AUSTRALIAN BANKERS' ASSOCIATION INC.

David Bell
Chief Executive Officer

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0401
Facsimile: (02) 8298 0402

26 March 2009

Mr John Hawkins
Committee Secretary, Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
economics.sen@aph.gov.au

Dear Mr Hawkins,

Exposure draft Carbon Pollution Reduction Scheme legislation

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments on the exposure draft Carbon Pollution Reduction Scheme (CPRS) legislation. However, due to the time constraints of this inquiry, we are unable to provide detailed comments on the specific provisions contained in the legislative package.

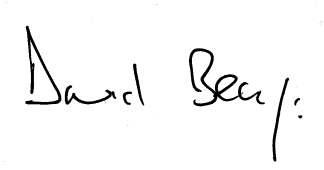
The ABA makes the following observations:

- Many of the areas of particular interest to the banking and finance sector are due to be addressed through regulations or legislative instruments and are currently unspecified.
- The commentary to the exposure draft Bills indicates that the regulation impact statement will be available at the time of introduction. Identifying the impacts and assessing the overall costs and benefits is vital to ensuring better regulation and decision making; minimising unnecessary, inappropriate, unduly burdensome regulation; and reducing the likelihood of unintended consequences.

Notwithstanding, the ABA provides to the Committee our initial views on the legislative package (see attachment). We would be happy to provide more considered comments in due course, and as far as possible, make additional representations to the Committee as part of our review of the exposure draft Bills and response to the Department of Climate Change. We look forward to continuing to work with the Federal Government on the implementation of the CPRS, especially on areas as they impact on the products and services provided by the banking and finance sector and the exchange of emissions units with low transaction costs through an efficient functioning carbon market.

If you have any queries regarding the issues raised in our submission, please contact me or Diane Tate, Director, Financial Services, Corporations, Community on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely



_____

David Bell

Australian Bankers' Association Inc. ARBN 117 262 978
(Incorporated in New South Wales). Liability of members is limited.

Submission on the exposure draft Carbon Pollution Reduction Scheme legislation

26 March 2009

Australian Bankers' Association Inc. ARBN 117 262 978
(Incorporated in New South Wales). Liability of members is limited.

Table of Contents

Submission on the exposure draft Carbon Pollution Reduction Scheme legislation

1. Introduction

Climate change is a global problem that requires a global solution. We believe it is important to encourage the development of a global carbon market, initially through the introduction of the carbon pollution reduction scheme (CPRS) and a carbon market in Australia.

The CPRS will impact on how decisions are made throughout Australia's economy and therefore efforts towards abatement of greenhouse gas emissions (GHGs). We believe it is in the long-term interests of the Australian economy, society and environment to take early action so that Australia can make a smooth transition to a lower carbon economy as well as address the vulnerabilities and take advantage of the opportunities presented by climate change.

The ABA supports the Federal Government's three pillar climate change strategy:

- Reducing Australia's GHGs;
- Adapting to climate change that cannot be avoided; and
- Helping shape a global solution.

Introducing a CPRS administered and regulated by the Federal Government will be an important part of delivering this strategy. The CPRS should provide a transactional space that allows price discovery to occur due to the exchange of units for value. Trading rules and operational arrangements for a carbon market will be required to ensure the exchange of emissions units takes place in a manner which is economically efficient.

It is the ABA's view that the CPRS should:

- Be a policy enabler to ensure that Australia meets its international legal obligations under the Kyoto Protocol.
- Be established around a clearly articulated objective to mitigate the adverse effects of climate change by limiting and reducing the release of GHGs into the atmosphere through a market-based mechanism which places a price on carbon.
- Be developed around a flexible, yet consistent framework, minimising market and policy changes over time, reducing regulatory uncertainty, managing transaction costs, minimising administrative complexities, and thereby encouraging confidence by participants.
- Be bound by uniform rules and be able to facilitate efficient and simple participation. Market efficiency must be supported by solid financial market conventions, trading and operating rules and regulatory and governance arrangements. Unnecessary regulation will adversely impact the efficiency and cost-effectiveness of emissions reductions.
- Improve investment and operational certainty while minimising artificial distortions on the economy and adverse impacts on the environment.

The CPRS should be part of a comprehensive and multifaceted portfolio of policy responses to address climate change and achieve sustainable reductions in GHGs, along with practical strategies that assist businesses, individuals and the community as a whole transition to a future carbon constrained economy. Practical strategies should include investment in and deployment of clean technologies (low to zero emissions technologies) and carbon capture and storage; development and commercialisation of renewable energy technologies and energy efficiency initiatives; implementation of a domestic offset regime and

encouragement of voluntary actions; and development of complementary measures and adaptation responses. We believe market-based approaches are likely to be the most effective and economically efficient way to achieve emissions reductions.

The ABA recognises that the CPRS will impact in different ways on different businesses, individuals and communities. We believe complementary measures should take into account the distributional impacts of structural adjustment and compensation strategies. This should be done in such a way as to limit artificial impacts on the price of carbon. In addition, complementary measures should target potential areas of market failure and address emissions reduction gaps that are not covered by the scheme.

1.1 Role of the banking and finance sector

Participation by the banking and finance sector will be critical to the successful design and implementation of the CPRS and in assisting businesses, individuals and communities shift to a lower emissions economy. Banks and other financial institutions are well placed to develop and deliver the necessary infrastructure and products and services to support the CPRS and assist businesses and households understand their exposures and take appropriate actions.

The banking and finance sector has an important role to play in a number of crucial areas, including:

- Facilitating the trade of carbon assets on the carbon market, including financing the creation and trade of carbon assets;
- Intermediating between private sector participant buyers and sellers and making secondary and forward markets;
- Advising private sector participants on commercial risks and opportunities, including carbon risk management techniques and reduction strategies;
- Investing and providing capital funding for the development of clean technologies, renewable energy technologies and energy efficiency initiatives;
- Lending to private sector participants and individuals; and
- Developing products, services and incentives to support other climate change policies and mitigation and adaptation strategies, including retail products and services.

1.2 Commencement of the scheme and market

The ABA makes a distinction between the CPRS and the carbon market. The CPRS should establish the scheme design parameters and supporting infrastructure as well as provide certainty in emissions reduction targets, trajectories, scheme caps, gateways and thresholds. A carbon market should deliver a credible price signal in a transactional space that enables the exchange of emissions units to entities that place the greatest economic value on them.

The ABA provides comments on the legislative package giving consideration to the impact of the CPRS and a carbon market on the Australian economy as a whole. While we recognise the challenges presented by the global financial crisis and economic and market downturn, we believe that a delay in implementing the CPRS would compromise the effectiveness of the CPRS, create unnecessary uncertainty and additional costs and threaten our ability to mitigate the effects and adapt to the impacts of climate change.

The ABA believes that delaying the introduction of the CPRS will have adverse consequences – that is, uncertainty needs to be minimised through action to establish a price for carbon and how this will impact decisions of businesses and households. A gradual adjustment will allow businesses and households to plan their responses, manage the changes in technology, and take appropriate actions.

Climate change has considerable economic, social, environmental and business risks. Continuing uncertainty is disrupting the efficiency of existing markets as well as creating difficulties with regards to financing terms and investing decisions. Australia needs leadership and early action to provide business, investment and operational certainty. Delays in introducing the CPRS will result in market irregularities, pricing anomalies and a sharper adjustment to meet established emissions reduction targets.

However, climate change also presents considerable opportunities. Trading, product creation and ancillary services (including risk consulting, funds management, legal and accounting) should be developed as export services regionally and globally. The design parameters of the CPRS should keep in mind opportunities for technology advances and international linkages as well as innovation in the financial services industry. Structural inconsistencies, regulatory complexities, unnecessary administrative costs and delay in implementation will disadvantage Australia. It is important for Australia to take action now and take advantage of the opportunity to position itself as a 'carbon hub' within the Asia-Pacific region. Delays in introducing the CPRS will result in infrastructure and skills development opportunities going overseas.

