

No future for mitigating climate change? Implementing Kyoto-Mechanisms-Contributions by the Financial Services Industry

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[notes of the tape-recorded minutes]

Ladies and Gentlemen,

With the concept of sustainable development, a new paradigm emerged which gave rise to hope for re-integration in development theory and development co-operation. This hope was not only based on the suggested integration of economic, socio-cultural and ecological dimensions of development, but also on its universal applicability, thus implying that global divisions could be overcome. The concept of sustainability is still far away from being "main stream" within the Financial Sector. There is an important risk, that pure shareholder value overcomes at any time the tripple bottom line.

Sustainable Development in the Financial Services Industry has still to prove that sustainable strategies and value creation are not contradictory: Sustainable strategies lead to an increase of reputation, innovative capacity and better awareness of stakeholders' and customers' perceptions and needs. They also contribute to gain in efficiency and reduce risks.

Mitigating Syndromes of Global Change is key for mitigating climate change:

The point of departure for the integrative efforts is the assumption which postulates that there are a multitude of environmental, socio-political, socio-economic and technical development problems which are particularly affecting developing and transition countries (the "South"). These problems occur in many different contexts and have tremendously accelerated during the 20th. Century. They are not independent of each other, but are closely interrelated and appear in specific combinations depending on the concrete situation. This clustering of problems can be expressed by the term "syndrome of global change. This basic assumption of clustered problems further implies that strategies attempting to mitigate syndromes can not be found by focusing on single problems, but by developing approaches which address the specific clusters and interrelations of development problems in an integrated way. Although many syndromes of global change are found in developing and transition countries, they may be caused by processes induced by the industrialised world. In these countries, many core problems are further aggravated by prevailing poverty, as well as by economic and institutional weakness. The majority of the world's population is thus affected by syndromes of global change. Local core problems, in turn, have global impacts, with an immediate relevance to the industrialised countries ("The North").

In relation to sustainability research relying on the syndrome approach has concentrated on developing indicators of sustainability and analysing their spatial and temporal variation. This focus is a response to one of the key demands which research is expected to fulfil, as formulated at the Rio Summit 1992. However, the most recent debates on sustainability and on the difficulties of concretising and implementing sustainability have highlighted how important it is to take account of the normative dimension of this meta-concept and drawn attention to the methodological implications. In particular, it was pointed out that the question of who - i.e. what part of society- sets the norms for sustainability is crucial and must therefore be considered by any approach to sustainability. If this normative dimension is not explicitly dealt with, goals of sustainability will inevitably be defined by the more powerful stakeholders - at global level e.g. "The North". This indicates that further productive debates on the syndrome concept and its relevance to sustainable development could be pursued by incorporating perceptions and approaches developed in the social sciences, in particular in political ecology.

Sustainable development poses an important business opportunity for the financial sector in the 21st century. (Economic) environmental and social constraints will increasingly determine the bottom line. The desire to strengthen competitiveness in such a world creates a need for capital, offering investors

and insurance companies a key role. Financial institutions have responded by developing innovative methods of financing sustainable development projects.

"Risk Management has always been a strange animal. It is not recognised as a science, and probably correctly so. There for it is truly inter-disciplinary tool to analyse and understand problems. Risk Managers can be scientist or engineers in charge of industrial plants, managers in charge of the insurance portfolio of a company, investors, military or police officers or managers in charge of security of any installation, concerned both with pure risks and entrepreneurial risks. The 21st century seems to have the reputation of that all problems are global."

