COMMENTS ON PROPOSED CHANGES TO AFSL REGULATIONS

Promote baselining and the sequestration of carbon for monetary gain to landholders

Since this would not usually be done without explaining the techniques for sequestering soil carbon it appears to be exempt.

The financial advice he provides is incidental to the main technical advice that he provides, namely, applying the CFI methodology to calculate how many ACCUs would be generated from the tree plantations. Therefore Alan's business would not be required to hold an AFSL.

Outlining to individuals and groups the risks and obligations entailed in selling carbon credits

Probably exempt even under current regulations.

The Government is developing alternative regulatory protections to protect against risks associated with ERF processes. The Government is developing a standardised disclosure document that will highlight the risks and benefits associated with participating in an aggregated project

Providing individuals and groups with a simple financial model of sequestration possibilities together with a range of financial returns

Some technical advice probably needs to be included with the financial advice.

Carbon service providers who only provide financial product advice which is incidental to technical advice relating to an ERF project would not be regulated as financial advisers

Discuss with an individual landholder possible rates of sequestration on his own land, the management technologies for sequestering soil carbon and the process for quantifying and selling any sequestered credits

Exempt under proposed new regulations.

Carbon service providers who only provide financial product advice which is incidental to technical advice relating to an ERF project would not be regulated as financial advisers

Call for expressions of interest in an aggregation proposal to sell credits into the ERF

Since this is a necessary prerequisite to the formation of an aggregation contract we assume it would be exempt.

Carbon abatement contracts, which a proponent and CER enter into after a successful ERF bid, would not be regulated as financial products.

Call for expressions of interest in an aggregation proposal to forward sell credits into the ERF

Since this is a necessary prerequisite to the formation of an aggregation contract we assume it would be exempt. See also the second extract below.

Carbon abatement contracts, which a proponent and CER enter into after a successful ERF bid, would not be regulated as financial products.

Therefore, this paper is proposing to exclude all carbon abatement contracts from the definitions of 'derivative' and 'financial product' in the Corporations Act.

These exemptions also need to apply to Voluntary Market abatement (see comments below on the Voluntary Market). If this exemption is not granted forward sold voluntary market credits will be classified as derivatives even if a project proponent only deals in the derivative on its own behalf.

Enter into an aggregation contract with "site owners" to sell credits into the ERF

Exempt under the proposed regulation changes.

(The Government).. is also developing best practice aggregation contracts which will include standard terms protecting the parties to the contract.

Although carbon abatement contracts are a kind of ACCU sales contract, under the proposed exemption, entering a carbon abatement contract is not regarded as dealing.

Enter into a carbon abatement contract with the CER after a successful ERF bid

Exempt under the proposed regulation changes.

Carbon abatement contracts, which a proponent and CER enter into after a successful ERF bid, would not be regulated as financial products.

Although carbon abatement contracts are a kind of ACCU sales contract, under the proposed exemption, entering a carbon abatement contract is not regarded as dealing.

Enter into an aggregation agreement with one or many site owners where the AACU's are issued to the aggregator by the CER.

This is highly likely where multiple site owners exist. The site owners, say farmers, are averse to paperwork and record keeping so we believe they would prefer this option. In order to facilitate this arrangement we think a Trust structure may be necessary to cover site owners' service requirement of the aggregator (e.g. custodial and depository) and their risk with the aggregator.

The Government is seeking views on whether further exemptions are appropriate. Two potential exemptions the Government could grant would provide that:

- *an aggregator is not considered to be dealing in ACCUs on behalf of a site owner if ACCUs were issued to the aggregator by the CER as a result of carbon abatement provided by that site owner; and*

- *an aggregator is not considered to be providing custodial and depository services to a site owner because it holds ACCUs which were issued by the CER as a result of carbon abatement provided by that site owner.*

Enter into an aggregation agreement with one or many site owners where Voluntary Market credits to the aggregator under the relevant Standard (e.g. VCS, Gold Standard or even CL's own standard).

Again this is highly likely where multiple site owners exist. The site owners, say farmers, are averse to paperwork and record keeping so we believe they would prefer this option. In order to facilitate this arrangement we think a Trust structure may be necessary to cover site owners' service requirement of aggregator (e.g. custodial and depository) and their risk with the aggregator.

There is no compulsion to contract with the CER. On occasions it may be more profitable to sell credits into the Voluntary Market. For example, Pioneer Soil Carbon Credits are not allowed under the CFI but are likely to be marketable to the voluntary market.

Holding site owner ACCU's or rights to future ACCU's generated to manage physical risk of losing soil carbon stocks in the future (e.g. degrading pastures; complete tillage of soil).

Again protection needs to be extended to voluntary market products.

The management of site owner risk is currently covered under the CFI by a requirement that a certain percentage of ACCU's are held in trust/reserve presumably by the CER. However, there are current discussions that could lead to much more efficient risk management arrangements evolving. These could, for example, involve the purchase of insurance products.

Further in voluntary markets while the abatement could be to all intents and purposes "ACCU's" they will not be called that because they are not CFI products.

Under risk management managed by, say, an insurance product part of the risk might be managed by assigning some or all of future abatement from a designated site i.e. forward dated ACCU's in the mandated market and forward dated voluntary market products.

