

7 July 2023

Climate Change Authority
GPO Box 2013
Canberra ACT 2601



Submitted online

Dear Climate Change Authority,

Setting, tracking and achieving Australia's emissions reduction targets submission

The Australian Financial Markets Association (**AFMA**) is responding to the Climate Change Authority's (the Authority) consultation: Setting, tracking and achieving Australia's emissions reduction targets.

AFMA is the leading financial markets industry association promoting efficiency, integrity and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our membership base is comprised of over 125 of Australia's leading financial market participants, including Australian and foreign banks, securities companies, state government treasury corporations, fund managers, energy firms, as well as other specialised markets, including carbon and other environmental products. AFMA and its members are actively involved in Australia's carbon market, and AFMA maintains market conventions and industry standard documentation for the market.

Given AFMA's role in the market and our membership, our role is to promote and support the development of a sustainable financial market in Australia. AFMA is supportive of the Government's emissions reduction targets and we are actively working with members on the myriad of technical issues that need to be addressed, elaborated and agreed upon to support financial market activity and to achieve these climate goals. AFMA's responses to the Issues Paper 'Questions for consideration' are therefore limited to issues considered within scope for AFMA around sustainable markets.

Key Points

- Markets are natural enablers of the transition, but all thriving markets require clear market signals.
- An emissions policy based on clear long-term targets is vital for markets to perform their intended function.
- Confidence in the quality of Australian Carbon Credit Units (ACCUs) is critical to ensuring they contribute to emissions reductions and for the success of the market.
- the regulatory framework should accommodate enhanced retail participation in the carbon market.

1. Frameworks

1.1. Strategic Framework

AFMA welcomes the inclusion of markets as an enabler of a prosperous, resilient net zero Australia. As Australia's peak financial market body, we know that financial markets hold the capability to not

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only provide the necessary, sizeable capital required to support the transition, building the next generation of assets; but also allocate that capital in the most efficient manner possible.

In order to do this however, all thriving markets require clear market signals, areas where we think this is particularly important include:

a) An emissions policy based on long- term targets

An emissions policy based on long term targets will be preferable for the market for investment purposes.

b) Coherent goals and objectives for the energy transition

Whilst there is strong support and ambition to achieve the energy transition, and it remains a point of focus for both government and the private sector AFMA considers that the market would benefit from a clear strategy about how the transition will be achieved. We are concerned that a cost effective, efficient and successful energy transition without these clear statements on direction from government, will be challenging. The government must be clear on the community direction and its aims which will enable market forces to get us there. Addressing outstanding firming capacity issues as part of this, is vital.

c) Legislate disclosure frameworks and standards

AFMA is committed to the work of the International Sustainability Standards Board (ISSB) and the implementation of the Taskforce on Nature-related Financial Disclosures (TNFD) recommendations. Globally harmonised government backed disclosure standards are an essential central pillar for inspiring confidence in investors. We must therefore ensure that investors are able to appropriately disclose. Treasury’s on-going policy work on the climate-related financial disclosure work is an essential part of this step. AFMA was pleased to respond in depth to the first consultation and looks forward to participating in the second recently released consultation. Our energy transition requires a legislative disclosure framework to create an environment of certainty, to be achieved.

Data collection infrastructure is the fundamental building block on which disclosure and targets rely. AFMA members are committed to the task on the basis that implementation recognises how long and hard the road will be; and realistic compliance expectations and standards that take account of these realities, are set. There is still much to be done to build up the quality of data collection which will underly this. AFMA is working with members and regulators to identify the data that will enable reporting. The settlement of consistent disclosure standards is essential for defining what data and systems need to be put in place, which is work we continue to advance. This work will likewise require support at the national level.

In conclusion, AFMA strongly encourages the Authority to highlight these outstanding market requirements, to government, to enable the markets to perform their intended role as an enabler for the prosperous, resilient net zero Australia; by removing these current barriers.

AFMA Recommendations

- i. Establish an emissions policy based on clear long-term targets.
- ii. Government to develop coherent goals and objectives for the energy transition.
- iii. Legislate disclosure frameworks and standards.

2. Carbon credit integrity

AFMA has long advocated for policy settings that are conducive to strong and stable carbon markets, underpinned by high integrity and investor confidence in the underlying products. Confidence in the quality of ACCUs is critical to ensuring they contribute to emissions reductions and for the success of

the market. At its simplest, purchasers of ACCUs need to be confident that the underlying emissions reduction projects achieve the emissions reductions that they claim. Lack of confidence in the crediting system could put undermine the business incentives ACCUs are based upon and put at risk the resulting environmental and economic benefits. AFMA supports the implementation of the Chubb Review's recommendations. AFMA still however has the following outstanding concerns about the regulatory framework for carbon which AFMA believes the Authority should consider whilst developing its advice to government.

