OPIC Risk Insurance REDD in Cambodia

Project background

The private U.S. investment firm Terra Global Capital has teamed up with Cambodia's Forestry Administration and Pact Cambodia (an international non-profit development organization) to conduct Cambodia's first ever Reduced Emissions from Deforestation and Degradation (REDD) project in the Oddar Meanchey Province.

The project claims that the project will help to avoid deforestation over a 30 year period, conserving 64,318 hectares of forests. Terra Global Capital seeks to generate forest carbon credits based on this claim, and these will be the main source of revenue for the project.

Project Financing

Start-up funding for the project was provided by DANIDA (Denmark), NZAid (New Zealand) and DfID (U.K). Funding for implementing the project is provided by Terra Global, Clinton Foundation, United Nations Development Programme (UNDP), Japan International Cooperation Agency (JICA) and Pact. The project will be implemented by the Forestry Administration of the Royal Government of Cambodia, Pact, Terra Global Capital, Children's Development Association (CDA) and the communities of the Oddar Meanchey province.

Forest carbon credits generated by the project will be issued on the voluntary carbon market, meaning they are unregulated by the UN or other public bodies. The Oddar Meanchey project is operating according to the Climate, Community and Biodiversity (CCB) standard, and the Voluntary Carbon Standard (VCS), which are self-regulated by the offset industry. The project has contracted SCS Global Services to "verify" (audit) its carbon reduction claims, in response to which carbon credits will be issued. No credits have yet been issued.

OPIC risk insurance

In November 2011, a U.S. Government agency, the Overseas Private Investment Corporation (OPIC), provided US$900,000 in political risk insurance for Terra Global Capital, the private investor in the project. OPIC's support for Terra Global Capital is the world's first political risk insurance coverage for a REDD project.

OPIC political risk insurance protects US investors against various possibilities, including war, civil strife, coups, terrorism and other politically motivated violence, as well as host government interference such as expropriation, abrogation, repudiation and/or impairment of contracts, and restrictions on the conversion and transfer of local currency earnings.

Terra Global Capital is particularly concerned about potential regulatory action by the government that could harm its investment, including national regulations that could change the way that REDD targets are currently measured and preventing existing projects like this one from earning carbon credits.

Terra Global Capital pays an insurance premium to OPIC. The exact amount is not disclosed, and varies widely according to country and the extent of the coverage. OPIC's published indicative rates suggest a figure of $0.40 to $0.75 annually per $100 coverage for asset protection, and quotes similar amounts for political violence, inconvertibility and expropriation. The actual figure could be as low as $3500 for this project, or over $20,000 per year if Terra Global has broader coverage.

For a company like Terra Global Capital, the potential advantage of taking out political risk insurance is that it can significantly reduce the project's overall "cost of capital," the interest rate at which they borrow money from a bank or other lender. Investors can recoup up to 90 per cent of the value of their investment from OPIC in the case of successful claims.

Misuse of risk insurance

REDD projects claim to curb deforestation and forest degradation, resulting in avoided carbon emissions for which they are awarded carbon credits (often referred to as "offsets") that can be sold on carbon markets. In order for any forest protecting activity to be awarded carbon credits, project proponents must show that without the activity and the carbon income, the forest would not have been protected (e.g. nothing else was going to save those hectares of trees).

If Cambodia's national laws about deforestation and forest degradation change in a way that protects forest in Oddar Meanchey Province – then the Terra Global Capital project is no longer the activity responsible for saving the trees. Thus, the project is no longer eligible to earn (and sell) carbon credits.

OPIC's use of political risk insurance to protect against the rightful application of national forest protection regulations turns the concept of political risk insurance on its head, and suggests, inexplicably, that the U.S. Government is providing insurance against other countries fulfilling their future international climate obligations.

What's more, OPIC states that it and other branches of the U.S. Government intervene to pressure host governments to prevent or remedy what the agency views as actions triggering the political risk insurance policy. OPIC's political risk insurance for Terra Global could therefore result in the U.S. Government pressuring Cambodia to drop or weaken forest protection regulations that the country has the right to establish to meet international climate change regulatory obligations and to access compliance carbon markets.

Who's risks are mitigated?

Forest carbon offset projects have a number of fundamental flaws associated with them, but in the case of Oddar Meanchey, it was the local government's lack of action that spurred two private buyers ready to spend nearly $1 million on the first batch of carbon credits to pull out. According to a June report, Pact has been paying the community forest groups that patrolling the project area to discourage logging and encroachment with funds from donors. But funds are getting harder to come by the longer the project goes without commercial buyers.

Another problem facing Terra Global Capital's investment is that carbon credits would have to sell for more than $15 per ton to compete with the likely revenue from growing sugarcane on the land instead, or even higher if it were used to harvest rubber. By contrast, the going price for voluntary forest carbon credits is roughly $5 per ton.

Terra Global Capital projects a 25 – 30 percent return to its investors. Since voluntary carbon markets are tiny and compliance carbon markets are in shambles, how can Terra Global Capital generate revenue flows sufficient to deliver such generous returns to investors, while still providing adequate revenues to fulfill income allocation agreements and to otherwise support project implementers and beneficiaries? This suggests that if a potential struggle ensues between investors and project beneficiaries over revenue sharing, there could be a situation in which there insufficient financial incentives pass along to local villagers. If the revenue stream for conservation never materializes, there is little incentive (or room for the financial luxury) to keep trees standing. There are continuing reports of land disputes and illegal logging (including by the military) in the area of the project.

A referenced text is available at www.climatemarkets.org