The ABA supports the:

- Introduction of a 'cap and trade' system[1]; and
- Existing timetable for commencement of the CPRS on 1 July 2010.

2. Carbon Pollution Reduction Scheme Bill 2009

The ABA notes that the objectives of the *Carbon Pollution Reduction Scheme Bill 2009* (CPRS Bill) include:

- Give effect to Australia's obligations under the Climate Change Convention and the Kyoto Protocol;
- Support the development of an effective global response to climate change; and
- Take action directed towards meeting Australia's targets of reducing GHGs to 60% below 2000 levels by 2050 and reducing GHGs to between 5% and 15% below 2000 levels by 2020 and to do so in a flexible and cost-effective way.

The ABA supports a scheme that enables Australia to meet emissions reduction targets in the most efficient and cost-effective way as well as provides transitional assistance for the most affected businesses and households. The CPRS should be based on principles that define a solid framework and design an efficient market including economic efficiency, flexibility, tradability, credibility, simplicity, integration and competition.

The ABA is concerned with a number of elements of the CPRS framework including the settings of the price cap, the taxation arrangements applied to emissions units, and the regulation of emissions units. We are also concerned about the timing of the impact analysis and regulatory impact statement, especially with regards to the application and impact of other statutory obligations (including the FSR regime and AML/CTF regime) on the CPRS.

The ABA notes that the legislation does not address the termination of State-based schemes, as foreshadowed by the Government in the CPRS White Paper. The future of other schemes needs to be addressed as the CPRS is introduced, including consideration of transitional arrangements (i.e. whether State-based schemes should be removed and/or harmonised with the national scheme). We believe that further consideration and clarification is required.

The ABA also notes that the legislation does not include details of the Climate Change Action Fund. We support the implementation of the Climate Change Action Fund as a transitional measure designed to encourage individuals to change their behaviour. The Government should set up clear investment and funding guidelines structured around the central criteria of the intent of the Fund, i.e. what it is trying to do and how[1]. It is important that consumers and the community have the information they need to be able to identify the actions they need to take as well as the products, services and tools necessary to take those actions.

While the ABA supports the implementation of the CPRS and a carbon market, there are a number of elements of the CPRS framework and design parameters which are concerning. The broad scope of proposals to apply additional regulation will increase the cost of emissions reductions and will likely have unintended consequences for the operation of the scheme and the efficiency of the market. We are conscious that much of the detail of the operation of the market and the regulation of emissions units will be contained in regulations that will not be available until late 2009 and early 2010.

2.1 Scheme caps and gateways

The ABA notes:

- Scheme caps for the first five years will be prescribed by regulations and made before July 2010.
- Annual scheme caps for future years will be made at least five years before the eligible compliance period[2]. The gateways may be made by regulations.
- Annual scheme caps will reflect a reduction in the quantity of GHGs which is between the upper and lower bound of the scheme gateway. The gateways will provide an indication for long-term cap setting, yet remain flexible to allow adjustments to be made so that emissions reductions meet the national emissions targets.
- The Minister is to make a recommendation on the scheme caps and gateways to the Governor General[3].

The ABA believes that in determining scheme caps it is appropriate for the Minister to give consideration to factors, including Australia's national interests, progress towards comprehensive global action, the economic implications of the scheme cap and the price of carbon, voluntary action to reduce GHGs, and levels of GHGs that are not directly or

[1] The ABA notes that the Fund could include projects that provide capital investment in clean technology, new, innovative low emissions practices, and energy efficiency projects; disseminate best practice and consumer information to businesses and individuals; and provide support for those industry sectors and companies not receiving other forms of financial assistance.
[2] The ABA notes that a compliance period for the scheme will be a period of one year, being a financial year. However, the international market convention is a calendar year.
[3] Section ^14 of the CPRS Bill indicates that the quantity of GHGs in terms of carbon dioxide equivalence (CO2-e) for a specified eligible financial year will be prescribed by regulations. The regulations must be made before July 2010. Section ^15 of the of the CPRS Bill indicates that the upper bound and lower bound for an eligible financial year will be prescribed by regulations.

indirectly covered by the CPRS. However, we believe the Minister should also give consideration to emerging climate change science, including targets and scenarios for stablisation of atmospheric GHGs. The design parameters which are critical to the credibility of the CPRS should recognise that economic efficiency and environmental integrity are both important outcomes of the CPRS.

The ABA believes that it is appropriate not to include the specific scheme caps and gateways in the legislation. It is a reality that the CPRS will need to be able to respond to reflect evolving climate change science and developing international negotiations and arrangements. Uncertainties of climate change should be dealt with appropriately by enabling flexibility to adapt. However, flexibility needs to be balanced with providing businesses, households and the market with certainty regarding the design parameters.

Therefore, the legislation must:

- Require the Minister to set the scheme caps and gateways in a timely manner, giving consideration to key issues.
- Ensure the scheme caps and gateways are prescribed by regulations[4].
- Make provision for a default cap setting mechanism in the event that there is no agreement or decision or a delay in identifying future scheme caps and gateways.

However, the legislation should not include a power to amend the scheme caps and gateways once set.

The ABA believes that it is important to ensure independence, transparency and accountability of decision making. Therefore, to ensure that the scheme cannot be politically influenced, it is appropriate that the final decision regarding the scheme caps and gateways is made by the Minister and Governor General. The triggers for changes should be clearly identified, articulated and justified well in advance – that is, whether adjustments will be made with the subsequent coverage of uncovered sectors or misalignment with subsequently agreed international commitments.

The ABA notes that the principle guiding the setting of the scheme caps and gateways is that stabilisation of atmospheric GHGs at around 450 parts per million of CO2-e or lower is in Australia's national interest. This is problematic for a number of reasons. Firstly, this is a global target and Australia can contribute to these efforts. Secondly, while we recognise that the global target or stabilisation baseline should be underpinning the CPRS framework for which the Government makes decisions as relevant for Australia, climate change science is evolving and the inclusion of a hard target may result in the legislation being inconsistent with widely recognised and endorsed global targets. We believe the legislation should allow for a more flexible response to climate change science and international negotiations and arrangements, without compromising clarity with regards to the stabilisation of atmospheric GHGs.

2.2 Liable entities

The ABA notes:

- Most sectors of Australia's economy will be covered by the CPRS. Agriculture will likely be included in the scheme in 2013. Forestry will be included on an opt-in basis.
- Liable entities must surrender a suitable number of emissions units to cover their emissions of GHGs during the compliance period.

[4] The ABA notes that the legislation states that the Minister "may" make regulations, not "must" make regulations. The gateways are critical to market efficiency and managing unnecessary price volatility. Certainty is necessary for business. Flexibility can still be retained through the identification of the upper and lower bound.

- Liable entities, in relation to direct emissions from a covered facility, can be a controlling corporation of a group, a non-group entity, or a holder of a liability transfer certificate. There will only be one liable entity at any point in time.
- The obligation transfer mechanism will allow emissions liabilities to be transferred, enabling flexibility to downstream the point of obligation.

2.2.1 Covered sectors

The ABA supports broad coverage of all emissions and industry sectors in the CPRS. Broad coverage provides market scale, breadth, depth and liquidity. Ideally, the CPRS should commence with all emissions and sectors, as changes to emission types and sectors covered later will impact the supply and demand for emissions units and impact on the efficiency of the carbon market (both the secondary and forward market).

However, the ABA recognises the difficulties of including the agriculture sector at the commencement of the scheme. It is important that methodologies to measure agriculture emissions are developed to support the credible inclusion of the agriculture sector. Ideally, the inclusion of agriculture should be clarified sooner than 2013 to provide greater certainty to the sector on when and how it will be covered. Therefore, we believe that a review in 2013 should not focus on whether to include agriculture in the CPRS, but if there are still problems with measuring agriculture emissions, on efforts that will overcome these problems.