2.1. Methodologies

AFMA supports reviewing the approved methodologies for creating ACCUs and verification processes to ensure they of high quality. To have confidence in the quality of ACCUs the market, stakeholders and those conducting projects need access to high quality information about the verification activities that have been conducted for a given ACCU. We also note that it is important that other officially endorsed methodologies that recognise carbon reductions outside the ACCU framework, such as the proposed Climate Active Guideline: Accounting for Carbon Sequestration from Tree Plantings, have integrity. While these may not enable the generation of ACCUs, if these approaches lack robustness, and do not apply the same standards as a crediting methodology — they could further undermine the trust that stakeholders have in carbon markets and offset units. Currently information on existing Emissions Reduction Fund projects is limited and as a result, detailed due diligence work can be difficult to undertake. AFMA considers that this information should be easily accessible and transparent in the Australian National Registry of Emissions Unit (ANREU).

2.2. Australian National Registry of Emissions Unit (ANREU)

Carbon market participants have repeatedly raised concerns about the functionality, information availability and usability of ANREU. This poses an integrity risk that should be swiftly addressed to ensure that the data in the registry meets the markets' needs and that it has appropriate functionality to support the market. As the market grows and we rely on the carbon markets to support the transition, it is important that the register underpinning the market is appropriately equipped. Specifically, AFMA would highlight the following areas requiring enhancement.

- a) Search and reporting functionality
- b) Account and user setup
- c) Transacting
- d) Application Programming Interface (API) access to ANREU

2.3. Integrity risk in other aligned markets

AFMA notes the Government's intention to have the Nature Repair Market (NRM) operate alongside the carbon market and that the Bill has similarities with the Carbon Credits (Carbon Farming Initiative) Act 2011. A number of activities may give rise to certificates under the Bill and ACCUs which AFMA foresees potential risk in. AFMA supports projects being able to generate multiple benefits but wants to highlight that some ACCUs are currently issued with co-benefits related to biodiversity, which purchasers are willing to pay a premium for. AFMA is concerned that there is the potential for double counting if the same activity can be counted towards a co-benefit under an ACCU as well as a certificate issued under the NRM. This therefore poses an integrity risk to both markets and AFMA as such proposed that there should be a prohibition on counting the same

activity towards both the ACCU co-benefits and NRM certificates, in its submission to the Committee inquiry.¹

Furthermore, clear accountability measures and safeguards for the Clean Energy Regulator (CER) and oversight/ review of the methodologies applied by them in the NRM, will be essential to combat integrity risk. Whilst at the time of writing this submission, the NRM is still making its way through the Parliament, AFMA would caution the Authority to consider this potential integrity and greenwashing risk.

AFMA strongly supported the enhancement to the Safeguard Mechanism to allow it to play a key role in meeting Australia's climate goals and welcomed the Bill's passage through Parliament. AFMA supports market-based solutions to decarbonisation and thinks that Safeguard Mechanism Credits (SMCs) will play an important role.

As SMCs will be a substitute for ACCUs for companies with obligations under the Safeguard Mechanism; as a result, we anticipate that there will be a link between the market for SMC and the market for ACCUs. AFMA considers that there is a risk of significant volatility during the early years, as with any new market, of the SMC scheme. Given the probable link between the SMC and ACCU markets, there is potential for this volatility to flow between markets. Therefore, we recommend that any changes to ACCUs should be minimised during the implementation of SMCs to reduce the potential for volatility in both markets.

2.4. Integrity buffers

With regard to further integrity buffers to be applied, the buyer of the credit should be privy to all information on the credit. However, should an integrity concern arise, AFMA does not believe that responsibility lies with the buyer when the integrity issue is caused by the producer. If a credit has been approved by the CER, then the buyer should have confidence in the quality of the credit and should not have to perform any additional verification. AFMA considers it is ultimately the role of the regulator to determine quality and the market will naturally follow the determination of the regulator, as is the case in all other major markets where the regulator or credit rating agency has made a determination on quality.

If, however a situation does arise where the credit is found to not meet the quality standards then AFMA proposes two approaches:

- 1) If the producer of the credit is at fault, then AFMA suggests that the producer should have to true up by purchasing replacement ACCUs.
- 2) If no one is at fault but the regulator subsequently revises a methodology, then AFMA assesses that looking toward future targets is the best course of action, rather than penalising buyers or producers of the original ACCUs.

