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AI Carbon submission on Corporations Amendment (Emission Reduction Fund Participants) Regulation 2015

John Lee
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Financial System and Services Division
The Treasury

Mr Lee,
We thank you for the opportunity to make a submission on the proposed changes to the Corporations Act in regards to the operation of the Emission Reduction Fund.

Australian Integrated Carbon Operates across the land sector as an integrated natural resource management services provider, with clients from Broome to Cairns, & Perth to Sydney. We hold an Australian Financial Services Licence with appropriate authorisations for advising, dealing, making a market in both carbon and derivatives. Our client base covers farmers, pastoralists, state government agencies and local governments, not-for-profits, resource companies, indigenous corporations and native title bodies corporate. With this wide view of the commercial carbon landscape, we feel capable of providing detailed feedback to the proposed amendments.

In summary, we hold serious concern that the watering down of customer and consumer protections in this sector as proposed will lead to not serve to deliver “easier participation in the market” but will in fact allow series cases of malpractice and poor advice. The net result of the poor advice and inevitable consumer losses that will follow will lead to a loss of faith in the market. Given the intent of the nascent carbon market is to provide significant reductions in greenhouse gases, the proposed amendments will have the long term negative consequence of inhibiting Australia from being able to achieve abatement targets rather than achieve them. As such, several of the proposed changes actually present a serious policy barrier to the achievement of Australia’s short-term (e.g. 2020) and emerging (2030-2050) commitments under international protocols.

We are concerned that ACCUs are financial products and contracts can be derivatives in some certain circumstances, and not in others. There is significant confusion in the sector as it is, and we feel that the proposed changes further muddy the waters and actually make a complex situation more complex, not less, which should be the aim of good regulation.

We provide detailed commentary below. If you have any questions regarding our submission, please contact me directly.

Dr Tim Moore,
Managing Director

Discussion question 1.

The proposed amendments to the "dealing in ACCUs" and "providing custodial and depository services" to the role of aggregator as stated fail to provide critical consumer protection. This is particularly the case in the land sector, in relation to carbon sequestration projects. Where projects carry a carbon permanence obligation, there is an additional set of risks that could arise as a result of participation in the carbon scheme, relating to land value and permanence obligations on title. The use of standardised contracts may be sufficient to provide protections to participants in simple energy efficiency aggregations or other emission avoidance projects. We do hold concern that participants are still exposed to a complex financial product and complex dealings on derivative products, including potential exposure to liquidated damages under a standard ERF purchase contract with the Clean Energy Regulator. However, for carbon sequestration projects there is an additional level of risk to project participation that requires providers of financial advice in relation to financial products such as ACCUs need to give reasonable consideration to how the client is advised on nature and opportunities to manage risks of participation. As such, the proposed amendments are risk broadly speaking, and much more so for the land sector.

We have recently seen clear examples of incredibly complex contracts and misleading or tricky behaviour already in the land sector by unlicensed and unqualified "service providers" seeking to get landholders to participate in carbon aggregation schemes.

Thus, the watering down of protections for those who may be able to enter an aggregation model as proposed in the discussion paper would appear to hold the likely outcome of worse long term participation rates in the scheme, rather than the purported increases. Again we emphasise the critical need for full and deep participation of the land sector to meet any vaguely ambitious emission reduction targets Australia may commit to. Failing to provide critical protection for landholders as currently in place under the existing regime will reduce Australia's ability to meet long term emission reduction targets.

4.1.3 proposed exemptions for carbon abatement contracts

Any change to exempt carbon abatement contracts from being labelled a "derivative" should only apply to a contract between a project owner and the Clean Energy Regulator. Any other forward delivery contracts over an ACCU or carbon right should still be recognised as a derivative, with appropriate licencing requirements applying to dealing, advising or issuing. This includes by any dealing of a project owner seeking carbon rights from other project participants.

Discussion questions 4 ,5 ,6

The proposed amendments to the view of certain aggregation arrangements as MIS are more complex than what is required. A simpler approach would be to provide a class order relief, with instruction that each application needs to make a simple application for relief via ASIC. This step means proponents would be made aware of the nature of the risks and the nature and intent of the Corporations Act in this case to provide relevant consumer protections. This way, ASIC can maintain awareness of who is operating schemes, and to allow ASIC to have at least some regulatory

oversight and to be able to provide advice to improves process and better inform participants of rights and obligations.

Section 4.3

When is a financial product not a financial product? When it's an ACCU that's in an aggregation contract, but not an ACCU that's in the secondary market. This proposed change only serves to propagate confusion and mis-understanding in the market. We see no benefit in exempting certain aggregation arrangements from being deemed to be financial products.

We see that any carbon abatement contract issued by the CER to be able to be clear of such a definition. Any other contract that deals with ACCUs or underlying carbon rights needs to be seen as a financial product.

Section 4.4. ACCUs

Dealing on own behalf considerations as they apply to ACCUs (e.g. no need for an AFSL when dealing on own behalf) provisions should stand.

5.1.3 Proposed exemption for incidental financial advice and Question 7

The reader will excuse have to excuse our language here but frankly, "the holes in that are wide enough to drive a truck through!"

The concept that complex financial product advice can be given by someone who can calculate cost of production is not well considered, in our view. Risk management, permanence obligations, ability to access insurance and "make-good" volumes as part of risk management strategies can't be adequately provided by those with just "technical service" skills. We have seen some poor decisions been made by land sector participants off the back of complete mis-truths and commercial behaviour lacking any ethics at all in this space already, and this will only get worse as the lure of the ERF will ring all the scammers and crooks out of the woodwork. There is no certification of competence or quality assurance for technical service providers as it is.

The proposed amendment is giving "carbon cowboys" and "used carbon salesmen" carte blanche to do as they wish by simply saying "oh this advice is incidental". Of all changes proposed in this consultation, this one is in our view the one likely to cause the most long term and significant damage to investor and consumer confidence and therefore most likely to pose significant risk to Australia achieving long-term emission reduction targets.

Our answer to Question 7 is a resounding no.

Section 5.2.2 and Question 8, 9 & 10

Similarly to Question 7, our view is no. Aggregators must make an offer on a future delivery of a product yet to be produced to a producer who may be exposed to future risk to get that carbon right owner to enter the aggregation. We cannot see how arrangements can be put in place that would make the aggregation arrangements not have a dealing term in them.

Section 5.3.2 and Questions 11, 12 & 13
As per our responses to Questions 7-10 previously, the answer is no. We cannot see how the holding of the beneficial rights or ACCUs behalf of someone participating in the aggregation is not providing a custodial or depository service of a financial service.

Section 5.4.2 and Questions 14 & 15
As per our responses to Questions 7-13 previously, the answer is no. We cannot see how someone can seek to prompt someone or allow someone to enter into a complex scheme without making a price offer to be paid in return for a carbon credit or underlying carbon right.

We do not support any of the proposed changes outlined in Questions 7-15 given the significant risk the proposed changes create for consumer protection and investor interest that is required to hit the 2020 and future emission reduction targets has committed to now and will continue to do so in the future.

Section 5.5 and Questions 16, 17 & 18
It is not possible to respond to these questions without the documentation being provided here. We are strongly in favour of the maintenance of the majority of the existing provisions as they currently stand, with the provision of a standing class order exemption upon application for relief from MIS.