The ABA is unable to provide comments on forestry (including definitions and project criteria) as the provisions have not yet been drafted.

2.2.2 Operational control

The ABA notes that the concept of "operational control" is critical to the operation of the scheme. A liable entity should be defined as the entity with operational control over the facility and responsible for GHGs emitted directly from the facility[5]. Importantly, this approach to point of obligation recognises that the entity with operational control has the ability to direct operations as well as has access to emissions data, and therefore is consistent with the *National Greenhouse and Energy Reporting Act 2007* (NGER Act). Some banks have already started to put in place reporting systems around this concept of operational control. However, we have some practical concerns with the definitions of "operational control", "groups" and "facility" as contained in the NGER Act.

While the ABA recognises that some recent changes to the NGER Act should simplify the administrative complexity of the law (e.g. proposed simplification to the registration process to require only members of a corporation's group directly relevant for reporting purposes to be listed, rather than all members of a corporation's group), the concept of "relevant" has not yet been clarified. The treatment of trusts, partnerships, joint ventures and other shared arrangements should be worked through with stakeholders. Furthermore, we believe that the CPRS should be consistent with the changes to the NGER Act in this respect, and as consistent as possible with other corporate reporting obligations (e.g. definitions should not result in reporting of information that would otherwise be deemed commercially sensitive or an unreasonable prejudice to be publicly disclosed).

[5] The ABA notes that section 11 of the NGER Act currently defines 'operational control' to be where the entity has the authority to introduce or implement operating, health and safety and environmental policies.

The ABA believes there is considerable confusion about the concepts of operational control in the NGER Act and "financial control" in the CPRS[6]. Overlap and ambiguity of these concepts creates difficulties and complexities in determining the owner of the liability. It is inappropriate for entities to have to seek their own legal advice. Therefore, we believe that further consideration and clarification is required, especially with regards to the intersection between the statutes, the determination of operational control versus financial control, and the use of a liability transfer certificate.

Furthermore, the ABA notes that there is a gap between the commencement of the scheme in July 2010 and the operation of the mandatory reporting system[7]. Amendments to the NGER Act should be streamlined in advance of the CPRS so that registered entities with reporting obligations are not subject to unnecessary legal uncertainties and additional compliance costs.

2.2.3 Liability transfer certificate

The ABA notes:

- For corporate groups, the entity within the group that has control and ability to implement operations should be the liable entity.
- A liability transfer certificate approved by the regulatory authority should enable an entity to transfer liability to another entity.
- The regulatory authority will assess applications for a liability transfer certificate. Applications will require a payment.
- A liability transfer certificate remains in force indefinitely, until surrendered to the regulatory authority or cancelled by the regulatory authority as the entity is no longer eligible (e.g. the entity breaches the requirement or becomes externally administered).

The ABA believes that allowing the transfer of liability will have a number of implications, including:

- A controlling entity within a corporate group can take on liability in relation to a particular facility in certain circumstances;
- An entity with financial control can take on liability in certain circumstances;
- An entity that takes on liability under the CPRS will also have to meet all reporting obligations under the NGER Act; and
- An entity that takes on liability must have the capacity, information and financial resources necessary to comply with the emissions and reporting regime.

[6] Section ^81 of the CPRS Bill outlines that a person with financial control may use a liability transfer certificate to transfer liability to another person. Part 3, Division 6 includes a number of provisions intended to explain the operation of the liability transfer certificate and the identification of financial control as including economic and commercial substance.

[7] The ABA notes that the trigger year for registered entities is the financial year commencing in July 2008 for the NGER Act.

While the ABA recognises that the liability transfer certificate is intended to address incidences where financial control may infer a liability in certain circumstances, it is currently unclear how the proposed changes to the NGER Act with regards to an entity nominating to take on the liability of operational control under the NGER Act intersect with the CPRS[8]. Therefore, we believe that further consideration and clarification is required, especially with regards to multiple partner arrangements, incorporated entities versus non-incorporated entities, guarantee arrangements and implications for project financing, 'passive' financing arrangements by banks and other lenders, credit defaults and companies in administration/receivership, investments by fund managers, and the operation of anti-avoidance provisions in light of potential ambiguities.

The ABA has not been able to conduct a thorough legal assessment of the implications of the CPRS, coupled with the amendments to the NGER Act.

2.2.4 Thresholds for covered facilities and sources of emissions

The ABA notes:

- GHGs[9] that are widely recognised internationally and defined by the Kyoto Protocol will be covered by the CPRS.
- Liable entities that operate facilities that have a total amount of 25,000 tonnes of CO2-e or more a year will be required to calculate their GHGs and meet their obligation to surrender emissions units accordingly. The legislation contains anti-avoidance provisions.
- Scope 1 emissions will be specified as covered by the CPRS. Scope 2 emissions (e.g. emissions relating to electricity use) and Scope 3 emissions (e.g. emissions relating to business travel, paper use, water management, waste disposal) are not included in the definition of a facility's emissions and are not covered by the CPRS.

The ABA believes that, as a minimum, liable entities' emissions calculations should include Scope 1 emissions. Mandatory reporting should avoid double counting. Given the difficulties associated with calculating and capturing Scope 2 emissions and Scope 3 emissions data, we recognise that only Scope 1 emissions should be covered by the CPRS at this time. However, the Government should encourage voluntary and best practice reporting of other emissions and work towards identifying a clearly defined set of methodologies for measuring (not estimating) emissions, where the entity is able to directly reduce or mitigate emissions. Emissions calculations should be consistent with globally accepted methodologies – ISO Standards and the Greenhouse Gas Protocol. We consider that this will promote the integrity and credibility of the CPRS as well as promote consistency and comparability of emissions reductions and reporting of emissions data across jurisdictions.

---

[8] Section ^17 of the CPRS Bill indicates that smaller entities with a total amount less than 25,000 tonnes of CO2-e or more a year will be exempt from the total amount of GHGs emitted from a facility of a controlling corporation. In addition, section ^17 of the CPRS Bill indicates that the holder of a liability transfer certificate in relation to a facility is not taken to have been under the operational control of a member. The commentary to the exposure Bill indicates that where a member of a controlling corporation's group takes on liability through a liability transfer certificate, the controlling corporation will not have liability for that facility under the CPRS or for the reporting obligations under the NGER Act – that is, the holder of the liability transfer certificate will have those liabilities and obligations. However, the controlling corporation must give its consent to the transfer and provides a statutory guarantee for the payment of the penalty for a unit shortfall and any late payment penalty for that member. In addition, section ^81 of the CPRS Bill indicates that financial control relates only to an entity that has significant ability to control the entity through financial means. The commentary to the exposure Bill indicates that it is not intended to include an agent or person acting on behalf of an entity that has financial or operational control of a facility.

[9] Carbon dioxide (CO2), methane (CH4), nitrous oxide (N2O), sulphur hexafluoride (SF6), perfluorocarbons (PFCs), and hydroflurocarbons (HFCs).

The ABA believes that the point of obligation and reporting obligation should be consistent across the NGER Act and the CPRS, as far as practicable. It is important that differences are justified and compliance costs are minimised. Therefore, we believe that further consideration and clarification is required.

