



26 September 2022

Prof Ian Chubb AC FFA FTSE
Chair
Independent Expert Panel

Submitted online: [Consultations Hub](#)

Dear Prof Chubb

Independent Review of ACCUs

The Australian Financial Markets Association (AFMA) is responding to the Independent Review of Australian Carbon Credit Units: call for submissions.

AFMA is the leading industry association promoting efficiency, integrity, and professionalism in Australia's financial markets. AFMA has more than 120 members reflecting the broad range of participants in financial markets.

Australian Carbon Credit Units (ACCUs) are a key instrument in meeting Australia's emissions reduction targets and climate change goals. For ACCUs to function as intended, the market requires confidence in the validity and integrity of the underlying methodologies used to generate units and of the actual performance of projects. AFMA welcomes this review as an opportunity to ensure that ACCUs are a high-quality product; and that the governance structures are appropriate for the current market. Our submission will focus on the important role of financial market participants in the market for ACCUs and highlight areas our members think the review should consider to ensure that the ACCU market functions well.

1. The role of financial participants

ACCUs are tradable instruments which means they can be bought and sold, and used as collateral for financing. There is currently a strong market for ACCUs in which financial market participants, e.g. banks, play key roles helping to match supply and demand and offering financing solutions to buyers and sellers of ACCUs. Some of the roles financial institutions currently perform in the ACCU market include:

- a) facilitating transactions by introducing buyers and sellers who may otherwise have had trouble identifying each other or who wish to trade anonymously
- b) aggregating volumes to allow a large purchaser to buy a significant volume from a number of smaller producers, or vice versa

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- c) assisting participants to manage timing mismatches between when ACCUs are produced and when buyers wish to purchase them, either by holding units directly or offering derivative structures such as forwards
- d) offering financing solutions such as repurchase agreements where parties can use ACCUs as collateral to potentially reduce their borrowing costs

AFMA considers that any reforms should continue to support ACCUs as a valuable tradable product and facilitate financial market participants continuing to participate in the market for ACCUs; to ensure that the market functions well and can contribute to the success of ACCUs assisting in Australia meeting its climate targets. Our submission sets out areas that the review should consider to promote the success of the financial market for ACCUs, based upon our members engagement and feedback.

2. Integrity of ACCUs

Confidence in the quality of ACCUs is critical to ensuring they contribute to emissions reductions and for the success of the market. At its simplest, purchasers of ACCUs need to be confident that the underlying emissions reduction projects achieve the emissions reductions that they claim. Lack of confidence in the crediting system could put undermine the business incentives ACCUs are based upon and put at risk the resulting environmental and economic benefits. This requires robust methodologies for creating the units and high quality verification practices to give subsequent purchasers confidence that the reductions are genuine.

AFMA supports reviewing the approved methodologies and verification processes to ensure they of high quality. To have confidence in the quality of ACCUs the market, stakeholders and those conducting projects need access to high quality information about the verification activities that have been conducted for a given ACCU. Currently information on existing Emissions Reduction Fund projects is limited and as a result, detailed due diligence work can be difficult to undertake. AFMA considers that this information should be easily accessible and transparent in the Australian National Registry of Emissions Unit (ANREU).

We also note that it is important that other officially endorsed methodologies that recognise carbon reductions outside the ACCU framework, such as the proposed Climate Active Guideline: Accounting for Carbon Sequestration from Tree Plantings, have integrity. While these may not enable the generation of ACCUs, if these approaches lack robustness, and do not apply the same standards as a crediting methodology — they could further undermine the trust that stakeholders have in carbon markets and offset units.

3. Fungibility and liquidity

Financial markets generally favour fungible products that are easily interchangeable; fungible product markets will commonly be more liquid as buyers and sellers will not differentiate between products and therefore have more opportunities to trade. Conceptually, ACCUs should be fungible products as all units should be equivalent to 1 tonne of carbon abatement. In practice, the market currently differentiates between different classes of ACCU with units generated from Human-Induced Regeneration trading at a premium to other units. This is reflected in industry documentation which increasingly allows parties to agree permitted methodologies for ACCUs provided under the contract.

