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11 September 2008

Senator the Hon. Penny Wong
Minister for Climate Change and Water
Parliament House
CANBERRA ACT 2600

Email: emissionstrading@climatechange.gov.au


Dear Senator

Re: Australian Government's Green Paper – Carbon Pollution Reduction Scheme

Thank you for the invitation to provide input on the Federal Government's Green Paper examining the establishment of an Australian Carbon Pollution Reduction Scheme.

IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 140 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice.

IFSA is supportive of the Federal Government's introduction of a national carbon pollution reduction scheme, including the proposed cap and trade framework. We believe that the design of an emissions trading scheme should facilitate market efficiency and integrity, and minimise uncertainty and the economy wide costs of reducing emissions.

The Australian investment community is aware of the impact of climate change on the wider economy and value of investments. We therefore support the Government's commitment to move forward on this matter to ensure that carbon risk is managed effectively.

We believe that the following principles should be adopted in the establishment of an Australian carbon pollution reduction scheme:

- the scheme's coverage of sectors and greenhouse gases is maximised;
- the market is allowed to set the carbon price through an open and efficient market, carbon permits should therefore be transferable and held by any legal or natural person;
- comprehensive disclosure on a consistent basis of the Government's rationale/methodology for setting scheme caps and gateways. Environmental integrity, including the evolution of scientific research, and economic efficiency are key public policy principles to inform of the ongoing development of these decisions;

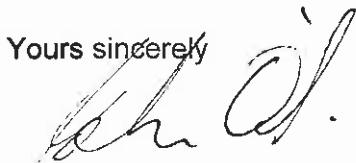
- a strong monitoring, reporting and assurance regime is adopted to ensure that emissions reported under the scheme are accurate and transparent;
- achieving a stable and credible carbon market is paramount to maintaining confidence in the market;
- ensuring that an Australian carbon pollution reduction and emissions trading scheme is able to integrate with existing and developing schemes is considered a key policy and strategic objective;
- efficient price discovery is an important component of auctioning permits, IFSA is therefore supportive of the commitment to progressively move towards 100 per cent auctioning of allocations;
- the allocation of revenue and ongoing assessment should be clearly defined/governed in order to promote the environmental integrity and economic efficiency of the scheme;
- compensation should not limit opportunities for abatement and we are supportive of a general commitment to progressively reduce the level of assistance allocated in line with international negotiations/linkages, enhancements to technology and the maturity of scheme caps and trajectories. IFSA recognises that there is a necessity to support industries that are considered 'trade exposed' and strongly affected, particularly during the introduction of the scheme;
- a conditionality of assistance criteria, subject to ongoing review and independent scrutiny, is established to facilitate the allocation of compensation.

The attached submission provides additional comments on the proposals that are particularly relevant to our members.

We look forward to engaging in further consultation with you and your Department on the proposals and trajectories prior to the public release of an exposure draft legislative package and establishment of a scheme regulator.

If you have any questions with regards to this submission, please do not hesitate to contact me or Joseph Sorby on (02) 9299 3022.

Yours sincerely



John O'Shaughnessy
Deputy Chief Executive Officer



Investment & Financial Services Association Ltd

IFSA Submission

September 2008

Carbon Pollution Reduction Scheme

Green Paper

Chapter 2: Coverage

IFSA is generally supportive of the Green Paper's preferred positions on the scheme's coverage, particularly:

- The coverage of greenhouse gases included under the Kyoto Protocol;
- The inclusion of transport emissions; and
- Further consideration of the inclusion of the agricultural sector by 2015 – we look forward to further engaging with Government on this matter.

IFSA endorses a commitment to maximising the scheme's coverage of sectors and of greenhouse gases. We recognise that by maximising coverage abatement opportunities and efficiencies are enhanced, the overall costs of the scheme for participants and the Australian economy are minimised, and unintended distortions are mitigated against.

- *Agriculture emissions and offsets*

We note that there are various methodologies under the clean development mechanism (CDM) that could be applied to certain agricultural projects in Australia. Given the size of emissions from the agricultural sector (estimated to be 16% of Australia's emissions), further consideration of including the sector as an allowable offset generator until it is covered under the scheme is necessary.

Offsets, in conjunction with internationally recognised standards, are an appropriate transitional strategy for a sector coming into the scheme and provides an incentive for emitters to make greater efforts to identify abatement opportunities.