Entities using derivatives for hedging purposes are presently exempted from financial licensing requirements, but project proponents are unlikely to benefit from this exemption. A person dealing in derivatives does not currently need an AFSL if that dealing is to manage a financial risk arising in the ordinary course of a business and the dealing is not a significant part of a person's business. However, since entering carbon abatement contracts is likely to be a significant part of most proponents' businesses, most proponents would need to hold an AFSL.

Ordinarily, a derivatives trader is required to be licensed to provide some protection to the other party to the derivatives contract. As the other party of a carbon abatement contract is the Clean Energy Regulator, which does not require such protection, the requirement that parties entering a carbon abatement contract hold an AFSL represents an unnecessary regulatory burden. Therefore, this paper is proposing to exclude all carbon abatement contracts from the definitions of 'derivative' and 'financial product' in the Corporations Act.

Some mechanisms that improve the sharing of risk and reward between the aggregator and site owners make the aggregation arrangement more likely to be considered a MIS. Such arrangements are more likely to be commercially acceptable to both aggregators and site owners, but the

regulatory consequences of being regulated as a MIS could deter the adoption of such risk management mechanisms.

The generic financial services law does not adequately protect members of an aggregation against risks associated with aggregation, such as changes in the price for ACCUs, and disincentivises the use of risk mitigation mechanisms. As such, the financial services regime could actually increase the risk exposure of site owners.

The draft regulation therefore provides a targeted exemption for aggregation arrangements from the definition of 'managed investment scheme'. The exemption is not intended to extend to schemes investing in or funding emissions offsets projects. Genuine investment schemes will continue to be regulated as MIS. Therefore, a scheme in which members contribute money or ACCUs to the scheme would not be exempt.

The exemption needs to be drafted so that it includes risk management arrangements where ACCU's, and rights to future soil carbon abatement are used to cover physical loss e.g. complete tillage, fire, erosion etc and refusal to deliver.

Income derived from Risk Management

The final form of risk management arrangements and/or products that might evolve outside the CER/CFI is by no means certain. The development of these products should not be hindered.

For example,

- Insurance companies may simply charge a price to assume the risk of physical loss of soil carbon stocks.
- Similarly to the CER they may require the assignment of a percentage of ACCU's to them for release once certain risk criteria are met. It may be that the insurer receives the benefit from any price increase and wears the loss from nay price decrease. So would the site owner and the aggregator be classified as operating a MIS?
- Alternatively, the ACCU's might be monetised and the funds managed by the insurance provider with the site owner and maybe the aggregator sharing in any income gains or losses. So would the site owner and the aggregator be classified as operating a MIS?

Project proponents bear responsibility to deliver abatement under a CER contract and depending on how a voluntary market sale is structured also to a buyer in that market if it involves forward sales. As already stated we see the buyers eventually accepting an insurance product to cover part or all of what they see as their risk. However, project proponents could use other methods or products to provide risk cover e.g.

- They could purchase ACCU's in the secondary market
- They could convince their counterparties to accept a certain level of counterparty risk based on their balance sheets
- They could pledge a percentage of their future abatement stream

Using "unders" and "overs" from individual site owners in an aggregation contract to cover/manage risk.

Exempt from MIS definition under the proposed regulation changes.

Entering into contracts with site owners to provide future soil carbon measurement and aggregation services.

Probable or possible in some or all contracts with site owners. Seems to be exempt under the proposed regulation changes.

Most aggregation contracts are not likely to be derivatives because they fall within the existing exemptions for contracts for provision of future services or, in some cases, for delivery of physical goods. However, it is uncertain whether all likely aggregation models would benefit from these exemptions. This could introduce competitive neutrality issues if some models become regulated and some are not regulated.

To provide regulatory certainty in respect of aggregation arrangements already benefitting from the proposed exemption from the definition of 'managed investment scheme', it is proposed that eligible aggregation arrangements also be exempted from the definition of 'derivative' in the Corporations Act.

Extending credit to site owners to cover existing liabilities (e.g. baselining) or to cover some or all of future baselining costs.

Not sure if this is caught as a supplying a financial product and hence would need AFSL.

Brokering of trades

Not exempt.

Thus, financial services in relation to ACCUs which pose similar risks to other financial services, such as the brokering of trades, will continue to be regulated in a similar manner.

CL is unlikely to want to conduct a brokerage business. Where we need to buy or sell ACCU's in either retail or wholesale markets we can use a licensed broker.

Trading in ACCUs on behalf of others, or operating a financial market in ACCUs

Not exempt with following possible exception.

An aggregator could be provided an exemption for dealing in an ACCU on behalf of a site owner if that ACCU was issued to the aggregator in recognition of carbon abatement (or means of undertaking carbon abatement) contributed by that site owner.

The exemption needs to cover both mandated and voluntary markets.

Making a Market

A person makes a market in ACCUs if they regularly state the prices at which they propose to buy or sell ACCUs on their own behalf and they have a reasonable expectation that they will be able to regularly effect transactions at the stated prices.

In the absence of a compelling reason for an exemption, no exemption should be granted.

It is unlikely that we would be interested in engaging in market making.