28 October 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 Draft Legislation

The Australian Financial Markets Association (AFMA) is responding to the Safeguard Mechanism Reform: Consultation on draft legislation.

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets. AFMA has more than 125 members reflecting a broad range of participants in financial markets.

AFMA's members are actively involved in Australian carbon and environmental product 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 the proposed Safeguard Mechanism Credits (SMCs) can play an important role. Given the importance of these reforms, we want to note that the consultation period is inappropriately short. We ask that future consultations on the more detailed delegated instruments be substantially longer to enable stakeholders to provide the highest quality feedback possible.

Broadly we support your approach of implementing a regulatory framework based on the well understood one used for ACCUs. Our submission focuses on areas where we consider the ACCU framework could be improved, including the treatment of ACCUs and SMCs as financial products, and the proposed information disclosure provisions.

1. Building on a well understood framework

The regulatory framework for ACCUs is well understood by the market and provides a solid foundation for SMCs. Modelling the regulatory framework on the arrangements for ACCUs will reduce regulatory uncertainty as many of the arrangements are similar to existing ones the market is familiar with.

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Enabling market participants to use their existing ANREU accounts to hold SMCs will also simplify implementation.

AFMA is pleased that ANREU account creation is not limited to entities with obligations under the scheme and that there are no restrictions on transferring SMCs to the accounts of entities without an obligation under the scheme. As indicated in our submission to your Safeguard Mechanism reform: consultation paper (Consultation Paper), AFMA considers that allowing broad participation in the SMC market by financial intermediaries is essential to ensuring the success of SMC as it will allow intermediaries to facilitate trading, offer risk management products and provide financing.[1]

i.	AFMA supports the use of the ACCU regulatory framework for SMCs including the decision to allow financial participants to participate in the market for SMCs.

2. Impact of the ACCU review

While AFMA supports using the ACCU regulatory framework as the basis for the SMC framework, we believe it is important to note that the arrangements for ACCUs are currently under review and we consider there are a number of areas where they could be improved. AFMA asserts that any relevant changes that are made to the ACCU framework should also be implemented for SMCs. Two areas where we think this is particularly important are enhancements to ANREU and the classification of ACCUs and SMCs as financial products.

2.1. Enhancements to ANREU

AFMA's submission to the Independent Review of ACCUs raised our member's concerns about the suitability of ANREU and noted that they compared its functionality unfavourably to the REC Registry.[2] Our members consider ANREU is difficult to use and that it does not provide useful information about activity in the market. They would like it to provide clearer data on the volume of units including; information about the traded volumes and numbers of certificates in existence. Our members also thought it should include read only functionality to enable support and risk areas within their businesses to access registry data without a danger of altering it.

AFMA recommended that ANREU should be reviewed to ensure that it is fit for purpose. We consider that any relevant changes that are made to ANREU for ACCUs should also be implemented for SMCs; and that the implementation of SMCs should be taken as an opportunity to enhance ANREU's functionality.

2.2. Classification as financial products

AFMA raised concerns about the treatment of ACCUs as financial products under the *Corporations Act 2001* in our submission to the Independent Review of ACCUs and consider that any decision about classifying SMCs as financial products should be delayed until the ACCU review is completed. In our submission to the review we noted that ACCUs are the only Australian environmental products that are classified as financial products and therefore, people wishing to deal in them are subject to

[1] https://afma.com.au/getattachment/Policy/Submissions/2022/R52-22_Safeguard_Mechanism_-Reforms/R52-22-Safeguard-Mechanism-Reforms.pdf?lang=en-AU&ext=.pdf

[2] https://afma.com.au/getattachment/Policy/Submissions/2022/R52-22_Independent-Review-of-ACCUs/R055-22-Independant-Review-of-ACCUs.pdf?lang=en-AU&ext=.pdf

additional licencing and consumer protection obligations that do not apply to other similar products, such as Renewable Energy Certificates.

In our submission we noted that the licencing requirement has deterred some intermediaries from participating in the ACCU market. Additionally, AFMA considers that the implications of the *Corporations Act's* consumer protection requirements are not fully understood in the context of ACCUs. We therefore encouraged the panel to engage with ASIC and Treasury about the appropriateness of applying Australian financial services law to ACCUs. We have the same concerns for SMCs and consider that a decision on classifying them as financial products should be delayed until the Independent Panel has made its recommendations. Many of our concerns about the classification of ACCUs and SMCs as financial products relate to the impact of financial services regulation on transactions with retail clients. In the case of SMCs, this issue could be avoided by requiring anyone transacting in SMCs to either have an obligation under the scheme or be a "wholesale client" within the meaning of the *Corporations Act 2001*.

AFMA objects to the use of the *Australian National Registry of Emissions Units Act 2011* (*ANREU Act*) definition of "eligible international emission unit" to categorise SMCs as financial products. SMCs are by design an Australian product that will be generated by activities in Australia and are not intended to be traded outside of Australia. It is therefore inappropriate for them to be described as international emissions units. If policy makers decide that SMCs should be classified as financial products, this should be done by adding them to S764A of the *Corporations Act 2001* in the same way as ACCUs. The decision to include SMCs in the *Corporations Act 2001* should be made in consultation with Treasury.

ii. Any relevant changes made to the ACCU framework should also be made for SMCs, including changes to ANREU's functionality.
iii. The decision on if to treat SMCs as financial products should be delayed until the issues are fully considered by the Independent Review of ACCUs.
iv. If SMCs are ultimately designated as financial products this should be done, in consultation with Treasury, by amendments to the *Corporations Act 2001.*

3. Registry Account information

AFMA supports the provision of high-quality information about the SMC market by the registry. As stated above in paragraph 2.1 we consider ANREU should provide clearer data on the volume of units including; information about the traded volumes and numbers of certificates in existence. But we do not think the proposed sections 60A and 60B are necessary for the implementation of the SMC reforms and are concerned the changes are being rushed when they should be dealt with as part of a broader review of the disclosure of information from ANREU, that should be done as part of the Independent Review of ACCUs.

Some of our members have raised concerns that disclosing the number of units in each account could be unhelpful because of the role played by financial market participants in the ACCU market and expected to be played by them in the SMC market.

As set out in our response to your Consultation Paper, financial intermediaries perform a number of functions in the ACCU market, which we expect will perform similar functions in the SMC market. Relevantly, financial institutions may offer:

a) financing where the institution takes custody of a client's units and returns them to their client on the repayment of the debt
b) forward products to clients which the institution will then offset by purchasing spot units which will be delivered to the client at the maturity of the forward contract.

Both types of transactions result in financial institutions holding large number of units in their ANREU accounts. But this can misrepresent their ability to freely transact the units as they are committed to delivering the units to their clients on repayment or maturity. As a result, this data may give an inaccurate picture of holdings in the market as it could give the impression that the financial institutions are long units while their clients, with surrender obligations, are short while, in reality, both have square positions.

We therefore think that disclosure of the information held in individual accounts should be considered as part of a broader review of ANREU's functionality to ensure that all information disclosed is helpful to the market.

v.	Sections 60A and 60B should be removed from the current changes and considered as part of a broader review of information disclosure from ANREU.

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.

Yours sincerely

Lindsay Gamble
Policy Director