

Contents

Consultation process.....	2
1. Summary	2
2. Glossary	2
3. Background on Emissions Reduction Fund (ERF)	3
4. Overview on proposed amendments	3
5. Financial Products.....	4
General definition of financial product.....	4
Derivative	4
Managed Investment Scheme (MIS)	5
6. Financial Services	10
Financial advice.....	10
Dealing	11
Custodial and Depository Services.....	13
Making a market	13
Consumer protections	14

Consultation process

The following seeks to add in on the conversation regarding the Emissions Reduction Fund (ERF) Policy initiative re questions posed for participants as procedural in the operation in the ERF processes.

1. Summary

The details have been interpreted and re written to provide clarity for the submitter.

Details on responses to questions posed are a combination of interpreted, re written, proposed diagrams and red font details the subject matter regarded as notable.

2. Glossary

Aggregator: a project proponent which makes a bid during an ERF auction on behalf of discrete or separate emissions abatement activities.

Aggregation arrangement: an arrangement under which aggregation occurs. The arrangement is usually governed by an aggregation contract, which governs the rights of the parties and under which the site owners grant the site owners a legal right to carry out the abatement project.

Carbon abatement contract: a contract between the Clean Energy Regulator and a project proponent which successfully bids in an ERF auction. It sets out the delivery schedule for the ACCU's and the price for the ACCU's.

Carbon service provider: Carbon service providers assist ERF participants in making a bid during ERF auctions by providing information, and advice, including both financial product advice and technical project advice.

Project proponent: the person who makes a bid during an ERF auction.

Site owner: the owner of a site on which carbon abatement activities will take place; a member of the aggregation arrangement who is not the aggregator.

3. Background on Emissions Reduction Fund (ERF)

ERF participants will be required to apply to the CER to register a project under an approved methodology. Participants may only register a project if they have the responsibility and legal right to carry out those projects.

Persons known as project proponents or aggregators may make bids in an ERF reverse auction. Once a project is registered, project proponents can enter into a contract with the Government for future delivery of an accepted volume of ACCUs at a price determined in the reverse auction process. This is known as a carbon abatement contract.

Only registered projects will be considered in the contract establishment and auction process.

The contract establishment process involves due diligence checks to confirm that the project is credible and can deliver the stated emissions reductions within the timeframes indicated.

4. Overview on proposed amendments

The overview on proposed amendments merits the conduct on regulatory requirements and the rigor on divergent obligations of participants;

The proposed exemptions will provide

- Carbon abatement contracts, which a proponent and CER enter into after a successful ERF bid, would not be regulated as financial products;
- Certain eligible aggregation arrangements would not be regulated as financial products;
- 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 advisors.

Government is developing alternate regulatory measures supporting analysis on participant's risks and responsibilities associated with ERF including

- standardised disclosure documentation
- best practice aggregation contracts

Two potential exemptions the Government could grant

- 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 the site owner.

Question 1.

Are any further amendments to the corporation's law required for the efficient operation of the ERF? No

5. Financial Products

General definition of financial product

Derivatives, managed investment schemes and ACCUs are classified as financial products and fall within the AFSL scope. A person who carries on a business providing financial services must hold an AFSL.

Derivative

A derivative is a unit which is given to have a commercial value determined by the value of an underlying asset.

Why use a derivative

A derivative is a financial product subject to market indices which provides a predictive value reducing the risk on price volatility decreasing or increasing providing business with clarity on cash forecasting.

A project proponent as the principal activities is to purchase derivatives from a site owner is required to hold an AFSL.

The applicability on participants AFSL requirements is accorded where principal activities warrant conduct and disclosure.

In the case of a derivative contract all parties to a derivative contract are considered to be issuers of that product.