2.3 Emissions units

The ABA notes:

- Australian emissions units (AEUs) will represent one tonne of CO2-e.
- AEUs will be auctioned or issued by the regulatory authority. AEUs will be mostly auctioned, but some may be issued at a fixed price or free of charge in accordance with assistance programs for certain sectors (e.g. emissions-intensive trade-exposed and coal fired electricity generation), representing between 25%-35% of all AEUs.
- AEUs will be issued at a fixed price where the price of carbon on the market exceeds the price cap. Liable entities can apply to the regulatory authority for AEUs issued at the fixed price.
- AEUs that are not auctioned cannot be banked or traded. Liable entities and others will be able to trade other AEUs amongst themselves and on secondary markets. Liable entities that do not have adequate AEUs to meet their compliance obligations can buy additional AEUs or borrow up to 5% from the follow year's vintage. Liable entities will be able to bank AEUs that have been auctioned.
- AEUs are personal property, fungible, tradeable, transferable.
- Liable entities will be able to use eligible international units[10] to meet their compliance obligations.
- Liable entities may surrender emissions units to the regulatory authority by electronic notification. Surrender of units can be made to meet compliance obligations or voluntarily.
- Eligible emissions units surrendered to meet compliance obligations cannot be reused for any or other purpose.
- By 15 December, a liable entity must surrender the number of emissions units required to meet their compliance obligation (six weeks after the final date for emissions reports to be submitted to the regulatory authority and 5 ½ months after the end of the eligible compliance period). Emissions units may be surrendered at anytime to meet the scheme obligations for the current compliance period.
- Liable entities that fail to meet their compliance obligations and do not avoid a unit shortfall will incur penalties, including an administrative penalty and an obligation to 'make good' the shortfall in the next compliance period. The administrative penalty is maximised to 110% of the average auction price of auctions held within the eligible compliance period. By 31 January, a liable entity (or the controlling corporation subject to a guarantee under a liability transfer certificate) must pay the amount of the unit shortfall.

[10] Eligible international units include three types of units under the Kyoto Protocol: certified emissions reductions (CERs) from the Clean Development Mechanism; emission reduction units (ERUs) from the Joint Implementation activities; and removal units (RMUs) from land use, land use change and forestry.

The ABA generally supports the above points as consistent with the views we provided to the Federal Government in previous consultations. However, we are concerned with a number of design parameters, including the setting of the price cap, international linkages, 5% holding reporting obligation, auctions and property rights.

2.3.1 Price cap

The ABA does not support price controls. Price controls distort the operation of the market. However, if the Government continues to deem it necessary to impose a price cap for a transitional period, the price cap should be set in the legislation and such that it has a "very low probability of use", as foreshadowed by the Government in the CPRS Green Paper. We consider that the price cap contained in the legislation has been set at a conservative level and therefore is not set at a level with a "very low probability of use"[11].

Too low a price cap will substantially undermine the objective of emissions reductions – that is, adjustments through technology will be weakened, GHG abatement activities will be hindered, price signals will be stifled, market development will be distorted, and market forces of supply and demand will be adversely affected. Furthermore, too flat an escalation could result in a sharp adjustment at the end of the transitional period.

A review mechanism should be included in the legislation to ensure that the price cap remains appropriate during the initial five year period, having regard to parity of international prices and international linkages as well as readily observable behaviour and outcomes in the carbon market. This will ensure that the price cap is not unduly prohibitive in managing extreme price volatility. In addition, it will assist in minimising the likelihood of pricing irregularities at cessation of the price cap as well as adverse consequences for importing eligible international units during the period of the price cap.

While the ABA recognises the challenge in setting a price cap during a period of difficult market conditions, and thus the price cap provides business certainty by establishing a maximum cost of compliance, too low a price cap undermines market certainty and transfers risks to the Government. Therefore, we believe that further consideration is required, especially with regards to the quantum of the price cap, the rate of escalation and the application for units at a fixed price. We suggest the price cap mechanism needs to be adjusted.

2.3.2 International linkages

The ABA supports in principle including a provision that enables a liable entity to import non-Kyoto units issued in accordance with international agreements other than the Kyoto Protocol. A provision that allows for non-Kyoto units to be prescribed by the regulations as eligible international units means that other types of emissions units can be added without amending the legislation. The ability to recognise other international units will provide flexibility to respond to emerging international agreements and bi-lateral agreements, where an independent review finds that establishing a bi-lateral linkage will not significantly impact the price for AEUs and will enhance domestic and regional emissions reductions. However, we believe that further consideration and clarification is required, especially with regards to international linkages and implications for innovation in domestic GHG abatement activities.

[11] Section ^89 of the CPRS Bill contains a price cap mechanism for the first five years, where the price cap is initially set at $40 per tonne in 2010-11, but rising at 7.5% per year to $53.42 per tonne in 2014-15.

The ABA believes that the legislation should include triggers and criteria for the basis of decision not to recognise an international unit for compliance purposes or a decision to disallow the future transfer of certain types of international units. The ability to import eligible international units is critical to the operation of the scheme and the efficiency of the market. We consider that greater clarity and accountability of decision making is required.

2.3.3 Significant holding

The ABA supports measures that ensure market integrity in relation to transactions in emissions units. While we recognise that the obligation to notify the regulatory authority of a significant holding in AEUs generally aligns with the 'substantial shareholder' provisions in the Corporations Act, we note that emissions units are not the same kind of product as shares. The substantial shareholder reporting obligation intends to inform the market with regards to holdings which can be used to influence corporate control.

The ABA assumes that this reporting obligation is intended to address the risk of 'cornering'. However, there are other provisions in the system that provides protections, such as the auctioning of units. In addition, other provisions in the legislative package have been included to deal with the risk of market manipulation and misconduct. Therefore, we believe that further consideration is required, especially with regards to the implications of a significant holding disclosure obligation for spot and forward trades and quality market information. Given that it is more likely that such information could have unintended consequences (i.e. misled the market or inadvertently allow another entity to take a position in the market against a liable entity), we suggest the provision should be deleted.

2.3.4 Auctions

The ABA notes that the CPRS provides for a progressive shift towards 100% auctioning. The Government has stated that further consultation is required on auction rules. We believe allocation should encourage the market forces of supply and demand, where AEUs are limited, the value of AEUs is enhanced, and companies are provided with an incentive to cut down on their need for units with the excess available to trade. Auctions should enable universal participation, subject to the lodgment of any required security deposit.

The ABA believes that auctioning should be consistent with norms of economic markets (i.e. take place via issuance of parcels of units at monthly intervals and via ascending clock auctions). Advance auctioning of a percentage of future year's vintage will create supply to enable any "5% shortfall" to be satisfied. Auctioning of an additional three vintages will provide an efficient price discovery mechanism, therefore, assisting liquidity in the forward market. We do not support the withholding of a portion of current year vintage for an auction after the end of the eligible compliance period. We also do not support double-sided auctions.

The ABA is unable to provide comments on the auction rules as the detail is to be prescribed by regulations.

2.3.5 Personal property rights

The ABA notes that the CPRS provides for the establishment of personal property rights. The Government has stated that further consultation is required on property rights and taking security over emissions units. We believe that AEUs should represent personal property rights. Carbon assets with distinguishable and tradeable rights will be a key to establishing a secondary market and promoting the forward market. Carbon assets will improve the efficient functioning of the CPRS, by reducing transaction costs, facilitating price discovery and transferring risk, and minimising counterparty and settlement default.

The ABA believes that legal ownership should only be transferred by entry into the national registry. (However, we note that there is no explicit provision that an entry in the national registry is sufficient evidence of legal title.) The creation of equitable interests in emissions units should be permitted. Taking security over emissions units should be permitted. Carbon assets with distinguishable and tradeable rights will better assist financial institutions to extend credit against the value of the underlying asset, and include its value in cash flow and balance sheet projections.

The ABA notes that the Government is due to consult further on several matters, including the auction procedures, policies and rules[12] and the ability to take security over emissions units. However, additional issues require clarification, including the implications of deferred payments for auctions and the ability to take security over emissions units, carry-over restrictions for eligible international units, equitable application amongst unit holders, and provisions allowing future exporting of AEUs. We note that matters such as deferred payment will likely have significant implications and consequences for provisions within the legislation.

2.4 Assistance program

The ABA recognises that transitional assistance is necessary to facilitate a smooth transition to a lower carbon economy. However, the level of free allocation will have implications for the efficiency of the market in terms of reduced liquidity. It is important that the assistance program does not have unintended consequences for the carbon market or unduly undermines the credibility of the CPRS.