Chapter 3: Carbon markets

The design of an emissions trading scheme should facilitate market efficiency and integrity, and minimise uncertainty and the economy wide costs of reducing emissions. A well functioning, fully informed and open carbon market will allow the scheme to achieve efficient price discovery and emissions reductions in a cost-effective way.

In order to ensure that the carbon price reflects the market's best estimates of both the current and future costs of reducing emissions, it is important that the market is allowed to set the carbon price through an open and efficient market. Consequently, we are supportive of carbon permits being transferable and held by any legal or natural person. The financial services industry looks forward to actively supporting an efficient carbon market through links to the secondary market and establishment of risk management products.

- Banking and price caps

Banking of carbon permits has the potential to reduce price volatility, encourage abatement activity and provide greater flexibility to participants. However, where there is a scheme price cap and unlimited banking, there is a risk to the current and future price caps and sending an accurate price signal to the market.

Given the comparative size of our national market, Australia is likely to be a price-taker once international links are established. In this context, any decision about price caps operating with unlimited banking should take into account speculation about future windfall gains from international linkages. This may complicate the establishment of a price cap and we therefore welcome further consideration of limiting banking if a price cap is put in place.

While it is important to promote a smooth transition for those covered by the scheme and reduce implementation/compliance costs, we support the following principles being adopted with regards to the establishment of a price cap:

- The price cap should be set at a level high enough so that it is used in only exceptional circumstances and therefore the probability of use is low;
- The price cap should not inhibit international linkages and agreements;
- The price cap is implemented as a interim implementation measure and reviewed in 2012 with a view to it ceasing in 2013, or earlier if required under international negotiations; and
- The Price Cap adopts the administrative penalty for non-compliance model.

IFSA considers the administrative penalty for non-compliance model the most effective technique to minimise use of the price cap and has the potential advantage of generating higher levels of compliance and integrity with the scheme.

IFSA also welcomes the inclusion of the make-good provision for non-compliance. IFSA notes that the provision is consistent with the EU model and will further maintain the integrity of the cap.

- Carbon permits to be treated as financial products

Australia's financial services industry is well regarded globally for the strength of its regulatory regime and market integrity. IFSA has a role in promoting industry integrity

and best practice through the ongoing development of our Standards and Guidance Notes. By adhering to IFSA's Standards, member companies have undertaken to develop processes and products that provide investors with a quality assurance regime that enhances the base-line legislative and regulatory framework.

Given the high level of integrity in the market, IFSA is therefore supportive of the Government's preferred position to include a carbon permit as a financial product under Chapter 7 of the *Corporations Act 2001* with appropriate adjustment to coincide with the characteristics of the scheme and permits. Adapting to the existing regulatory regime has the advantage of achieving consistency with the regulation of similar financial products and administrative costs for industry.

We would welcome further consultation with Government on providing further clarity with regards to the characterisation of permits. IFSA supports carbon permits being regulated as a new category of financial product, rather than the proposed classification as a derivative or "miscellaneous" financial product.

We note that the Green Paper refers to the permits as being similar to shares or debentures; we had traditionally understood the focus to be on these instruments as derivatives. However we believe the proposed characterisation is preferable, as a result of the deemed issuer rules and expectations regarding the relative skill and experience levels required to advise and deal in derivatives.

Given the number of market participants who would be existing licensees, and the often lengthy process involved in amending an AFSL (particularly the time involved in preparing proof documents), we suggest that some form of modified or streamlined procedures be put in place for existing licensees to vary their licenses to be authorised in relation to the permits, and to be prepared in conjunction with the introduction of the scheme.

Additionally, ASIC should recognise that experience in trading other types of financial products should be relevant in obtaining the "permit" authorisation. If this other experience is not recognised, then market participants would presumably need to bring in external expertise from existing emissions trading markets (such as the European Union Emissions Trading Scheme) in order to meet the organisational capacity requirements under the AFSL.

Further issues for consideration include disclosure requirements for trading permits as financial products and whether there is scope for a standard disclosure framework or terms to be established. As noted above, analysis will also need to be undertaken to consider necessary amendments to ensure the existing regulation under Chapter 7 of the *Corporations Act 2001* are workable in the context of the scheme permits.