Exemptions on AFSL is identified where derivatives

- provides for business hedging i.e. rates of exchange today v forward contracting rates of exchange 30, 60 or 90 days
- The insignificance of in the business activities relative to other of the business activities

The relevance is in this case with the CER as the issuing party the difference on the application of derivative as a type of financial product 'not traded on financial markets'. This and the Governments due diligence is regarded to qualify perfunctory as standards on reasonable measures. **The sufficiency of which, in context ERF, is to exclude all carbon abatement contracts from the definition of 'derivative' and 'financial product' in the Corporations Act.**

Questions 2.

Is the proposed exemption appropriately drafted? Yes

Are further exemptions from the regulation of derivatives required? [See details page 5 para 3](#)

Managed Investment Scheme (MIS)

An MIS is a type of financial product used for collective investment. A type of scheme in which

- People (members) contribute money to acquire right to benefits produced by the scheme
- The contributions are pooled, or used in common enterprise to produce financial benefits, or benefits consisting of rights or interest in property, for the benefit of members
- The members do not have day-to-day control over the operation of the scheme

Interests in a MIS are regulated under Chapter 7 of the Corporations Act 2001.

An MIS is marketed to retail clients regulated under Chapter 5C of the Corporations Act 2001.

In order to operate an MIS the responsible entity (RE) must be a public company, hold an AFSL and comply with various statutory duties. This includes acceptable tangible financial resources to act as the RE.

ASIC describes tangible asset requirements that a RE must meet in accordance with ASIC Class Orders. For a registered MIS where assets are held in custody the RE must generally hold the greater of

- \$150,000;
- 0.5 per cent of the average value of the scheme property; or
- 10 per cent of average responsible entity revenue

Other responsibilities of the MIS under Chapter 5C include a

- Constitution;
- Compliance Plan

Aggregation in the context of ERF is regarded unlike other MIS.

It is important to note the distinction on exempted and required process regulations applying to aggregation in the context of ERF

- Aggregation exempted accepted as a single entity with multiple sites principally a single ERF contract with some residual dealings in ACCUs

The relevance is in this case with aggregation it as a process primarily for the purpose of generating carbon abatement, as compared with as a process primarily for the purpose of collective investment.

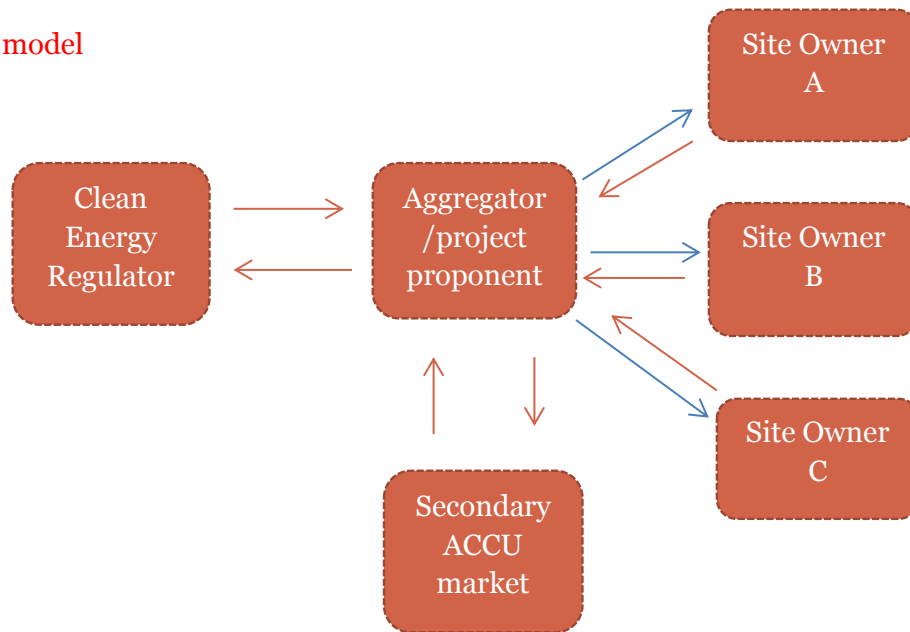
Aggregation is simplified to process multiple sites as a single purpose arrangement solely for the generation and sale of ACCUs *that do not require*