AFMA surmises the price differentiation in the ACCU market is a result of consumer preference by companies that have adopted voluntary net-zero and ESG commitments, placing a higher value on some types of units. This is likely as a result of these buyers having less confidence in some methodologies and placing additional value on the co-benefits associated with other units, such as benefits to indigenous communities. These buyers are keen to purchase high quality ACCUs and are sensitive to the potential reputational impacts of

buying offsets that are perceived to be lower quality. The increasing differentiation within the ACCU market splits liquidity between the different classes of product — making the market as a whole, less liquid. While buyer preference is likely to mean that product differentiation will remain a feature of the ACCU market; AFMA submits the panel should consider why the market is placing different values on different methodologies and what can be done to ensure that all ACCUs are seen as high quality.

4. Interaction with the Safeguard Mechanism Reforms

The Commonwealth Government is currently consulting on reforms to the safeguard mechanism, including the potential introduction of Safeguard Mechanism Credits (SMCs). Under the current proposal, SMCs will be a substitute for ACCUs for companies with obligations under the safeguard mechanism. As a result, we anticipate that there will be a link between the market for SMC and the market for ACCUs.

AFMA considers that there is a risk of significant volatility during the early years of the SMC scheme. Given the probable link between the SMC and ACCU markets there is potential for this volatility to flow between markets. We therefore recommend that the panel should avoid changes that are likely to increase the volatility of ACCUs, such as the introduction of international offsets, during the SMC implementation (anticipated to be 2023-25).

5. Retail participation

ACCUs were originally developed as a product to be traded between large, sophisticated counterparties. This has changed as more small, unsophisticated participants become involved in the market particularly as landholders involved in the creation of ACCUs; and from 1 July 2023 smaller businesses seeking carbon neutral certification under Climate Active. Retail participation is not a feature of other Australian environmental certificate markets such as Renewable Energy Certificates (RECs) and Victorian Energy Efficiency Certificates, where most participants in the market are sophisticated. The panel should therefore consider if the regulatory and market arrangements for ACCUs are appropriate for less sophisticated participants.

5.1. Retail purchases

Changes to the Climate Active certification program have led to increased interest in ACCUs from smaller retail customers. This has created a challenge for the market, as currently ACCUs are predominately traded on a wholesale basis; and it is often quite difficult for clients to buy the smaller quantities that participants in Climate Active may want. For example, from 1 July 2023 a business looking to offset 1000 tonnes of CO₂-e under Climate Active will need to purchase 200 ACCUs (in total valued at ~\$6000 at current prices). This is currently difficult as the standard minimum market parcel is 5000 ACCUs and there are limited mechanisms to purchase smaller quantities.

A further complication is that, unlike other environmental certificates, ACCUs are financial products under the *Corporations Act* and are therefore subject to licencing requirements for anyone wishing to deal in them. There are also consumer protection requirements, including requirements related to the design and distribution of products, that apply when dealing with retail customers. We are concerned the implications of these retail protections on the ACCU market are fully understood as ACCUs have not traditionally been offered as a retail product.

Classifying ACCUs as financial products bring the benefit that there are existing consumer protection arrangements for retail customers, but the licencing requirements have deterred a number of participants who are active in other environmental product markets from dealing in ACCUs. AFMA is also not confident that the application of the protections for retail purchasers of ACCUs is fully understood.

The panel should consider if the current regulatory regime for financial products is appropriate to ensure retail customers can access ACCUs; and that they are covered by appropriate consumer protection provisions or if there is a need to develop separate ACCU specific arrangements. The regulatory arrangements for issuing and dealing in financial products are complicated and AFMA encourages the panel to engage with Treasury and ASIC about their application to the ACCU market.

5.2. Role of the Australian Carbon Exchange

The Clean Energy Regulator is currently pursuing a project to establish an Australian Carbon Exchange. We understand that part of the motivation for developing the exchange is to give retail customers a place to buy and sell ACCUs. AFMA is concerned about the progress of this project and cautious about its potential to work as an effective platform for retail trading.