What are the insurance and re-insurance solutions to face the challenges of the 21st century:

The research project INTEREST (Insurance, Technological Risk, and Emerging Science and Technology Policies) comprises five organisations from four different Member States of the European Union and from Switzerland. In addition partners are coming from different sectors and hence have a wide range of complementary skills to offer, including risk management, technology assessment, research policy evaluation and sustainable development policies and strategies. The main aim of the INTEREST project is to highlight the role which the insurance sector plays to support innovative projects likely to promote sustainable development and to recommend appropriate ways for accentuating such a role. In view of the great opportunities that sustainable development and new technological progress may offer to the insurance sector, in particular by developing innovative arrangements in which insurance and regulatory mechanisms play complementary roles, members have defined five specific objectives of the project:

1. Identify the past and present role of "insurance" in view of innovation for sustainable development.
2. Identify opportunities for promoting sustainable development through innovation by adjusting or sharing responsibility patterns vis-a-vis risk between private sector actors on the one hand and regulators and policymakers on the other.
3. Establish how and to what extent sustainable development innovation can be promoted using insurance-based methodologies notably in matters of risk management, prevention and management.
4. Establish how and to what extent sustainable development innovation can be promoted by the insurance sector using a wider set of tools, such as technology assessment, to improve it's capacity to manage novel risks.

Escalating demand for energy propels economic development but threatens Earth's climate.

Energy use meets a basic human need, but the environmental impacts of rising energy production and consumption are introducing considerable uncertainty to industries- from oil and gas to reinsurance and agriculture. These uncertainties result from the costs and benefits of climate change. The price of fossil fuels may rise as the market internalizes environmental externalities. In response, proactive businesses are conducting inventories of their operations to reduce energy intensity and greenhouse gas emissions. Some major multinational companies have made voluntary commitments to reduce greenhouse gas emissions and to support markets for trading carbon emission allowances and reduction credits. These commitments are driving new markets in alternative energies, energy conservation services, and energy efficient technologies. INTERERST has clearly shown the need for Technical Performance Achievement (TPA) the insurance solution, a Special Purpose Vehicle (SPV) the re-insurance carrier to promote RES-Direct-investments in Developing Countries.

Global Climate Change

The project: IMKYM-COFIN (Implementing Kyoto Mechanisms-Contributions by Financial Institutions) is at the core of international concerns as discussed in the proceedings international climate change conference under the UNFCCC. The objective of this research and development project - co-financed by the European Commission, Research Directorate-General and the Swiss Federal Office for Education and Science - is to develop innovative financial products that are tailored to meet the needs of participants in emerging greenhouse gas emission markets and prospective users of the Kyoto Mechanisms. Thus, it also aims at exploring how private-sector financial institutions may contribute to effective and efficient implementation of greenhouse gas emission trading systems and the Kyoto Mechanisms

Main components of the project are:

- pricing of emission permits
- private-sector insurance against financial risks associated with the use of Kyoto Mechanisms
- re-optimize project finance techniques
- efficient portfolios of commercial climate protection projects
- private-sector investment funds
- policy recommendations

Let me sum up some first IMKYM-COFIN results:

We formulated greenhouse gas price scenarios for three time segments: 2000-2004 (pre-EU trading system), 2005-2007 (EU trading system), 2008-2012 (1st Kyoto Protocol compliance period). Whether the various uncertainties surrounding the GHG market eventually result in prices that are lower or higher than those predictions, the identification and examination of a broad set of indicators that shed some light on future GHG prices contribute to a better understanding of the bases on which price expectations ought to be constructed.

By developing innovative tools to explore systematically if structuring conventional projects in such a way that they generate additional GHG emissions reductions or emissions credits might be financially viable. Although still under construction the model provides already interesting data about the effects of emissions trading on project cash flows. The outputs possibly might enhance and show a project's profitability and bankability therefore proving financial worthiness of emissions trading to sponsors, financial institutions and policy makers.

The market seems to be too premature for an analysis of the demand for insurance solutions. Most companies cannot estimate the risks associated with the Kyoto Mechanisms and the need for insurance solutions seems to depend on the development of the rules for the mechanisms as well as on market evolution.

However, traditional insurance should likely be adaptable to cover the project-based activities since risks induced by the Kyoto Mechanisms aspects can be an extension of well-known risk and new risks emerging mainly from the legal framework to be established by UNFCCC which is traditionally not covered by insurance

Ladies and Gentleman let me conclude on Global Climate Change and the Financial Services Industry.