- Analysis and allocation and re-allocation of members' funds to shares of many different companies

Measures on the defined terms *that do not require aggregation analysis, allocation and re-allocation* etc. perhaps considered in the context of Diagram 1: possible aggregation model where the aggregator sells ACCUs to the CER on behalf of stakeholders to regard analysis, allocation and re-allocation etc. is intrinsic to the aggregation process

Diagram 1: possible aggregation/project proponent

model



Genuine MIS remains regulated with RE AFSL requirements recognised as fundamental as a financial product scheme investing in or funding emissions offsets projects.

Aggregation in the context of ERF is exempt as a targeted measure providing a safe harbour affording aggregation to be undertaken in an efficient manner see identified as Example 2: a forestry aggregation arrangement

Identified as Example 2: a forestry aggregation arrangement

Hans who is an aggregator, contracts with thirty farmers to create an aggregation arrangement with the intention that Hans would bid as the project proponent into the ERF. The farmers will plant trees on their land, generating carbon abatement equivalent to 100 ACCUs each. One farmer, Zoe, is concerned that she may produce less abatement than expected. To manage this risk, the aggregation contract states that if one farmer produces more abatement than expected and another farmer produces less than expected, then the excess abatement will be deemed to make up the shortfall of the second farmer.

Although this clause is sensible risk management tool, it would have made this aggregation arrangement a managed investment scheme if not for the proposed exemption. Hans' business would be required to hold an AFSL, It would have to become the responsible entity of the registered scheme and meet the financial requirements applicable to responsible entities. These requirements may have made the arrangement financially unviable. Hans may decide not to adopt such a clause even though it improves the operation of his aggregation arrangement.

The proposed exemption would exempt this aggregation arrangement from the definition of 'managed investment scheme' and 'financial product'. The farmers undertake the carbon abatement by planting trees. If, in an alternate scenario, the farmers had permitted Hans to enter their land to plant trees then they would be providing of the means (i.e. the land) of undertaking abatement to him. This would also be exempt.

Under the proposed exemption, Hans' business would not be required to hold an AFSL or comply with the conduct and disclosure requirements of the financial services regime.

Conversely not all aggregated schemes are exempt see identified as Example 3: An aggregation/investment scheme

Identified as Example 3: An aggregation/investment scheme

Another aggregator, James, contracts with several farmers to create an aggregation arrangement with the intention that they would bid in the ERF. The contract contains the same clause as in the previous example. The farmers grant James permission to enter their land, to plant trees, and the Farmers also contributes money to finance that planting. In return, the farmers will obtain a share of the proceeds of selling the ACCUs plus interest on their money.

The aggregation arrangement is similar to how other managed investment schemes operate – the farmers are earning a return on their investment, rather than merely contributing carbon abatement. The arrangement does not benefit from the proposed exemption as the farmers are contributing both land and money for the aggregator to undertake carbon abatement.

Therefore James' business must hold an AFSL authorising it to act as a responsible entity and must meet the net tangible asset requirements applicable to responsible entities.

Question 4.

Is the proposed exemption appropriately drafted? Does it permit aggregation to take place in an efficient and effective manner? **With adjustments to regard reference question 5.**

Question 5.

Are there other aggregation arrangements which should be exempted from regulation as a MIS? What are the benefits of this arrangement over arrangements within the scope of the exemption as presently drafted? **See details page 7 para 2**

Question 6.

Is the exclusion from the exemption for aggregation arrangements for a predominantly investment purpose sufficiently broad? Yes

6. Financial Services

Financial advice

Financial advice, known as financial product advice under the Corporations Act, defined as

‘ a recommendation or a statement of opinion that is intended to influence a person in making a decision in relation to a particular financial product or could reasonably be regarded as being intended to have such an influence’

The role of a carbon service provider in providing financial advice assists ERF participants in making a bid during ERF auctions providing information and advice this includes technical and non-financial nature (technical advice), which is not regulated under the corporations law.

