Kyoto Protocol: Some Provisions Too Vague

The UNEP Insurance Industry Initiative for the Environment recently presented its report to a meeting of financial services executives in Oslo, Norway. The Initiative was established jointly by insurance firms and UNEP in 1997, with the goal of examining the implications of climate change and exploring new, environmentally sound ways of managing financial assets.

The report warned that the industry's ability to play a facilitating role in meeting Kyoto Protocol greenhouse gas emission reduction targets will be hampered as long as the Protocol's provisions on emissions trading and other market-based mechanisms remain vague.

It states that the mechanisms introduced to help in achieving emission reductions "are not well enough defined to assess the viability and commercial interest of the insurance industry in covering related risks."

The report notes that the impact of climate change is of particular concern to insurers because of the potential adverse effects it may have on health, property, and life insurance coverage. Computer simulations already project that a single major storm in certain areas of the United States could result in US$100 billion in damages.

The insurance industry, according to the report, has the skills to provide effective assessment and quantification of risk that might be crucial in implementing the three flexible market mechanisms under the Kyoto Protocol – joint implementation, emissions trading and the Clean Development Mechanism (CDM). But to improve the viability and credibility of such projects, observable emission baselines need to be developed and independent verification of emissions credits must be established.

Emissions trading – which permits individual governments to trade emission credits with the intention of meeting the Kyoto Protocol reduction targets – is "the most uncertain setting from the viewpoint of commercial insurance", the report notes. It goes on to say that the long time scales required for international verification procedures and the scale of the related political risk would seem to render this an inappropriate area for commercial insurance at present.

The liability conditions for emissions trading was seen as another major obstacle. Under the Kyoto Protocol, a seller of emission credits must prove that it does not require the surplus credits to meet its reduction obligations. However, monitoring schemes and other measures to deal with non-compliance of this provision are still absent, which creates considerable political risk and hinders the participation of the insurance industry.

The group notes, however, that an emissions trading scheme based on the concept of buyers' liability or joint liability could encourage the use of securitization techniques that are currently offered by the financial services industry. ❐