Man-made climate change poses a major risk to the global economy. Less developed countries are most vulnerable, but every nation will be affected. The precise effects cannot be predicted, but they include already changing weather patterns and the possibility of a sudden and irreversible step shift in climatic patterns. The experience of the insurance industry shows that already costs from natural disasters are rising swiftly, and that even small changes (less than 10%) in weather events severity will generate multiple increases in that damage.

The greenhouse gases which create this problem are long-lived, so action is urgently needed. To stabilise them at just twice their natural level requires cuts of 60% in current emission levels. The Kyoto Protocol provides a number of valuable financial and regulatory mechanisms for reducing emissions and managing the impacts of climate change. However, the emission cuts within the Protocol are themselves small in scale and can be only a first, but important step.

A long-term international political framework for climate stability is essential. To ensure that all future economic development is sustainable, it must be based on the principles of precaution and equity. Recent studies show that this can be achieved more quickly and with less economic dislocation, by harnessing markets with a skilful blend of policies and measures.

The major market participants (investors, industrial companies, policymakers) can create the conditions for a carbon-light economy now, so that when a global consensus on emissions control is achieved it will rapidly take effect.

The financial sector has a key role to play in delivering effective market solutions to climate change, by working with securities and exchange regulators and other agents, to develop financial markets, improve methodologies, and facilitate transactions. Engaging with other stakeholders (particularly along the business-to-business axis) and supporting products and services that contribute towards adaptation and mitigation efforts are also critical areas, and all could yield significant business opportunities.

A proactive stance by financial institutions will help to reduce the threats, besides providing opportunities. Costs or liabilities arising from changes in government policies or from direct climate impacts like property damage could be very great, but they can be reduced or avoided through collaboration with other stakeholders and by diligent planning.

There are four types of barriers to action by the financial sector: cognitive, political, analytical, and market operational. Many companies and professionals are unaware of the seriousness of the issue, or do not see any financial reasons to tackle it. The delay and disagreements in reaching a clear, durable framework for international and national policy have discouraged financial institutions from early engagement. It is difficult to integrate the climate change issue into financial assessments because there is a general absence of information on corporate emissions and strategies. The often uncertain prospects for alternative energy technologies and the still early state of the emissions markets have deterred investors from participating in these activities.

This leads me to

Threats and opportunities facing the financial services industry

In order to engage the finance and insurance services sector more fully in addressing the climate change issue, policymakers should

- Grasp the urgency of attaining long-term climate stability in accordance with the UNFCCC, reaching consensus on a long-term policy framework for achieving this goal based on the principles of precaution, equity and cost-effectiveness,
- Accelerate the introduction of policies and measures that influence the flow of capital, particularly investment capital from institutional investors, so as to encourage sustainable energy consumption,
- Alert the financial community to the possible economic implications of climate change through awareness raising measures, and
- Involve them in public-private partnerships and in other ways, to ensure that adaptation and mitigation programmes are fully effective.

Roadmap for financial services' participation

- Policymakers have to provide a Basis for the Development of credible strategies, foster improved Corporate Governance and provide greater support for less developed countries.
- Commercial banks should incorporate climate change into business practice and support less developed countries through microfinance to assist the transition to a market-scale economy.
- Insurance companies have to recognize climate change explicitly in product development and should support Flexible Mechanisms by adapting existing insurance products to the particular circumstances of the GHG emissions market. They also should include climate change factors in valuation and asset selection procedures.

Sustainability the day after September/11th.

is much more than environmental performance. Only the balance between economic, environmental and social development - based on global dialogue - will challenge priorities and potentials of our global village. We have lost a lot of time since 1992 in greening discussions and environmental housekeeping ! We have to understand more about the socio-economic and socio-environmental component of sustainable development. If developing countries do not profit - sustainable conflicts between North and South will be the new chapter of Agenda 21. To solve this, the financial services industry has to develop concepts, competencies and connections with regard to political risks and to explore global opportunities in a much broader sense.

Thank you