Example on advice may include

- Costs of a project
- Number of ACCUs a project may generate
- Operational risks associated with the project
- Methodologies for calculating how many emissions reductions would be generated by a project
- Calculating the cost of producing each ACCU
- Recommending a bid price into an ERF auction

The proposition on exemption in the context of ERF is put forward on the basis that advice is minor and/or regarded as incidental to technical project advice. That in this case the regulatory burden is merited to exempt under these conditions terms of reference under the Corporations Act.

Financial advice in the context of ERF is exempt see identified as Example 4: Carbon Service provider.

A carbon service provider named Alan assists Hans in making his ERF bid. Alan makes inquiries of each farmer – for example, how many trees they would plant, about the soil conditions and so on. Alan then applies the relevant CFI methodology to calculate how many ACCUs are expected to be generated. Alan also asks each farmer how much it would cost to plant those trees. From this, Alan can calculate how much it would cost to produce each ACCU. Alan provides a report to Hans including all this information, and concluding that it would cost \$10/ACCU and that Hans should bid \$12/ACCU to earn an appropriate return on investment and to provide a buffer against operational risks.

Because ACCUs are financial products, Alan could, if no exemption is provided be considered to be providing financial advice to Hans by advising what price he should bid. Although Hans could have asked a professional financial adviser to give him this advice separately, it would be more efficient for Alan to do so since he was already familiar with each farmer's operations and already had the requisite information and required expertise.

The exemption would cover Alan's activities. 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.

Question 7.

Is proposed exemption for financial advice which is incidental to technical advice appropriately drafted?' Yes

Dealing

Broadly based the term includes issuance in the context of buying and selling financial products. The act defines dealing as:

- Apply for or acquire a financial product;
- Issuing a financial product;
- Relate to securities or managed investment interests-underwriting the securities or interests;
- Varying a financial product;
- Disposing of a financial product
- Arrange for a person to engage in such conduct

A person who deals on their own behalf is not considered to be dealing, unless they are an issuer of that product.

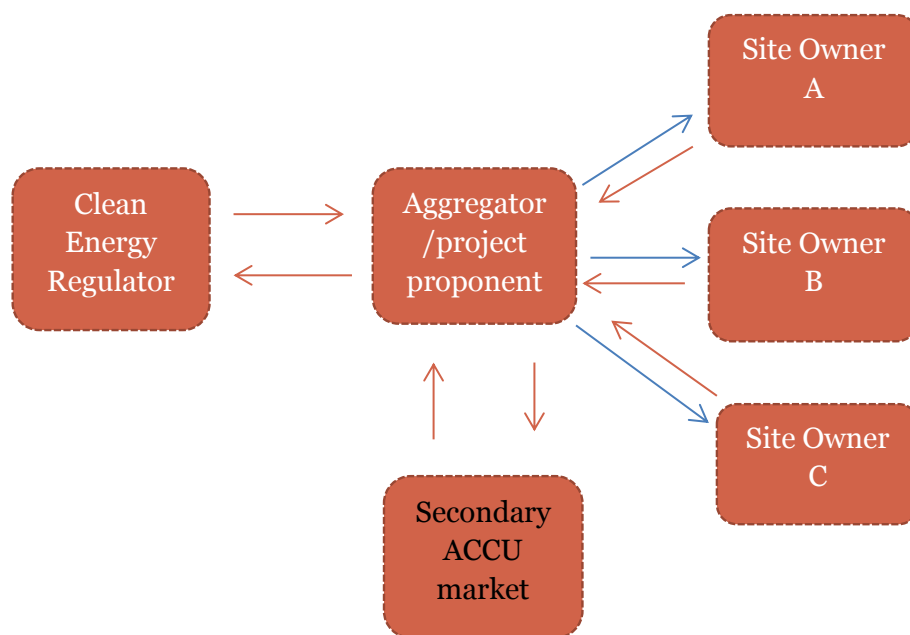
Dealing requirements specifies EFSL as a pre-requisite

The view is to regard aggregators as dealers in their acting as project proponents. In this case the terms merit dealing.