Chapter 4: Emissions targets and scheme caps

As institutional investors, our members have an interest in the development of emissions targets and modelling, including medium-term emissions trajectories (which will determine the carbon price), compensation methods and the usage of permit revenue. All these factors will influence company valuation outcomes of the scheme and therefore the investment conclusions and implications for investors.

We anticipate the release of the forthcoming Treasury modelling on national targets and trajectories as important to help assess the impacts of the scheme from an investor's perspective. We note that as we move towards greater scheme detail on trajectories being released, such information has the potential to be price sensitive and it is important that the flow of information is appropriately managed to reflect this.

In order to facilitate certainty and market integrity; we welcome comprehensive disclosure on a consistent basis of the Government's rationale/methodology for setting scheme caps and gateways. We submit that environmental integrity, including the evolution of scientific research, and economic efficiency are key public policy principles to inform of the ongoing development of scheme caps.

We look forward to further working with Government on developing the interim national targets and trajectories.

- Setting of scheme caps and gateways

We believe that the proposed time structures to release emissions trajectory information under the operation of the scheme appear reasonable, specifically:

- An indicative gateway of at least 10 years beyond the scheme cap;
- Gateways should be updated every 5 years in order for 5 years of firm scheme caps and 5 years of gateways to be public information at any point in time; and
- In the event of international commitments extending beyond five years, scheme caps would be extended.

Chapter 5: Reporting and compliance

Given the central role of emissions data to the scheme, a strong monitoring, reporting and assurance regime will ensure that emissions reported under the scheme are accurate and transparent.

The transparency of reporting is an important aspect for investors as we need to be able to get access to meaningful and accurate data that is reflective of a potential liability to be able to make any meaningful assessments on the way a company may be impacted. IFSA is therefore supportive of using the National Greenhouse and Energy Reporting System as a starting framework, with further consideration on reporting the type of emissions (scope one and two emissions), source of emissions and the facilities/activities covered by the emissions reported by an entity.

- *Defining the liable entity*

Consistent with the current reporting obligations under the National Greenhouse and Energy Reporting System, IFSA is supportive of the Government's preferred position to adopt an operational control approach to allocate obligations under scheme.

- *Monitoring, reporting and assurance*

In order to ensure simplicity and reduce compliance costs, IFSA supports the scheme operating on a financial year basis and large emitters being required to have statements assured by an independent accredited third party. We also welcome the Government's preference to further consider this threshold on the basis of international developments, implementation of the scheme and a detailed cost/benefit analysis for smaller entities.

Maximising the potential for strong links with international markets will require a robust and credible national scheme that is compatible with approaches proposed by other countries. There is a key role for accounting and auditing standards in ensuring the international credibility of the Australian scheme.

IFSA acknowledges that the International Accounting Standards Board (IASB) is currently considering standards for appropriate reporting of emissions-related assets and liabilities. An exposure draft of the IASB standards is due in the latter half of 2009. Where the IASB standards are not in place at the commencement of the scheme, IFSA welcomes the consideration of interim Australian-specific accounting requirements on the condition that they remain temporary and future alignment with IASB standards is planned from the beginning of the scheme.

Furthermore, the *National Greenhouse and Energy Reporting Act 2007* and associated subordinate legislation may require modification prior to the start of the scheme. We would therefore support further detailed development of the monitoring, reporting and audit requirements under this Act to ensure credible demand-side information is available to financial markets. IFSA believes that emissions information management systems should have standards and controls equivalent to existing financial systems in the:

- transparency and reliability of data;
- robustness of its internal controls; and
- comprehensiveness of internal and external audit processes.

- *Compliance and enforcement*

From a financial services industry perspective achieving a stable and credible carbon market is paramount to maintaining investor confidence in the market. In addition to the above, IFSA is also supportive of the Regulator being granted a range of compliance, investigation and enforcement powers, and a broad range of mechanisms to respond to non-compliance.

Chapter 6: Linking the scheme to international markets

Ensuring that an Australian carbon pollution reduction and emissions trading scheme is able to integrate with existing and developing schemes should be seen as a key policy and strategic objective. IFSA is supportive of unlimited importation and initiating international linkages/agreements as soon as practically possible. We therefore welcome the Government's commitment to designing a scheme which can link with international markets and schemes, with a preference for open trade.

International linkages provide the benefits of scheme stability, liquidity, remove possible 'forum shopping'/arbitrage opportunities for participants and broaden the abatement opportunities for emitters. Consequently, IFSA generally supports the Government's criteria on linkages, including:

- The stability and ongoing credibility of the scheme;
- The environmental integrity and effectiveness of the scheme; and
- The scheme's consistency with international objectives and obligations.