AFMA notes the issues paper raises also the question of a demand-side integrity role. AFMA firmly believes that it is for government to set integrity rules and requirements, not demand side. Whilst buyers/ users should have access to all relevant information to make their own assessment on the product from their own personal commercial decision-making perspective, they should not be assessing integrity. AFMA affirms that only government and regulators should be assessing and qualifying integrity.

¹ <https://www.afma.com.au/policy/submissions/2023/r34-23-senate-committee-nature-repair-market-bill.pdf?ext=.pdf>

AFMA Recommendations

- iv. AFMA supports reviewing the approved methodologies and verification processes to ensure that they are of high quality.
- v. Provide appropriate functionality, information quality and usability of ANREU in line with market needs and growth.
- vi. Address the potential integrity risk of double counting a biodiversity co-benefit under an ACCU as well as a certificate issued under the proposed Nature Repair Market.
- vii. Government and regulators should have primary responsibility for assessing and confirming unit integrity.

3. Retail participation

Recent reforms to the carbon market have increased participation by small businesses and individuals. While in many ways this is a positive development it is important to ensure that the regulatory framework provides appropriate protections for these customers.

Unlike other environmental certificates, ACCUs are financial products under the Corporations Act 2001 and are therefore subject to licencing requirements for anyone wishing to deal in them. There are also consumer protection requirements, including requirements related to the design and distribution of products, that apply when dealing with retail customers. We are concerned the implications of these retail protections on the ACCU market are not fully understood as ACCUs have not traditionally been offered as a retail product.

Classifying ACCUs as financial products brings the benefit that there are existing consumer protection arrangements for retail customers, but the licencing requirements have deterred a number of participants who are active in other environmental product markets from dealing in ACCUs. AFMA is also not confident that the application of the protections for retail purchasers of ACCUs is fully understood.

Consideration should be made as to whether the current regulatory regime for financial products is appropriate to ensure retail customers can access ACCUs; and that they are covered by appropriate consumer protection provisions or if there is a need to develop separate ACCU specific arrangements. The regulatory arrangements for issuing and dealing in financial products are complicated and AFMA encourages engagement with Treasury and ASIC about their application to the ACCU market.

The CER is currently pursuing a project to establish an Australian Carbon Exchange. We understand that part of the motivation for developing the exchange is to give retail customers a place to buy and sell ACCUs. AFMA is concerned about the progress of this project and cautious about its potential to work as an effective platform for retail trading.

Our observation is that successful exchanges typically develop organically to meet the needs of the wholesale market. Markets that develop predominantly for retail participants, such as unregulated cryptocurrency exchanges, or even ASX listed penny stocks, are prone to high volatility and vulnerable to market manipulation; and therefore, may not be suitable for retail participants looking to transact ACCUs. For comparison, the ASX allows retail customers to buy and sell securities, but retail customers do not directly trade on the exchange. Instead, financial intermediaries facilitate trading and settlement with the exchange on behalf of the retail customers.

We are concerned that the current project is likely to incur significant implementation costs and that there is a serious risk that it will not deliver on its objective of facilitating retail access to the ACCU market. We suggest that work on the exchange should be paused while policy makers and market participants consider how to provide retail customers access to ACCUs, this could include over-the-counter products or simpler retail platforms.

The role of unregulated intermediaries negotiating with unsophisticated landholders for the creation of ACCUs is also an area of concern. AFMA suggests that the activities and business models of these intermediaries be looked into, with particular consideration of appropriate supervision, and accountability arrangements. It would also be beneficial to understand from Treasury and ASIC if these intermediaries are issuing, advising on, or dealing in financial products without holding an Australian Financial Services Licence; or alternatively, if they are acting as authorised representatives of licensees, if appropriate supervisory arrangements are in place.

AFMA Recommendations

- viii. Government should consider the need for protection of retail participants in the ACCU market, this should include reviewing the application of the Corporations Act licencing requirements and consumer protection provisions to the market for ACCUs.

4. International units

As addressed above in section 2.3, AFMA considers that given the current rate of change in the Australian carbon market there is significant risk of volatility in the next few years. We therefore think it is appropriate to minimise changes to the regulatory framework in the short term while the market stabilises. We recommend delaying consideration of the introduction of international units for two years.

AFMA Recommendations

- i. Minimise changes to the regulatory framework whilst the market is stabilising.
- ii. Delay consideration of the introduction of international units for two years.

Thank you for considering the points and suggestions raised in this submission. AFMA would welcome the opportunity to discuss this submission further and would be pleased to provide further information or clarity as required. Please contact me via myoung@afma.com.au or 02 9776 7917.

Your sincerely,



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