In the context of ERF exemption on dealing in ACCU as aggregator on behalf of site owner(s) could be applied as permissible where the aggregator in recognition of carbon abatement or the means of undertaking carbon abatement are contributed by the site owner.

The exemption see Diagram 2: possible aggregation/ dealer model in dealing the context of ERF and AFSL thresholds becomes effective when the numbers on ACCUs are greater than the proposed ERF sum. Consequently opening trading on a secondary market in this case an EFSL is required as a pre-requisite.

Diagram 2: possible aggregation/ dealer model



Question 8

Could aggregators efficiently adopt a model in which they did not engage in activities considered to be dealing on behalf of other for the purpose of the corporation law? **Yes see question 9**

Question 9

Is an exemption required from dealing in relation to ACCUs? **See details page 12 para 2 & 3**

Question 10

Is the potential exemption for aggregators outlined above appropriate? **Yes**

Custodial and Depository Services

What are custodial and depository services

A person providing custodial and depository services holds assets on trust for or on behalf of a client.

The questions apply to the custodial and depository licensing requirements on assets held and transferred on in the context of ERF.

The exemptions canvassed in the case of ERF assets held and transfer on relate to the threshold on the transactions duration; that an allowance on the transactions duration i.e. 30 days is made provisional as accepted terms.

Terms outside of the provisional as accepted terms would require AFSL.

Question 11

Could aggregators efficiently adopt a model in which they did not engage in activities considered to be providing custodial or depository services? Yes

Question 12

Is an exemption required for providing a custodial or depository service in relation to ACCUs? Yes

Question 13

Is the potential exemption for aggregators outlined above appropriate? Yes

Making a market

What is 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.

The questions refer to a targeted exemption or not in making market regulations the context of ACCUs.

It is moot to the extent that the terms in context of ERF are not market making in the ordinary sense of derivative based instruments where 'all parties to a derivatives contract are considered to be issuers of that product' in substance the transaction given that the transaction is conducted with the CER exempts ordinary market making terms.

The threshold on exemption applying to market could be argued in the context of ERF effective when the numbers on ACCUs are greater than the proposed ERF sum.

Consequently opening trading on a secondary market in this case ordinary market making regulations apply.

On and above any merited exemption ordinary making market regulations are regarded providing transparency on boundaries with the dynamics predicated on fit for purpose processes. To this extent and at this time no exemption is viewed as necessary.

Question 14

Is an exemption required to provide that an aggregator making a market in ACCUs or ACCU derivatives to a client it is not making a market for a financial product? [See details page 13 para 6 & 7](#)

Question 15

Should any other exemptions be provided for particular financial services provided in respect to ACCUs? [See details page 14 para 1](#)

Consumer protections

The ERF regulations under review outlined exemption, thresholds and associated process requirements.

In managing residual risk Government in consultation with Dept. of Environment, Treasury and ASIC is developing standardised disclosure documents highlighting the risks and benefits. The Dept. is also developing standardised aggregation contracts which would include some basic protection for smaller parties to the contract.

To underscore risk recommendations on parties to seek advice from legal services and industry associations.

Question 16

Will an appropriate level of consumer protection be achieved by the alternative targeted protections discussed above? Yes

Question 17

Should the regulation require persons benefiting from the exemptions to provide the standardised disclosure statement to ERF participants? Yes

Question 18

What other protection might be necessary? [See details page 14 para 4](#)

Australian Government
Corporations Amendment
(Emissions Reduction Fund Participants)
Regulation 2015
Consultation Paper Request for Feedback and Comments

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