2.5 National registry

The ABA notes:

- Interests in eligible emissions units will be included in the national registry.
- All Kyoto units will be able to be held and transferred in the registry (however, not all Kyoto units are eligible international units).
- Each AEU will have a unique identification number (including the vintage year).
- The National Registry of Emissions Units will be maintained by the regulatory authority.
- Some information held in the registry will also be published in the Liable Entities Public Information Database and on the regulatory authority's website.

The ABA believes that a national registry must be established to manage the administration of eligible emissions units. AEUs should be represented by an electronic entry in the registry, rather than by a paper certificate. Tracking of emissions units should take place from creation to retirement. Emissions units should be managed like other tradable instruments or commodities, recognising third parties' rights and interests. Legal title should be represented in the national registry and only transferable by entry into the registry. Therefore, further consideration and clarification is required, especially with regards to legal entitlement and assignment of interests.

[12] The ABA notes that further consideration should be given to the type of auction, timing of auctions, participants in auctions, parcel size at auctions, vintage units to be auctioned, requirements for participants to lodge a deposit prior to auction, guarantees provided by participants to meet obligations and timing of payments.

The ABA believes the national registry should track the issuance, holding, transfer, surrender, cancellation and retirement of emissions units. The national registry should provide details of cancellation and retirement of AEUs for meeting compliance obligations and voluntary actions. It will be important to ensure electronic or online functionality of the registry and interoperability between clearing and settlement facilities and the registry.

The ABA believes that the national registry should also ensure that Australia meets its obligations under the Kyoto Protocol and maintains accurate accounting of emissions units. It is important to avoid unnecessary complexity and confusion between the compliance market and other voluntary actions. Therefore, we believe that the national registry should not include details of cancellation or retirement of non-eligible emissions units or offsets. However, the national registry should reconcile eligible emissions units retired for voluntary actions.

The ABA is unable to provide comments on the national registry, account opening procedures and unit transfers as the detail is to be prescribed by regulations.

2.6 Reporting and publication of information

The ABA notes:

- Liable entities must meet their reporting obligations.
- The Liable Entities Public Information Database will be maintained by the regulatory authority. Certain information about liable entities will be entered into the database and made publicly available[13].
- The regulatory authority will also publish certain information about auctions and units on its website[14].
- The regulatory authority will publish notifications of substantial holdings in AEUs on its website.
- The regulatory authority will publish enforceable undertakings (where a person takes action to rectify a breach) on its website.

The ABA believes that carbon accounting should be done via a reporting framework that ensures transparent, relevant, reliable and comparable data. A carbon accounting framework for providing assurance on emissions and energy data should be based on existing standards for emissions measurement, accounting, audit/assurance and review and consistent with international standards. A carbon reporting framework should apply a central reporting system, underpinned by the NGER Act, and be consistent with other corporate disclosure regimes, as far as practicable. Therefore, we consider that carbon reporting should provide data on business activities that reduce GHGs as well as data about energy consumption. Carbon reporting should also promote transparency of information about GHG abatement activities. The NGER Act should be used as the basis for emissions estimation methodologies, and therefore reporting, monitoring and assurance under the CPRS.

---

[13] The ABA notes that the following data will be entered in the database: emissions number for the eligible compliance period, unit shortfall for the eligible compliance period, unpaid administrative penalties, number of surrendered eligible emissions units, number of voluntarily cancelled AEUs, and information about holders of registry accounts.

[14] The ABA notes that the following information about the last auction (AEUs unit price, total number of AEUs issued per unit price) and the last six months (number of AEUs issued as a result of auctions, total auction proceeds, information about AEUs issued for a fixed price, information about AEUs issued free of charge, information about surrender of borrowed and banked eligible emissions units, information about Kyoto units, information about total emissions numbers and unit shortfalls, information about the characteristics of eligible emissions units) will be published on the regulatory authority's website.

The ABA believes that the CPRS should also ensure that data is of a quality that can be relied upon in financial markets and supplied in a manner that does not generate an artificial carbon price, and thereby contributes to a fully informed market. Quality information will be crucial to ensuring the effective functioning of the CPRS and carbon market and to managing price volatility. An efficient market means the market is fully informed with all relevant information being reflected in the price of carbon. Investors will require information to analyse a company's material business risks resulting from climate change and a carbon price.

The ABA believes that the carbon market should receive information about supply (i.e. AEUs issued and intended to be issued) and demand (i.e. actual emissions). The availability of transparent market information about supply, demand and price will be essential to the efficient functioning of the market. Forecasting trends and sector impacts will be assisted by disaggregated information, i.e. supply and demand by sector. However, it is not necessary for disaggregation to be at the entity level. It is important that information disclosed to the market enables comparison of emissions between sectors and across countries.

The ABA believes that the regulatory authority should make information publicly available at the time the information is available – that is, an emissions report is submitted, other information is filed, auctions are held, etc. The market requires regular data to adjust prices to reflect fundamental information and to avoid sharp adjustments and extreme price volatility. We note that the NGER Act requires the regulatory authority[15] to publish emissions and energy data on its website by 28 February in a financial year. We have previously indicated that more regular reporting and subsequent disclosure of emissions data, say quarterly, would promote market efficiency. Therefore, we believe that further consideration and clarification of reporting, collection and publication of data is required, especially with regards to types and form of data publicly disclosed (e.g. aggregated and disaggregated), method and timing of disclosure, balancing transparency of information and ensuring commercially sensitive information is protected, and addressing concerns with potential fraud[16].

The ABA believes that liable entities should also be able to streamline the reporting of information based on reporting standards that are consistent with existing domestic and international schemes and voluntary initiatives[17]. Climate risk disclosure may include reporting of energy production and consumption, current GHGs and identified key climate change related risks. We consider that as reporting frameworks evolve, standardised disclosures could also consist of total historical, current and projected GHGs, analysis of emissions management, assessment of physical risks of climate change and analysis of risks related to regulation of emissions.

---

[15] The ABA assumes that references in the NGER Act will also subsequently be amended to Australian Climate Change Regulatory Authority.

[16] The ABA notes that data sources may include:

- *Liable entities*: emissions number, type and number of emissions units surrendered by vintage, unit shortfall and associated information about non-compliance (e.g. review decisions, unpaid administrative penalties), and voluntarily cancelled emissions units.
- *Emissions units*: number of units issued during an auction (volume) and the charge for the units at auction (price), number of units issued at a fixed price during a period, number of units allocated free of charge and recipients under assistance programs, aggregate data on AEUs issued free of charge, surrender of borrowed and banked eligible units, total emissions numbers and unit shortfalls.
- *Registry accounts*: name of person with an account in the registry.
- *Other information*: benchmark average auction price, average auction price over six months adjusted for fuel taxes, total emissions and total surrenders by vintage by sector, register of obligation transfer numbers, register of reforestation projects, and information required to be disclosed under the NGER Act.

[17] The ABA notes the *Global Framework for Climate Risk Disclosure* recognises the value of mandatory financial reports, the *Carbon Disclosure Project* and the *Global Reporting Initiative*, and the evolution of efforts and partnerships to standardise climate risk disclosure and reporting, including the *United Nations Environment Programme (UNEP) Finance Initiative*.

The ABA believes that information about the characteristics of AEUs and eligible international units will assist in providing information to the market about emissions units, especially for retail investors. We note that the Government will not be issuing a disclosure document (i.e. prospectus or product disclosure statement) as applies to the issuance of financial products.

2.7 Compliance and enforcement

The ABA has not been able to conduct a thorough assessment of the implications of the compliance and enforcement provisions in the legislation. Further consideration needs to be given to the implications of information gathering and monitoring powers, liability of directors and officers, enforceable undertakings, administrative and civil penalties and criminal offences, and review of decisions. However, we provide some preliminary views on the record keeping requirements.

2.7.1 Record keeping requirements

The ABA believes that the record keeping requirements should be limited to only that which is necessary to enable the regulatory authority to monitor compliance and to ensure the integrity of the CPRS.

