



12 December 2011

The Manager
Consumer Credit Unit
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: carbonfarming@treasury.gov.au

Dear Sir/Madam

Exposure Draft – Regulating Australian Carbon Credit Units and Eligible International Emissions Units as Financial Products

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the exposure draft of the proposed amendments to the *Corporations Regulations 2001* and the *Australian Securities and Investments Commission Regulations 2001*.

AFMA has played a leading role in the development of spot and forward trading in environmental products including Renewable Energy Certificates and New South Wales Greenhouse Gas Abatement Certificates. As the national association for participants in wholesale financial markets, AFMA has established trading protocols and developed standard contracts documentation, as well as providing data services, dealer accreditation, training and other services to facilitate the efficient operation and development of the market. AFMA continues to participate in the development of carbon markets in Australia including those for Australian carbon credit units and the carbon pricing mechanism under the *Clean Energy Act 2011*.

AFMA supports the proposals in the draft regulations to avoid unnecessary compliance costs. We believe a longer transitional period is needed and that the arrangements could be clarified through drafting changes as outlined in our comments below. We have assumed that the regulations will provide a model for similar treatment of carbon units issued under the Clean Energy Act and have approached the regulations on that basis.

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AFMA does not regard any part of this submission as confidential.

Scope

The amendments are being made in respect of Australian carbon credit units and eligible international emissions units. Given that carbon units under the Clean Energy Act are also to be designated as financial products under section 764A(1)(kaa) of the *Corporations Act 2001*, all three categories of product could be addressed within the one set of amending regulations. This would assist in identifying the need, if any, for different treatment among these three categories of product, for example, relating to the timing of the proposed 7 month transition window.

Paragraph 2, proposed 7.1.071(2)

Members have expressed concern that a transitional period of 7 months from 8 December 2011 will be too short for the following reasons:

- Sufficient time is needed for new market participants to apply for licences and for existing licence holders to apply for licence amendments. Licence amendments may take as long as an application for a new licence; and
- The transitional window also needs to allow for ASIC to put in place the procedures and policies under which applications for new licences and licence variations are made and assessed.

AFMA proposes that the transitional period be extended to at least 12 months, and that the window commences only when ASIC has all necessary policies and procedures in place to allow applications for new licences or licence variations to be made.

Paragraph [8], proposed 7.6.01(1)(ma)(i)

Paragraph 1(A) should extend to facilities which are financial products due to the operation of section 763A.

Paragraph (1)(B) should read “*dealing in Australian carbon credit units or eligible international emissions units*” for consistency with paragraphs (A) and (C). Paragraph [8], proposed 7.6.01(1) (ma)(iii)

This requires that the dealings be entered into “*for the purpose of managing financial risk in relation to the surrender, cancellation or relinquishment of Australian carbon credit units ...*”.

We propose that the text be replaced with “*the dealing is entered into for the purpose of managing a financial risk that arises in the ordinary course of a business*” (adopting the language in paragraph (m) of Regulation 7.6.01(1)).

This change would address the following concerns with the current wording:

The phrase “*managing financial risk in relation to the surrender, cancellation or relinquishment of [units]*” can be read narrowly to cover only financial consequences

arising under the legislation and to exclude financial risk arising in other ways in connection with these products in the ordinary course of business, for example due to delivery default.

The proposed paragraph only allows the risk of the person engaging in the dealing, or their related body corporate or associated entity to be considered. There seems no reason to adopt a more narrow approach than paragraph (m) of Regulation 7.6.01(1)). The proposed wording may be unduly narrow in the case of a partnership, joint venture or trust.

Changes to part 7.7 (financial services disclosure)

These provisions replace the requirement to provide a Product Disclosure Statement with information provided by the Carbon Credits Administrator about the financial product.

The provisions could be amended to clarify what information must be given in relation to derivatives over Australian carbon credit units or eligible international emissions units or financial products under section 763A. At present the requirements are open to interpretation.

By way of example, in paragraph [11] the proposed Regulation 7.7.10(a)(i) is said to apply to part 7.7 of the Act *“in relation to an Australian carbon credit unit”*. It is not clear whether this phrase is intended to extend to derivatives over those units, however on one interpretation it does, since the replacement wording refers to *“the acquisition, or possible acquisition, of an Australian carbon credit unit”* and the terms of the acquisition may themselves be a derivative.

In order to assist in applying these provisions in practice:

- the drafting could be clarified to explain whether the rules apply when the acquisition of units is undertaken on terms which themselves amount to a derivative (or financial product under section 763A); and
- further changes could be made to clarify what does and does not constitute a derivative over a unit. Such clarification is necessary in light of recent case law considering section 761D and section 763A. One way to achieve this might be to include a new regulation to the effect that for the purposes of section 761D(3)(a), Australian carbon credit units or eligible international emissions units are to be treated as if they were tangible property for the purpose of that section. The terms of an acquisition or possible acquisition of those units can then be structured to fall within section 761D(3)(a). By virtue of section 765A(1)(n) such transactions will not be financial products within the general definition of financial products under section 763A.

Paragraph [13], proposed 7.9.09B

Proposed 7.9.09B should be amended from *“in relation to an Australian carbon credit unit and an eligible international emissions unit”* to *“in relation to the acquisition or*

possible acquisition of an Australian carbon credit unit and an eligible international emissions unit” for consistency with proposed regulation 7.7.10AI.

Paragraph [15], proposed paragraph 19.4 in new Part 19 of Schedule 10A, amendment to subsection 1012IA(1)

In the proposed amendment to subsection 1012IA(1), replace “an acquisition” with “an acquisition or possible acquisition” for consistency with proposed regulation 7.7.10AI.

Thank you for considering this submission, please contact me if you would like to discuss any of the points raised in further detail.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Jeffree', with a long horizontal flourish extending to the right.

Damian Jeffree
Director, Policy
AFMA