The Government's preferred position on initially linking the scheme with the Kyoto Protocol's flexibility mechanism appears to be an appropriate starting position for international linkages.

IFSA notes that an Australian emissions trading scheme provides countries in the region with an alternative to the costly establishment of their own ETS, particularly where the necessary scale or expertise may not exist.

Additionally, the establishment of a regional trading scheme will significantly mitigate against the issues associated with emissions and production transferring to another country in the region due to the lower operating costs or carbon price in that country.

IFSA looks forward to working with Government on establishing international linking arrangements, including the negotiation of unilateral and bilateral agreements. We also note that treaties, particularly of the kind noted above, will need to reflect some degree of recognition of the home country's monitoring and regulation in this area in order to allow for recognition of participants, intermediaries and credit generating activities in a way that does not delay international agreements or impose additional compliance burdens on participants.

- Other considerations

IFSA is supportive of the Government's preferred positions on the recognition of various Kyoto units under the scheme, including emissions reduction units (ERUs), removal units (RMUs) and certified emission reductions (CERs). We are also supportive of not accepting assigned amount units (AAUs), pending international developments and a review in 2013. The recognition of international units is an important step in the development of global carbon markets and should be subject to regular review/consultation.

Chapter 7: Auctioning of Australian carbon pollution permits

Efficient price discovery is a key component of auctioning permits, IFSA is therefore supportive of the commitment to progressively move towards 100 per cent auctioning of allocations. We note that comprehensive auctioning can contribute to the efficient price discovery of a permit and also has the advantage of sending a clear price signal to investors and assist with company valuations.

In order to maintain the stability and viability of the scheme, we are also supportive of regular auctioning of permits, with the Government's preferred position of quarterly auctioning each financial year a sound starting point.

- Allocation of permit revenue

We recognise that the auctioning of permits and the subsequent redistribution of revenue is necessary to facilitate an efficient transition and minimise the costs of the scheme. The allocation of permit revenue is significant for investors because it will have an impact on the total economic cost of the scheme; it will directly impact economic outcomes such as the behaviour of households, business and the development of new technologies; and will influence the relative impacts of the scheme across industries.

The principles governing the allocation of revenue should be subject to further consultation/assessment and clearly defined in order to promote the environmental integrity and economic efficiency of the scheme. IFSA notes that alternate energy or innovative technologies which provide low abatement opportunities should be encouraged and be explicitly identified as an appropriate purpose for which revenue is to be allocated.

Furthermore, the allocation of revenue should be reviewed by Government, in close consultation with an independent industry stakeholder group, on an annual basis.

- Special purpose fund

IFSA encourages the consideration of an operating model that involves part or all of the permit revenue being allocated to a special purpose fund which may be applied for certain appropriate purposes that help to achieve the objectives of the scheme, for example investment in climate solutions technology at stages of the investment life cycle that do not currently have adequate levels of funding.

This fund could have a governance arrangement similar to that of the Federal Government's funds established to benefit the education sector, and could allow the market to contribute to determining the best use of funds within an area of permitted investment. For example, the principles governing the purpose(s) of the fund and how the revenue is used could be legislated and the spending overseen by an independent body charged with this responsibility.

Chapter 8: Household assistance measures

We note that the Government has committed to developing measures to assist households, particularly low-income households, adjust to the impacts of the scheme and the scheme is not intended to have adverse income or distributional effects. Given that the general allocation of revenue will have a significant impact on the economic and social cost of the scheme, we welcome further clarity/transparency on the parameters for allocation and transfer its administration to the regulator.

Chapter 9: Assistance to emissions-intensive trade exposed industries

Given the risks associated with carbon leakage and reducing international competitiveness, IFSA recognises that there is a necessity to support industries that are considered 'trade exposed', particularly during the introduction of the scheme. The issue of assistance is a crucial one for investors because it impacts on the total economic cost of the scheme, the valuation of companies and also the relative impacts across industries.

Consequently, we are interested in achieving a transparent assessment/allocation process and support the development of a review board, including representatives from Government and industry (trade exposed and non-trade exposed) to oversee the allocation of assistance. It is envisaged that the group would provide recommendations to Government on an annual basis on whether assistance continues to be consistent with the proposed criteria, appropriately balances the competing policy objectives and continues to be consistent with Australia's global commitments.