Participants in the CPRS will be required to keep records so that the regulatory authority can check accuracy and completeness of information provided to the regulatory authority. This obligation is not limited to liable entities. It will be important that record keeping requirements do not impose unnecessary regulatory burden or compliance costs on scheme participants or impose inconsistent obligations on those entities that are required to meet similar record keeping requirements for other statutory and regulatory reasons. Streamlining record keeping requirements will enable entities to use existing systems and procedures. Therefore, we believe further consideration and clarification is required, especially in the context of potentially capturing broader entities and voluntary participants and ensuring consistency with other corporate and financial record keeping requirements.

The ABA is unable to provide comments on the record keeping requirements as the detail is to be prescribed by regulations.

2.8 Independent reviews

The ABA notes:

- An expert advisory committee will conduct periodic reviews of certain matters relating to the CPRS[18]. The first review will be completed before 30 June 2014. Subsequent reviews will be conducted every five years. Periodic reviews must make provision for public consultation.
- An expert advisory committee will conduct special reviews as instructed by the Minister. Special reviews must make provision for public consultation.

[18] The ABA notes that the following matters will be considered in the periodic review: effectiveness of reporting requirements imposed on liable entities, effectiveness of coverage of GHGs, administrative costs incurred by liable entities, whether national targets should be changed or extended, policies and procedures relating to auctions, extent to which units other than AEUs should be able to be surrendered, assistance programs, arrangements for governance and administration of the CPRS.

The ABA believes that the CPRS should contain consultation mechanisms to ensure that the Government assesses the effectiveness and efficiency of the CPRS. It is important that the Government engages with the banking and finance sector prior to any review or revision of the policy, technical and administrative settings for the CPRS. Therefore, we support an independent expert advisory committee being constituted every five years to conduct a public strategic review of the CPRS. However, we believe that the legislation should allow for more frequent review if circumstances are changing rapidly.

The ABA believes that the expert advisory committee should assess the costs and benefits of any recommended actions. In addition to the matters specifically identified in the CPRS Bill, the periodic review should also give consideration to the regulatory burden, administrative and compliance costs of scheme participants, which may or may not be liable entities (e.g. intermediaries, legal, advisory and support services). The review report should be tabled in Parliament and made publicly available.

The ABA believes that the expert advisory committee should have members from across relevant expertise areas, including economics, law, business, financial markets, trading and environmental instruments, climate change science, accounting, and GHG and energy measurement and reporting. It is important for the expert advisory committee to be adequately resourced, independent and with the appropriate mix of expertise.

The ABA believes that members of the expert advisory committee should have limited liability. It is important to encourage interest from those with expertise in being members of the expert advisory committee. For example, members of the expert advisory committee should not be liable to an action for damages in relation to acts done in good faith (or omissions) in the performance of their functions or powers under the Act or the associated provisions.

The ABA believes that it may also be necessary to conduct special 'care and maintenance' reviews to assess the operation of administrative arrangements, especially in the early years of the CPRS. It is important to ensure that the design parameters can be reassessed prior to five years in cases where certain design parameters inhibit efficient and cost-effective abatement of GHGs. For example, a mechanism for reviewing the price cap during the initial five years of the CPRS should be introduced to ensure that the price cap is not unduly prohibitive in terms of international prices or does not hinder the capacity for international linkages.

3. Australian Climate Change Regulatory Authority Bill 2009

3.1 Powers and functions

The ABA notes that the Government will consolidate the existing Greenhouse and Energy Data Officer and the Renewable Energy Regulator into the new regulator also responsible for administering the CPRS – Australian Climate Change Regulatory Authority. We believe that this approach will minimise regulatory duplication, inconsistency and gaps; streamline some reporting procedures and processes; reduce some regulatory burden for liable and registered entity's; and harmonise some administrative functions.

The ABA believes that the regulatory authority should have compliance, investigative and enforcement powers, including the ability to conduct compliance and/or assurance audits or to direct third party audits. The commentary to the exposure Bill indicates that the Government has established a new regulatory authority is necessary as there is no single existing regulator with the capabilities needed to administer the range of functions required under the climate change laws.

The ABA notes the primary function of the regulatory authority is to administer the CPRS, national RET, and National Greenhouse and Energy Reporting System (NGERS). It is important for the regulatory authority to be independent. The regulatory authority should be subject to Ministerial direction only on general matters. We support a clear delineation between the responsibilities of the Government and the regulator authority being established in the legislation. We believe that the Minister should release a Statement of Expectations and the regulatory authority should release a Statement of Intent.

The main functions of the regulatory authority should include:

- Administering the climate change laws
- Maintaining the National Registry of Emissions Units
- Auctioning AEUs
- Allocating AEUs to emissions-intensive trade-exposed and coal-fired electricity generation activities in accordance with the assistance program and scheme rules
- Assessing unit shortfalls in relation to surrendered emissions units by liable entities
- Overseeing the transfer of liability for emissions between entities in some circumstances
- Assessing the eligibility of reforestation projects and unit entitlements associated with those projects
- Monitoring and enforcing compliance with the CPRS
- Conducting and/or coordinating education programs about the CPRS
- Collecting, analysing, interpreting and disseminating statistical information in relation to the CPRS
- Enforcing the reporting of GHGs, energy consumption and production by registered corporations under the NGER Act and liable entities under the CPRS
- Maintaining the Liable Entities Public Information Database
- Disclosing emissions and energy data on a corporate-level
- Administering the national Renewable Energy Target (including accrediting eligible renewable energy power stations, maintaining a register of Renewable Energy Certificates (RECs), monitoring and enforcing compliance).

The ABA believes that the regulatory authority should have staff from across relevant expertise areas, including economics, law, business, financial markets, trading and environmental instruments, accounting, and GHG and energy measurement and reporting. It is important for the regulatory authority to be adequately resourced, independent and with the appropriate mix of expertise.

The ABA believes that the regulatory authority must ensure that it coordinates its efforts with other relevant regulatory authorities, especially where there is overlap of administrative functions across statutes (i.e. Australian Securities and Investments Commission (ASIC), Australian Competition and Consumer Commission (ACCC) and Australian Prudential Regulation Authority (APRA)). Monitoring the operation of the CPRS will include the efficient functioning of the carbon market. Regulatory arrangements should ensure that regulatory duplication is minimised.

The ABA notes that the Consequential Amendments Bill will make changes that enable ASIC to disclose information to the regulatory authority. We believe that information sharing arrangements need to be formalised – that is, information exchange protocols should only permit the sharing of information relevant to the trading of emissions units and the integrity of the market.

3.2 Public disclosure

The ABA notes that the regulatory authority will publish for each eligible compliance period (financial year) an entity's emissions numbers and the entity's total Scope 1 emissions. Information will be published on a corporate-level, not a facility level. As information obtained by the regulatory authority may be commercially sensitive (e.g. data could disclose the market share of a corporation, details of supply arrangements, details of other business arrangements), information disclosure protocols should be established. Corporate-level disclosure is adequate for the purposes of maintaining a fully informed market.

The ABA believes that further details are required about the public disclosure of information held in the national registry and collected by the regulatory authority. We suggest that the legislation be amended to clarify that the regulatory authority will publish appropriate data submitted in accordance with the NGER Act, such as the emissions report, and will publish appropriate data as available in accordance with the operation of the CPRS. The concept of "appropriate" should be worked through with stakeholders.

4. Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009

4.1 Australian Securities Investments Commission Act 2001 and Corporation Act 2001

4.1.1 Financial products

The Consequential Amendments Bill will make AEUs and eligible international emissions financial products for the purposes of the *Australian Securities and Investments Commission Act 2001* and the *Corporations Act 2001*.

While the ABA supports ensuring market integrity in relation to transactions in emissions units and ensuring market manipulation and misconduct is prohibited, we do not believe that this is best achieved by regulating emissions units as financial products. Treating emissions units as financial products brings with it the myriad of legal obligations and, in the absence of regulatory relief, will impose unnecessary compliance costs on liable entities and other scheme participants. Over-regulation of the carbon market will stifle participants, unnecessarily increase transaction costs and lead to unintended consequences for the CPRS and other domestic markets.

