

27 February 2023

Safeguard Mechanism Taskforce
Department of Climate Change, Energy, the Environment and Water



Submitted via Consultation Hub

Dear Safeguard Mechanism Taskforce,

Safeguard Mechanism – Position Paper

The Australian Financial Markets Association (AFMA) is responding to the *Safeguard Mechanism Taskforce’s Safeguard Mechanism – Position Paper*.

The Australian Financial Markets Association (AFMA) is the leading 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 and industry service providers.

AFMA’s members are active participants in Australia’s carbon markets and we strongly support the development of the Safeguard Mechanism as a market led approach to meeting Australia’s net zero commitments. AFMA maintains industry standard template documentation for transacting in Australian Carbon Credit Units (ACCUs) and administers the Carbon Market Conventions that streamline market practices and enable Australia’s over-the-counter markets; to operate to high standards, consistent with international markets.¹ AFMA stands ready to support the success of the Safeguard Mechanism by providing similar market documentation and conventions.

1. A market led approach

AFMA considers that the design of Safeguard Mechanism Credits (SMCs) is likely to support the development of a functional and efficient market that can contribute to the achievement of Australia’s net zero commitments. Utilising the well understood regulatory framework for ACCUs will give the market confidence in the product, aid industry wide understanding, and facilitate transacting in SMCs. Allowing intermediaries to participate in the SMC market will facilitate trading and positively enable the development of complementary risk management and financing products.

- i. The design of SMCs is likely to support the development of a functional market.

¹ <https://afma.com.au/Site/media/Media/Documents/Standards/Market-Conventions/Carbon-Market-Conventions.pdf>

2. Baselines provide clear market signals

Clear signals are important for the development of any functional market. AFMA therefore welcomes the proposal for setting baseline decline rates set out in the position paper as it provides the much needed market certainty on the decline rates between now and 2030, as well as a clear and timely process for determining the rates for future periods. We assess that this approach is likely to provide clarity about the overall targets which will assist the market to naturally develop.

- ii. The approach to setting and reviewing benchmarks provides valuable clarity to the market which will aid the market for SMCs, to develop.

3. Supporting a stable market

As identified in the position paper, there is a risk that there will be volatile pricing in the early years of the scheme. This is of particular concern because of the link between the SMC and ACCU markets, which could lead to volatility spilling between the markets. AFMA assesses that it may be prudent, considering some further measures, to ensure price stability in the initial years of the scheme.

We note that the scheme now includes a cost containment measure to mitigate the risk of high prices, but suggest policy makers consider the following mechanisms to support stable pricing:

- a) ensure the headroom in the Safeguard Mechanism is set at an appropriate level to avoid over allocation of units. The proposed hybrid approach to setting baselines appears a sound approach but the setting of baselines remains a key task;
- b) minimise 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 becomes established.

- iii. Policy makers should consider additional measures to maintain pricing stability of SMCs in the initial years of the scheme.

4. Need for a high-quality register

Our members continue to raise concerns about the suitability of ANREU for ACCUs (as expressed in AFMA's recent 2023/24 Pre-Budget submission), and its ability to support SMCs. Our members consider that ANREU is difficult to use, does not support integration with external systems and that it does not provide useful information about activity in the market.

It would be beneficial to market participants, to provide clearer data on the volume of units, including information about the traded volumes and numbers of certificates in existence. AFMA considers that the scope of the data should be developed in consultation with market participants to ensure that it facilitates trading of ACCUs and SMC. Our members' view is that publishing individual holdings of ACCUs and SMCs is unlikely to be valuable to the market; they consider that high quality aggregated information will be more useful.

Our members also consider that ANREU should include read only functionality to enable support and risk areas within their businesses to access registry data without a danger of altering it. Additionally they consider that it should support connectivity with third party systems, including market operator systems.

- iv. ANREU should be reviewed to ensure it is fit for purpose and any enhancements should be implemented prior to the commencement of trading in SMCs.

5. Implementation considerations

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. The proposed approach of finalising the rules for SMC's to 1 July 2023, and issuing the first SMCs in January 2025, will give the market adequate notice to ensure they are able to appropriately trade the product upon commencement. It will also allow AFMA and our members time to revise the industry standard template documentation and Carbon Market Conventions to incorporate SMCs— essential for market efficiency and best practice purposes. But members have raised concerns that the three month window for trading SMC's for the current surrender year may be too short and suggest that you consider extending this period to 6 months.

- v. The implementation time for SMCs is appropriate.
- vi. The period for trading SMC for the current surrender year should be extended to 6 months.

AFMA would welcome the opportunity to discuss the development 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