

Insurance and Risk Management

Introduction

A number of forest owners have entered the Emissions Trading Scheme and have carbon credits – NZUs for sale. The next step is to consider how many credits to sell and whether they should be insured. This Info Sheet introduces some concepts around insuring against the liabilities of selling carbon credits. This sheet should be read in conjunction with Info Sheets 12 – Forest Management and 14 – Risks and Liabilities.

Options

As a Kyoto forest owner, planted post 1989, who is registered and participating in the ETS you are uniquely placed to benefit from the carbon credits (NZUs) issued by the Government. The credits are issued in return for the CO₂ your forest is currently sequestering.

Once you've submitted your return, and received your credits from the Government, the options available to you include;

- a. Doing nothing and the credits being held on your account. This is a safe strategy but is effectively like having cash in the bank earning 0% interest.
- b. Trading your credits – this can be done through a facility offering aggregation services (the pooling of smaller credit holders), or if of sufficient size you can sell your credits direct to an emitter or through a broker.

Under option **b** there are a number of issues you need to consider. We'll briefly discuss two key issues:

- Of the total number of credits received, how many should I sell?
- When do I sell my credits and how do I address the liability I will potentially attract?

How many credits do I sell?

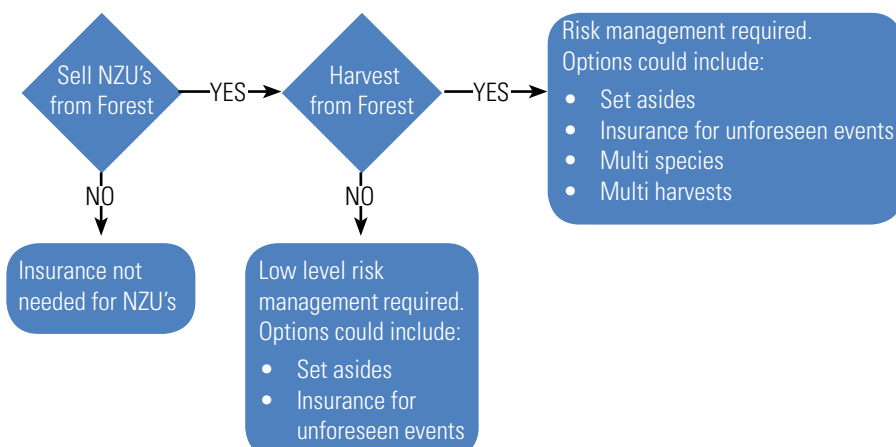
There are many factors to weigh up when deciding how many credits to sell. These cannot be fully discussed here, but you should consider the following factors: The age of the forest, tree species, price of carbon, price of timber, cost of harvesting, land topography, intended future land use and so on. For more detailed advice on forest management contact a registered forestry consultant at www.nzif.org.nz. Info Sheet 14 provides further comments on selling credits, including landowner risk profile and timber vs carbon revenue.

Contents

- Introduction
- Options
- How many credits do I sell?
- Selling credits – Addressing the liability
- Insurance cover provided



CARBON CREDIT (NZU) INSURANCE FLOW DIAGRAM



Selling credits – addressing the liability

When you sell credits you will be required to pay back some or all of those credits to the Government, if carbon stocks reduce. Carbon stocks may reduce through a programmed harvesting and clearing exercise, or following an unforeseen event such as fire, wind, natural disaster etc. An emissions return formula is used to assess your liability to the Government. There are a number of variables which may impact on your liability. Here are two examples:

1. Foresters who have a harvesting programme.

As a forest owner in this category, you are likely to have the credits available for trading significantly reduced through the impacts of harvesting on the carbon cycle. For more information on carbon and harvesting see the Info Sheet 12 – Forest Management.

2. Foresters who do not have a harvesting programme.

As a forest owner under this option, you can weigh up the benefits (financial returns) of trading your credits (within accepted thresholds), or doing nothing.

The projected price for credits in the near future will vary considerably, \$20 to \$95 depending on who you listen to. For example, if you sell 10,000 credits at \$25 for a \$250,000 return on 1 April 2011, then 6 months later a fire destroys 50% of your forest you will be required to pay the Government 5,000 credits. Over this time the market spot rate for credits has since moved to \$35, leaving you to find \$175,000 to buy these units (a net loss of \$50,000 on 5,000 credits).

The solution is to arrange a quality insurance programme to adequately indemnify you for any unforeseen events, so the financial loss can be off-set.

Exactly what risks will be covered by the insurance programme, the deductible applied, and the basis of settlement, are some of the issues that must be understood and agreed prior to signing a contract.

While trading your credits is clearly an opportunity for you to receive income from the land, it is important to understand and build a robust insurance and risk programme to protect your financial exposure. This is an emerging market, and the traditional insurance model for forests will not deliver you the desired result in this new environment.

Insurance Cover Provided

Traditionally, forestry insurers have covered losses arising from fire, this being the principal threat to forests. Cover can also be provided for losses arising from other risks such as; hail, earthquake, windstorm, volcanic eruption etc. Exactly what risks can be covered will vary from property to property, depending on the factors mentioned above (see 'How many units do I sell'). The unique aspect to insuring carbon credits arises when establishing the insured value and basis of settlement. The redemption liability is only one factor to consider. You will also need to gain an understanding of, and obtain prudent advice on, a number of other issues around carbon trading such as re-establishment and loss of future earnings.

Further Reading

Carbon Farming Information Report
www.carbonfarming.org.nz
www.maf.govt.nz/climatechange/reports/forestry-insurance-risk-pooling-mitigation-options/

This info sheet was prepared with the assistance of Sage Partners • www.sagepartners.co.nz