The ABA believes that the carbon market should be bound by uniform rules and able to facilitate efficient and simple participation. Market efficiency must be supported by solid market conventions, trading rules and regulatory and governance arrangements. Therefore, we believe that the carbon market should be established to function and operate similar to other Over-The-Counter (OTC) markets with standardisation of contract documentation and widely accepted market conventions to facilitate trading in emissions units.

While the ABA recognises that emissions trading differs from trading in other commodities in that entities trade in order to surrender emissions units to meet compliance obligations, this factor should not distinguish the market from other commodities markets.

The ABA believes that it is unnecessary to treat emissions units as financial products for a number of reasons, including:

- AEUs are issued by the Government, and therefore are a reliable instrument;
- Auctioning rules are set by the Government, and therefore can be regulated;
- Transactions involving derivatives would attract the provisions within the Corporations Act (derivatives are financial products, and therefore markets and services would be regulated accordingly by ASIC);
- Transactions that are not conducted as part of the auction or involving derivatives would not be unregulated as they would attract the market conduct provisions within the *Trade Practices Act 1974*;
- Information and emissions data is disclosed to the market by the regulatory authority, and therefore promotes market integrity; and
- Consumer protections relating to financial products seek to regulate the offer of such products to retail clients, and it is unlikely that AEUs will be traded by retail investors (assuming clarity of the 'retail/wholesale' distinction in the context of emissions units).

Furthermore, the ABA identifies a number of problems with treating emissions units as financial products, including:

- Emissions units being designated as financial products for the purposes of the *Australian Securities and Investments Commission Act 2001* and the *Corporations Act 2001* carries with it regulatory and compliance obligations regarding the provision of financial services (including licensing, conduct, advice and disclosure), increasing the costs of participating in the scheme and market;
- Adjustments made through regulations will result in a mixture of legislative instruments, create unnecessary legal complexities and hinder understanding of the CPRS framework, making the CPRS framework unwieldy thereby increasing the costs of participating in the scheme and market and potential regulatory uncertainties and risks with the operation of the scheme and market;
- Administrative burden for participants (i.e. licence variations for existing holders of Australian Financial Services Licences or new licences for other liable entities) and regulators (i.e. new processes, procedures, relief instruments) will increase the implementation and ongoing costs associated with the introduction of the scheme and market – this is likely to also create additional challenges for smaller entities and will likely create delays in commencement;
- No other jurisdiction has taken the decision to regulate emissions units as financial products – this could present problems in terms of international linkages, competitiveness, international trade and establishing Australia as a regional 'carbon hub'[19]; and
- Barriers to international trade as exemptions available for foreign-regulated entities are limited to particular types of financial products – this is likely to present problems in terms of international linkages.

[19] For example, the ABA notes that New Zealand and the United Kingdom do not regulate units as financial products.

Therefore, the ABA believes that primary trading in emissions units should not be regulated as a financial service and emissions units should not be treated as financial products. However, the Government has decided emissions units will be regulated as financial products, but with some adjustments to that regime to fit the characteristics of units and to ensure no unnecessary compliance costs. The Government believes that adjustments can be made via regulations, rather than via the legislation.

The ABA understands that the Government's main concerns are with market misconduct (market manipulation) and collusion (market power), and that the Government does not believe that existing powers under the Trade Practices Act are adequate to address these concerns. However, we believe that the Trade Practices Act is adequate to address market misconduct concerns with trading in emissions units. Furthermore, derivatives would be a financial product and the existing derivatives provisions will govern derivative trades and the forward market. This would ensure that various obligations are appropriate for the market and the market participants.

The ABA believes that any legal or natural person should be able to trade AEUs and regulatory requirements should not unduly limit scheme and market participation. However, a close examination of the specific Chapter 7 obligations will be required to identify appropriate carve-outs and minimise unreasonable and unnecessary additional regulatory burdens. Therefore, further consideration and clarification is required with regards to the various FSR obligations, especially the availability of licensing exemptions for certain classes of licensees or some activities (e.g. self dealing by liable entities or managing a financial risk by liable entities in certain circumstances), auction participation and market making, implications for deferred payments on availability of licensing exemptions, implications of auctioning and the disposal/acquisition of emissions units for compliance purposes, implications for smaller entities and the 'retail/wholesale' distinction, point of obligation and company structures, disclosure and advice requirements, availability of exemptions for foreign-regulated entities, and interaction of ASIC with the regulatory authority.

The ABA notes that the banking and finance sector is currently consulting with the Department of Climate Change and Treasury on specific Chapter 7 obligations that should be adjusted so that regulation does not impose unnecessary administrative burdens or compliance costs as well as does not act as a barrier to entry. A thorough review of the Chapter 7 obligations will be required to make appropriate adjustments and remove the many unnecessary obligations that come with treating emissions units as financial products. It is essential that the scheme effectively interacts with the financial services laws, yet does not have broader implications that will adversely impact the efficiency and cost-effectiveness of emissions reductions.

The ABA is concerned that the Government has not thoroughly assessed the regulatory and financial impact of applying the FSR regime to the CPRS. The potential compliance costs to business would be inconsistent with the scheme objective of imposing the least possible administrative burden on business and the overall objective of reducing the regulatory burden on business.

The ABA supports the comments on market integrity and financial products as provided by the Australian Financial Markets Association (AFMA).

4.2 National Greenhouse and Energy Reporting Act 2007

4.2.1 Definitions

The ABA believes that guidance is required on key definitions and their application in practice to assist registered entities with interpretation of their legal obligations, and subsequent reporting obligations. We support the regulatory authority providing guidance.

Groups

The ABA notes that the definition of "groups"[20] contained in section 8 of the NGER Act is to be amended by the Consequential Amendments Bill to remove references to joint ventures and partnerships. However, it is unclear how trusts will be treated.

Facility

The ABA believes that the definition of "facility"[21] contained in section 9 of the NGER Act should be amended. The current definition of facility is quite ambiguous.

Operational control

The ABA notes that the definition of "operational control"[22] contained in section 11 of the NGER Act is to be amended by the Consequential Amendments Bill to broaden the range of entities that can have operational control to include any person as well as to clarify instances where shared arrangements exist and where entities may have equal authority to implement operational, health and safety and environmental policies over a facility. As previously stated, we believe further clarification is required.

Emissions

The ABA notes that the definition of "emissions" will be revised by the Consequential Amendments Bill to separate Scope 1 emissions from Scope 2 emissions. The intention of this amendment is to enable different reporting requirements to be applied to entities with obligations under the CPRS and other entities. We believe further clarification is required with regards to the interaction between the NGER Act and the CPRS. Emissions liabilities and reporting obligations should be aligned, as far as practicable.

Greenhouse gas

The ABA notes that the definition of "greenhouse gas" will be amended by the Consequential Amendments Bill to allow additional GHGs to be defined by the regulations. We believe that this amendment will provide the CPRS framework with flexibility, yet certainty regarding the current obligations in relation to emissions.

Non-group entity

The ABA notes that the Consequential Amendments Bill will also insert a definition of "non-group entity" to identify entities that are not part of a controlling corporation group. Non-group entities will have comparable obligations as controlling corporations.

---

[20] Section 8 of the NGER Act defines a controlling corporation's group to consist of the controlling corporation, the controlling corporation's subsidiaries; any joint ventures; and any partnerships.
[21] Section 9 of the NGER Act defines a facility as an activity, or a series of activities (including ancillary activities), that involve the production of greenhouse gas emissions, the production of energy or the consumption of energy.
[22] Section 11 of the NGER Act defines operational control over a facility if the entity has the authority to introduce and implement operating, health and safety and environmental policies.

