CarbonPool

White paper

In-kind insurance:

Why it's the solution the carbon market needs

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Introduction

People often ask us: Why do you pay your claims in carbon credits? The answer is that **money doesn't make the climate good**; only replacing a carbon removal credit with a carbon removal can do that. That is why CarbonPool insures carbon credits and pays claims in carbon credits ("in kind").[1]

Paying claims in kind is better for the buyer, better for the climate, and better for the carbon markets. **Here's why.**

What buyers really need

For companies seeking to achieve net zero or making a climate claim, for developers and intermediaries delivering carbon removals, and for investors financing carbon removal projects, it is carbon removals—not cash—that they need to meet their objectives and obligations.

All companies have a carbon footprint, and many have set targets to reduce and remove their emissions. There is increasing pressure to act because of tightening regulations, growing stakeholder expectations, and the urgency around accelerating climate change. Companies run an increasing risk if their reduction and removal projects underperform or suffer a reversal.

Traditionally, carbon market participants have protected themselves from this risk by "self-insuring": buyers overbuy, while developers and investors maintain internal buffers.

But this self-insurance approach is inherently inefficient. **Self-insuring is like buying two cars, just in case you crash one: that is, very inefficient.**

Insurance, by contrast, as in other sectors, is more efficient as it mutualizes the risk with other market participants and eliminates the need for each participant to size and build a buffer.

If carbon insurance claims are paid in cash, the insured party must then take the extra step to purchase replacement credits. So, while cash insurance can eliminate the risk of underperformance, it also introduces new risks:

[1] Set to receive insurance and reinsurance license by FINMA in Q4 2024.

- **Firstly, there is market price risk**, as the cash payout may not be sufficient to buy the carbon credits that the buyer requires.

- **Secondly, the right type of credits may simply not be available** when they are needed.

- **Thirdly, cash payments burden the buyer** with investing the time and resources necessary to source the new credits, potentially at short notice.

Enter in-kind insurance. When a claim is paid in similar credits, the customer's real need is met immediately: it gets replacement credits for its shortfall, one for one. **Each ton lost is replaced by one ton removed.** This eliminates both the risk of underperformance and the risk that quality replacement credits may not be available or may be very difficult to source.

Providing continuity for the climate

Insurance payments in cash, as opposed to payments in kind, do not provide timely climate impact. Company decision-making processes are often lengthy, and the cash received might not be quickly, or fully, reinvested into carbon removal efforts. Carbon dioxide is continuously building up in the atmosphere and harming the climate, meaning any delay will have a negative impact.

Conversely, in-kind payments directly mitigate the effect of any re-emitted carbon, or missing carbon removals, with recently sequestered carbon. This keeps up the continuity of efforts to address climate change. **Payment in kind is thus timelier for the client and the climate.**

Benefiting the carbon market as a whole

An in-kind insurer like CarbonPool can help stabilize and improve carbon markets. We protect buyers and investors against key carbon market risks like under-delivery and reversal, we incentivize investments in good carbon projects, we help customers select projects with lower risks, and we invest in projects ourselves. In short, we have a lot of skin in the game. All this promotes market growth and quality initiatives.

This also has several positive effects on the market as a whole.

Bolstering market liquidity

In-kind insurance reduces the need for market participants to hedge against supply, price, shortfall, and reversal risks. This frees up credits for other buyers, and frees up capital to spend, for example, on additional reduction and removal initiatives.

Stabilizing the market

In-kind insurance buffers demand volatility, stabilizing market dynamics. When large claims are paid out in cash, the insured parties are forced to quickly source large spot volumes, which can cause price jumps and reduce liquidity in the market. This does not happen with in-kind insurance, because credits are steadily sourced in advance.

Unlocking project financing

If developers are able to guarantee quantities of carbon credits through in-kind insurance, projects can attract more risk-averse sources of capital and fully unlock the value achieved from long-term offtake agreements. For investors, insurance can make a project meet their underwriting standards by guaranteeing its output, i.e., the number of carbon removals produced.

Giving buyers, the climate, and the market what they need

Insurance has stabilized markets and businesses for centuries, unlocking growth, mitigating risks, providing stability in the short term and investment in the long term. Many will benefit from insurers that pay in kind: companies reducing their carbon footprint, developers and intermediaries delivering the credits, investors in carbon removal projects, and carbon markets as a whole.

In-kind insurers like CarbonPool ultimately enable more and better initiatives to address climate change.