newsletter N° 1, July 2023

To understand the main challenges in the Peruvian voluntary carbon market ecosystem, Profonanpe has conducted various interviews with its key stakeholders: project developers, government agencies, investors, corporate credit buyers, and international brokers.

On the supply side, the principal challenge mentioned by project developers has been access to financing over the years, as well as the process of selling credits, affected by market price fluctuations. Delays in regulatory framework adjustments are also mentioned.

On the demand side, the main challenges for international buyers are compliance with social and environmental safeguards related to carbon projects and the lack of transparency in the market.

## Diagnóstico del Mercado de Carbono Voluntario Peruano

	DESARROLLADORES DE PROYECTOS	GOBIERNO	COMPRADORES CORPORATIVOS	OTROS
Entrevistas con actores del ecosistema para entender los principales retos				
Otros actores relevantes por entrevistar*				
Principales conclusiones	<b>OFERTA</b> <ul style="list-style-type: none"> <li>- Acceso a <b>financiamiento</b></li> <li>- Colocación y <b>venta de créditos</b> emitidos</li> <li>- Riesgo asociado a la <b>fluctuación en los precios</b> del mercado</li> <li>- Demoras en la definición del <b>marco regulatorio</b></li> </ul>		<b>DEMANDA</b> <ul style="list-style-type: none"> <li>- No se encuentran créditos en el mercado spot que <b>cumplan con salvaguardas sociales y ambientales</b> (por Ej. estándares de CORSIA)</li> <li>- Poca <b>transparencia</b> en el mercado sobre características de <b>desarrolladores</b> y proyectos <b>en desarrollo</b></li> </ul>	

\*Análisis no identifica al 100% de actores relevantes.

### Potential benefits of Carbon Projects

Carbon projects can bring multiple social, environmental, and economic benefits to the areas where they are implemented, beyond the carbon reduction or capture they generate<sup>6</sup>:

- They can contribute to the protection of biodiversity.
- They can benefit local and indigenous stakeholders and create access to sustainable employment.
- They can improve people's health by reducing local pollution.
- They represent a mechanism for mobilizing capital to the Global South, where there is a significant amount of natural capital with many options for developing Nature-Based Solutions.
- They provide an opportunity to pivot and scale new climate technologies, thereby reducing their cost and facilitating large-scale implementation.

<sup>6</sup> City of London, UK Voluntary Carbon Markets Forum, "The future of Voluntary Carbon Markets", May 2022

In this context, Profonanpe aims to contribute to the healthy development of the carbon ecosystem, promoting the design and implementation of projects that meet the high social and environmental standards being defined internationally, and contributing to generating the credit supply that the Voluntary Carbon Market (VCM) needs. Additionally, Profonanpe seeks to encourage the development and implementation of Nature-Based Solutions projects that support creating an innovative ecosystem based on science and technology to reduce global warming and biodiversity loss while caring for nature.

### **Revolving Seed Capital Fund for carbon projects**

Profonanpe is designing a seed capital fund for the financing of carbon projects, which will contribute to invigorate the NBS sector through access to capital and the design of high social and environmental standards.

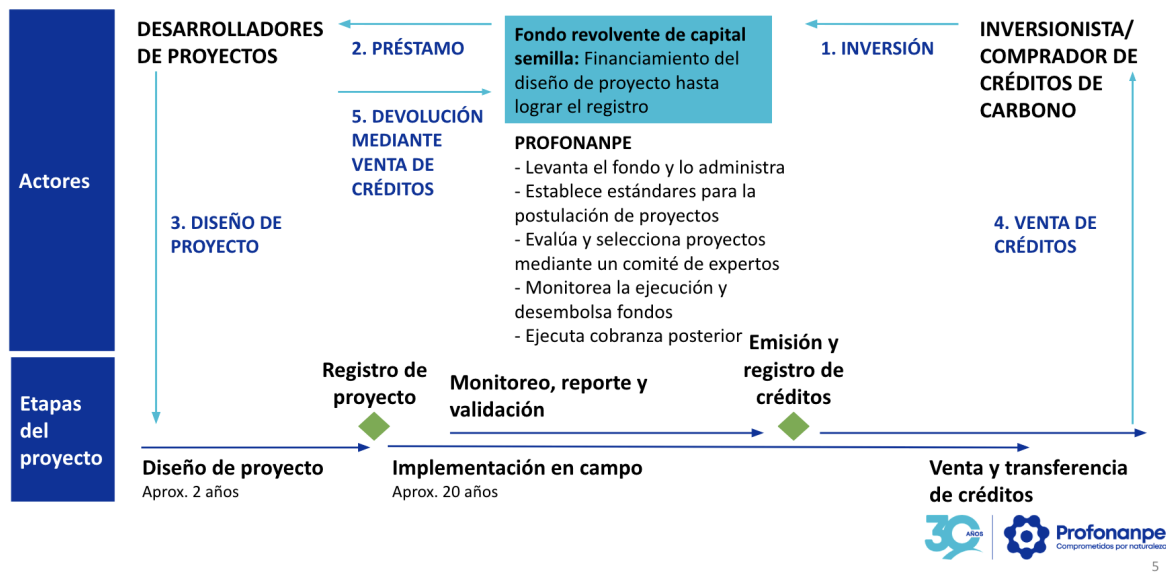
Profonanpe raises, manages and invests funds from private investors through a financial vehicle. This vehicle operates as a revolving seed capital fund, financing the initial stages (feasibility design) of NBS carbon projects for voluntary markets. Funded developers must (i) meet the highest environmental standards, (ii) involve local/indigenous stakeholders as partners in project design and implementation, and (iii) repay any amounts received by the fund through the sale of credits to Profonanpe investors or third parties, at least at market value.