4.2.2 Reporting

The ABA notes that a single emissions report will satisfy an entity's obligations under both the NGER Act and the CPRS. Liable entities under the CPRS will be registered entities under the NGER Act. Liable entities will be required to report emissions to the regulatory authority by 31 October each year. We believe it is important to streamline reporting of emissions and energy data. The emissions report should also satisfy an entity's reporting obligations pursuant to other relevant Federal and State-based regulations.

The ABA believes that the reporting obligation should not conflict with other reporting or disclosure obligations imposed on companies, such as under the Corporations Act and ASX market rules and create information discontinuity between markets. Ideally, the emissions reporting obligation should be aligned to financial reporting obligations and accounting/verification systems, as far as practicable. The Online System for Comprehensive Activity Reporting (OSCAR) should assist entity's to calculate emissions factors and use reporting methodologies in a simple and transparent manner and enable entity's to upload electronic data in a streamlined, yet tailored manner.

The ABA believes that the reporting obligations for a facility and the liability obligations for emissions should be aligned[23]. We are unable to provide comments on the calculation of reporting thresholds. Therefore, further consideration and clarification is required, especially with regards to the implications of a nomination as having operational control under the NGER Act and the liability transfer certificate under the CPRS.

4.2.3 Audit

The ABA notes that the audit functions required for the CPRS, NGER and the national Renewable Energy Target (RET) will be consolidated in the ACCRA Bill and the NGER Amendment Bill to integrate the reporting requirements and audit processes across the statutes. Larger entities with a total amount of 125,000 tonnes of CO2-e or more a year will be required to have their annual emissions report audited by an independent auditor before submitting to the regulatory authority. The threshold will be prescribed by regulations. We believe that quality information will be crucial to ensuring the effective functioning of the CPRS and carbon market.

The ABA believes that the legislation should provide for a review of data collection and reporting processes to ensure the effective operation of the scheme (i.e. cap setting accurately reflects market information) and the credibility and quality of information. A review should take place within the initial years of the operation of the scheme.

The ABA notes that the liability of directors and officers is likely to engender audit processes being adopted more broadly across entities.

4.3 Taxation Amendments

The ABA notes:

- The cost of an emissions unit is deductible, with the effect of the deduction being deferred through the rolling balance (in the standard case where banked units are valued at cost) until its sale or surrender.
- The proceeds of selling an emissions unit are assessable income.

[23] Section 13 of the NGER Act will be impacted in terms of registration and reporting thresholds – that is, emissions from the facility will count towards the emissions of the corporate group of the holder of the liability transfer certificate.

- Any difference in the value of emissions units held at the beginning of an income year and at the end of that year are reflected in taxable income, with any increase in value included in assessable income, and any decrease in value allowed as a deduction.
- Taxpayers can elect to value all emissions units held at the end of the first income year they hold units at either cost or market value. The choice of valuation method continues to apply but, as a transitional measure, can be changed once before the 2015-16 income year.
- Where an entity surrenders an emissions unit for a purpose unrelated to producing assessable income, the deduction for the cost is effectively reversed by including in assessable income an amount equal to the amount deducted for its acquisition.

The Government has indicated that the taxation treatment of emissions units aims to ensure that the CPRS is cost-effective. Auction of AEUs will provide the Government with revenue which will be used to provide assistance to businesses and households. Taxation will also provide the Government with revenue which could be used to redistribute and offset the costs of transitioning the Australian economy. However, the benefit of additional revenue should be weighed up against the costs of additional complexity in the CPRS and differences across similar schemes and markets that may adversely affect the international competitiveness of the scheme and market.

The ABA believes that tax and accounting treatment should seek to minimise complexity and compliance costs and be based on simplicity, efficiency and equity. Therefore, we believe that the Government should reconsider the tax treatment of CPRS transactions, including direct and indirect impacts as well as the uncertainty regarding the application of State taxes. Effective tax rules will be essential to the success of the CPRS.

4.3.1 Income Tax

The ABA believes that it will be necessary to develop discrete provisions of the income tax law for the CPRS. Eligible emissions units purchased by investors who are carrying on a business or other income-earning activity should be subject to the same tax treatment as in existing legislation. For example, provisions should allow a deduction for expenses (including the cost of acquiring an eligible emissions unit) and include proceeds of a sale of an emissions unit in assessable income. Banking should have the effect of deferring a deduction. AEUs freely allocated should be included in assessable income in the year the unit is received. Similarly, any cash grants should be included in assessable income in the year the grant is received. Taxation anomalies that may occur due to the timing differences between surrender of a unit and a deduction and the implications for financial accounts may need to be clarified.

4.3.2 Goods and Services Tax

The ABA notes that the Government intends to apply the normal GST rules to CPRS transactions. This approach seeks to ensure that CPRS transactions receive the same treatment as transactions in the broader economy. Eligible emissions units and Kyoto units would be personal property rights and are not real property for the purposes of the GST Act.

The ABA does not support CPRS transactions being subject to normal GST rules. GST is a consumer tax, whereas the CPRS is a business-to-business market. In addition, GST treatment will create complexities due to the range of tax outcomes for trading eligible emissions units (e.g. spot versus forward trading; trading by domestic versus foreign entities). Subjecting emissions units to tax treatment that differs from other traded instruments is problematic in terms of implications for trading systems and working capital for participants (emitters and traders), pricing discrepancies across international schemes and markets[24] and non-recoverable circumstances.

The ABA is concerned that the Government has not thoroughly assessed the regulatory and financial impact of applying GST to CPRS transactions. The potential compliance costs to business would be inconsistent with the objective of not imposing a scheme-related tax burden on business and the overall objective of reducing the regulatory burden on business.

The ABA supports the comments on GST as provided by the Australian Financial Markets Association (AFMA).

4.3.3 Taxation of Financial Arrangements

The ABA believes that trading in eligible emissions units and associated derivatives should be excluded from calculations of taxation of financial arrangements (TOFA).

4.4 Anti-Money Laundering and Counter Terrorism Financing Act 2006

The ABA notes that the Government intends to deem acquiring or disposing of emissions units as a designated service for the purposes of the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (AML/CTF Act).

The ABA has not been able to conduct a thorough assessment of the implications of the application of the AML/CTF Act, as previous consultations have not given consideration to this proposal. However, we provide some preliminary views. This amendment may have far reaching implications for liable entities and other scheme participants and could substantially increase the regulatory burden and compliance costs associated with the CPRS. The administrative burden for liable entities and other scheme participants will increase the implementation and ongoing costs associated with the introduction of the scheme and will likely create delays in commencement.

Furthermore, it is not clear at this stage that the acquisition or disposal of emissions units creates a money laundering or terrorism financing risk. Banks, financial institutions and all other reporting entities have created very large, complex and expensive systems based on risks with designated services as agreed with the Minister. Therefore, further consideration and clarification is required, especially with regards to the application of the obligation only to agents and subsequent possible regulatory gaps, changes to systems and procedures for scheme participants with existing obligations under the AML/CTF Act, new comparable systems and procedures for liable entities not currently captured by the AML/CTF Act.

The ABA is concerned that the Government has not thoroughly assessed the regulatory and financial impact of applying the AML/CTF regime to the CPRS. The potential compliance costs to business would be inconsistent with the scheme objective of imposing the least possible administrative burden on business and the overall objective of reducing the regulatory burden on business.

The ABA is unable to provide comments on the anti-money laundering and counter terrorism financing obligations as the amendment has not yet been drafted.

---

[24] The ABA notes that New Zealand recently made a similar decision regarding imposition of tax on transactions and announced that NZUs and Kyoto units would be treated as zero-rated (after initially applying GST provisions).

5. Conclusion

The ABA believes that significant and immediate action to reduce GHGs and adjust to the effects of climate change will go to minimising the impact of climate change on Australia's economy and society. Governments, businesses and the community must take action to mitigate, abate, prepare and adapt to the consequences of climate and weather-related changes due to global warming. We look forward to continuing the constructive dialogue with the Federal Government to resolve the outstanding regulatory issues associated with the introduction of the CPRS and a carbon market in Australia.

26 March 2009
Australian Bankers' Association