



20 September 2022

Department of Climate Change, Energy, the Environment and Water  
GPO Box 3090  
Canberra ACT 2601

Submitted online: [Consultations Hub](#)

Dear Sir/Madam,

### **Safeguard Mechanism Reforms**

The Australian Financial Markets Association (AFMA) is responding to the Safeguard Mechanism Reforms consultation paper.

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets. AFMA has more than 120 members reflecting a broad range of participants in financial markets.

AFMA and our members are actively involved in Australian carbon and environmental markets; as such AFMA welcomes the proposed enhancements to the Safeguard Mechanism to allow it to play a key role in meeting Australia's climate goals. AFMA supports market-based solutions to decarbonisation and thinks that the proposed Safeguard Mechanism Credits (SMCs) can play an important role. Our submission focuses on key elements that we consider need to be included in the design of SMCs; to promote the development of a healthy market that can maximise their contribution to achieving Australia's climate goals.

#### **1. The role of financial participants**

AFMA members are currently active in all Australian carbon and environmental product markets performing key roles helping to match supply and demand and offering financing solutions to buyers and sellers. Some of the roles financial institutions currently perform in these markets include:

- a) facilitating transactions by introducing buyers and sellers who may otherwise have had trouble identifying each other or who wish to trade anonymously;
- b) aggregating volumes to allow a large purchaser to buy a significant volume from a number of smaller sellers, or vice versa;

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- c) assisting participants to manage timing mismatches between when certificates are produced and when buyers wish to purchase them, either by holding units directly or offering derivative structures such as forwards; and
- d) offering financing solutions such as repurchase agreements where parties can use certificates as collateral to potentially reduce their borrowing costs.

AFMA considers that SMCs should build on the architecture developed for other environmental products such as Renewable Energy Certificates (RECs) and Australian Carbon Credit Units (ACCUs) to ensure that a well-functioning market develops. As with the existing markets, AFMA considers that financial market participants have an integral role to play in the market.

## **2. Participation in the SMC market**

The consultation paper has proposed that SMCs should not be able to be used outside the Safeguard Mechanism. AFMA supports developing SMCs as a wholesale product that can only be traded between sophisticated market participants and used within the Safeguard Mechanism. For the reasons stated above, we consider that financial market participants should be able to participate in the market, including by being able to hold credits in registry accounts.

## **3. Integrity of SMCs**

Confidence in the quality of SMCs will be critical to ensuring they contribute to emissions reductions and for the success of the market. Simply put, purchasers of SMCs need to be confident the underlying activities achieve the emissions reductions that they claim. This requires a robust process for creating credits and high quality verification practices to give subsequent purchasers confidence that the reductions are genuine.

Additionally, as ACCUs can also be used under the scheme, it is equally important that they should be of the highest quality. AFMA supports the Independent Panel's review of ACCUs and anticipates that its work will enhance confidence in the ACCU market.

## **4. Objectives**

Section 1.2 of the consultation paper sets out the policy principles that are guiding the Governments decision making. AFMA thinks that they are solid principles to deliver on the Government's climate targets; but that it would be advantageous, to consider an additional principle to guide decision making about the SMC market. We suggest that the development of the SMC market should be guided by the principle that it is fair, transparent and efficient.

## **5. Pricing stability**

A number of our members have highlighted the risk that there will be volatile pricing in the early years of the scheme due to either over or under allocation of SMCs. This is of particular concern because of the link between the SMC and ACCU markets which could lead to volatility spilling between the markets. We consider this risk could be reduced by:

- a) ensuring that the headroom in the safeguard mechanism is set at an appropriate level to avoid over allocation of units;
- b) minimising changes to the ACCU regime, such as the introduction of international offsets, during the implementation phase of SMCs, to encourage stability in the ACCU price while the SMC market gets established;

- c) consider implementing a floor price in the first two years to remove the risk of the price collapsing.

We suggest the Government should model a range of scenarios to determine likely price outcomes under different policy settings to inform the selection of settings. The parameters for the modelling should be determined in consultation with the market, AFMA would be glad to assist in industry discussions.

## **6. Borrowing and banking**

AFMA supports the inclusion of borrowing and banking in the SMC framework. We believe it will minimise participants compliance costs and increase the overall efficiency of the scheme. In section 4.1 of the consultation paper, you propose breaking implementation into two phases. If you adopt this approach, we encourage you to allow at least limited banking and borrowing between phases.

## **7. High quality register**

Having a high-quality register will be critical to the success of the SMC market. The register should:

- a) Be easy to use;
- b) Contain accurate and timely data about individual credits, including evidence of their creation and any verification activity;
- c) Provide market wide data on the volume of units in existence and information about traded volumes.

AFMA suggests that the administrator of the register should consult with the industry about the information that will be available on the register to ensure that it is fit for purpose.

Our members would appreciate clarification on if SMCs will be recorded in ANREU or a new register; and have provided feedback that the Renewable Energy Certificate (REC) Registry would serve as a better model than the Australian National Registry of Emissions Units.

## **8. Implementation**

Our members had the following feedback on the implementation process for SMCs:

- a) They require clarity about when crediting and trading of SMCs is expected to commence. The paper proposes that the safeguard rule changes will take effect from 1 July 2023 but also suggests that SMC trading will start on this date. Could you please clarify if SMCs will be allocated from 1 July 2023; or if they will only become available from 1 July 2024 when covered facilities will have been able to demonstrate performance against their baselines?
- b) Market participants will need an implementation period between when the design of SMCs is finalised and the commencement of trading to allow them to seek internal approvals and to set up the product in their risk management system. We suggest that the design of SMCs should be settled at least 6 months before trading is expected to commence to ensure that the maximum number of participants are able to participate.

## **9. Impact of the Chubb review**

AFMA understands that the regulatory architecture for SMCs is likely to be similar to the existing arrangements for ACCUs. The current independent review of ACCUs may recommend changes to

these arrangements. AFMA suggests that the Government should consider adopting any recommendations from the review that are applicable to SMCs.

AFMA would welcome the opportunity to directly discuss the development of a market for SMCs and any market implications of the Safeguard Mechanism. Please contact me on 02 9776 7994 or by email at [lgamble@afma.com.au](mailto:lgamble@afma.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Lindsay Gamble', written in a cursive style.

**Lindsay Gamble**  
**Policy Director**