This fund creates a mechanism capable of financing long-term projects, overseeing processes that promote good social and environmental practices, and generating carbon credits that meet the standards required by the REDD+ Amazon Indigenous REDD+ (RIA<sup>7</sup>) guidelines and the international private sector. It also provides incentives for the development of new NBS carbon projects, such as agroforestry, soil carbon and blue carbon.

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<sup>7</sup> RIA is a model that seeks to incorporate territories, peoples, and indigenous organizations in REDD+ initiatives in a fair and culturally appropriate manner, respecting their traditional and ancestral knowledge. It operates in Peru, Colombia, Brazil, and Ecuador.

# 1 Fondo revolvente de capital semilla para proyectos de carbono basados en Soluciones de Naturaleza



## Roles and responsibilities of involved actors:

### Profonanpe

- Raises the fund and manages it.
- Defines investment conditions and associated benefits for investors.
- Launches calls for the submission of Nature-Based Carbon Projects for financing at the design stage through a debt mechanism. Calls may be based on project type as well as the design of initiatives for a specific territory.
- Defines project requirements to access financing, with the aim of meeting the highest environmental and social standards in the market.
- Establishes guidelines regarding the methodology for distributing benefits and responsibilities within projects.
- Provides recommendations in terms of legal and tax design for project management. May assume the role of a fiduciary manager in cases convenient for the involved parties.
- Sets up an external expert committee that selects projects eligible for financing.
- Monitors the execution of the design process and disburses funds according to defined milestones.
- Handles the collection of the granted credit once the project begins issuing credits.
- Creates a "blacklist" for developers/actors who do not comply with the agreements established in the fund.

### Investor/Credit buyer

- Investors allocate resources to the seed capital fund to gain the right of first option for purchasing credits generated by funded projects.
- They share their evaluation criteria/standards applied in the credit purchase process, allowing Profonanpe to incorporate these requirements into the design of calls for proposals.

- Investors have the right to be informed about the progress in the design process of funded projects.

### **Project Developer**

- Project developers participate voluntarily in the call formulation process, contributing their knowledge and experience.
- They submit proposals to calls launched by Profonanpe. The projects presented must meet the requirements specified in the calls. The submitted proposal should include a work plan and specific milestones.
- They commit to designing the project involving local/indigenous actors as allies.
- They commit to using the funds received for the design of the selected project.
- They commit to informing Profonanpe about progress in the design process, the successful project registration, and credit sales processes.
- They commit to granting the first option to purchase issued credits to fund investors, as agreed.
- Commits to comply with the benefit-sharing mechanism designed at the design stage throughout the operation of the project.

### **Local/indigenous stakeholders**

- Local/indigenous stakeholders voluntarily participate in the process of formulating calls for proposals, contributing with their knowledge and experience.
- They share their criteria and standards that apply to the process of project design and implementation (e.g. RIA), so that Profonanpe can include these requirements in the design of the calls for proposals.
- In many cases they have the rights (not formalized) over the issuance of credits in specific territories.
- They are important actors in the implementation of carbon projects and should act as allies in the project design process.
- They can apply for project financing.
- They are responsible for designing processes that guarantee the distribution of responsibilities and benefits among the people in their communities.