The criteria used to determine which emitters are entitled to an allocation of free permits and to what extent should be considered carefully, with objectivity of criteria being a particularly important characteristic. IFSA cautions against approaches which do not sufficiently address the risks associated with manipulation and distortion by industry participants subject to the compensation regime. The assessment methodology should be robust and designed to manage the risks while also facilitating an annual review of the efficacy of the process.

IFSA further recognises that compensation should not limit opportunities for abatement. We are therefore supportive of a general commitment to progressively reduce the level of assistance allocated in line with international negotiations/linkages, enhancements to technology and the maturity of scheme caps and trajectories. This commitment is consistent with the objective of maximising coverage and the environmental coverage of the scheme.

We look forward to further consultation on the Government's proposed assessment criteria, particularly the trade characteristics of eligible activities and the management of risks that will arise in administering the compensation system. Transparency and ongoing review of the assessment criteria is crucial to maintaining a stable and open market. Where information on emissions intensity is used to determine assistance, this information should come from an independently verified source and be able to be linked to reporting under the National Greenhouse and Energy Reporting System.

- Initial assistance rates

We note that the proposed 60% / 90% scaled compensation limits and usage of the CO₂ tonnes/\$Mill revenue measure for emissions intensive trade exposed industries are crucial variables in determining potential company level valuation impacts of the scheme. As discussed above, we encourage ongoing disclosure of methodologies/definitions and further consultation around these issues to ensure maximum transparency.

Chapter 10: Strongly affected industries

IFSA also recognises that in order to achieve an efficient transition to a low-carbon economy, there needs to be sufficient flexibility to support structural change, including adjustment in the strongly affected non-trade-exposed (domestic) industries. However, assistance should be considered an interim measure and not limit opportunities for abatement (see above).

As a general principle, assistance should not prevent emitters and industries from embarking on structural adjustment to reduce emissions. Targeted up-front assistance is necessary in order to promote adjustment and the transition to a low-carbon economy. IFSA is supportive of creating a conditionality of assistance framework which upholds the economic and environmental objectives of the scheme.

IFSA welcomes further consideration of the Government's proposed assessment criteria to include an additional rule that assistance is contingent on a verified commitment and plan by an entity/industry to initiate adjustment measures. A formal application process should be initiated and evaluated by Government, in close consultation with an independent industry stakeholder group, on an annual basis.

We look forward to further working with Government on developing the framework governing the conditionality of assistance criteria and subsequent review process.

As indicated above, we are also supportive of a general commitment to progressively reduce the level of free permits allocated in line with international negotiations/linkages, enhancements to technology and the maturity of scheme caps and trajectories. Furthermore, the allocation and assessment process should be reviewed annually with the support of an independent stakeholder group.

- *Alternate compensation method: output based permit allocation*

One approach for ongoing compensation during the scheme's operation (for both trade exposed and strongly affected industries), and worthy of further consideration is the output based allocation model. The proposed approach allocates permits in proportion to the output or production from the activity that causes the emission.

The approach has the potential to promote demand side abatement to be eligible for permits, thereby providing the same incentive that higher electricity prices under auctioning provide for energy efficiency projects.

We note that the Government is committed to the proposed implementation timetable and look forward to working with Government on further developing principles to underpin the compensation measures.

Chapter 11: Tax and accounting issues

Tax efficiency and transparency will also be crucial for the success of any Australian emissions trading scheme. There will be a need to ensure that the taxation implications for foreign companies or intermediaries trading on an Australian carbon market are neutral (taking into account the taxation of any “gains” in their home country) and competitive vis-a-vis alternative markets in the region and beyond. We also recognise the importance of achieving tax neutrality with regards to contracts if Australia seeks to become a regional trading hub.

With regards to the taxation implications of global trading, we welcome further consideration including the treatment of any income derived as a capital gain and/or as exempt from Australian source taxes.

Chapter 13: Governance arrangements and implementation

We recognise that the guiding approach to governance arrangements is to provide as much certainty and predictability for regulated entities and the market as is practicable while retaining a legitimate degree of flexibility for the Government to adjust the scheme in response to changed circumstances.

IFSA is supportive of the Government’s commitment to provide five years notice on any changes to the key design features of the scheme.