Our observation is that successful exchanges typically develop organically to meet the needs of the wholesale market. Markets that develop predominantly for retail participants, such as unregulated cryptocurrency exchanges, or even ASX listed penny stocks, are prone to high volatility and vulnerable to market manipulation; and therefore, may not be suitable for retail participants looking to transact ACCUs. For comparison, the ASX allows retail customers to buy and sell securities, but retail customers do not directly trade on the exchange. Instead, financial intermediaries facilitate trading and settlement with the exchange on behalf of the retail customers.

We are concerned that the current project is likely to incur significant implementation costs and that there is a serious risk that it will not deliver on its objective of facilitating retail access to the ACCU market. We suggest that work on the exchange should be paused while policy makers and market participants consider how to provide retail customers access to ACCUs, this could include over-the-counter products or simpler retail platforms.

5.3. Certificate generation

The role of unregulated intermediaries negotiating with unsophisticated landholders for the creation of ACCUs is an area of concern. AFMA suggests that the panel look into the activities and business models of these intermediaries, consider appropriate supervision, and accountability arrangements. The panel should also speak to Treasury and ASIC to consider if these intermediaries are issuing, advising on, or dealing in financial products without holding an Australian Financial Services Licence; or alternatively, if they are acting as authorised representatives of licensees, if appropriate supervisory arrangements are in place.

6. ANREU

AFMA's members have raised a number of concerns about the suitability of ANREU for the market and have compared it unfavourably to REC Registry. They commented that it 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 broken down by methodology and co-benefit as well as information about the traded volumes and numbers of certificates in existence. They would also like it to include read only functionality to enable support and risk areas within their businesses to access registry data without a danger of altering it. We also note that increased retail participation in the ACCU market may require a very significant increase in the number of registry accounts and question if ANREU can accommodate this increase.

AFMA recommends that ANREU should be reviewed to ensure that it is fit for purpose.

7. CER's role in the market

The CER is the largest participant in the ACCU market through the Emissions Reduction Fund. As a result, their actions can have a significant impact on the market. This was seen in the substantial reduction in ACCU prices following the announcement of the fixed delivery exit arrangements in March 2022. To ensure confidence in the market, the CER should manage its activity to minimise similar disruptions to the market in future. This could be facilitated by the CER providing clear long term guidance about its intended activity in the market.

Additionally, the panel may wish to assess whether there is any conflict within the CER's operational model that might influence their independence when issuing and validating ACCUs.

AFMA would welcome the opportunity to directly discuss the implications of the panel's review to the ACCU market. Please contact me on 02 9776 7994 or by email at lgamble@afma.com.au.

Yours sincerely



Lindsay Gamble
Policy Director

Summary of AFMA suggested areas of focus

1. Role of financial participants

- 1.1. Reforms to ACCUs should continue to support them as valuable tradable products and facilitate financial market participants continuing to participate in the market.

2. Integrity of ACCUs

- 2.1. AFMA supports reviewing the approved methodologies and verification processes to ensure that they are of high quality.
- 2.2. Other officially endorsed carbon reductions outside the ACCU framework should meet the same high standards as ACCUs.
- 2.3. To have confidence in the quality of ACCUs, the market access to high quality information about the verification activities that have been conducted for a given ACCU. AFMA considers that this information should be easily accessible in ANREU.

3. Fungibility and liquidity

- 3.1. The panel should consider why the market is placing different values on different methodologies and what can be done to ensure that all ACCUs are seen as high quality.

4. Interaction with the Safeguard Mechanism Reforms

- 4.1. Changes to ACCUs should be minimised during the implementation of Safeguard Mechanism Credits to reduce the potential for volatility in both markets.

5. Retail Participation

- 5.1. The panel should consider if the market is currently providing appropriate mechanisms for retail customers to purchase ACCUs.
- 5.2. The panel should consider the application of the *Corporations Act*:
 - a) licencing requirements; and
 - b) consumer protection provisions, including those related to product design and distribution, on the market for ACCUs.
- 5.3. The panel should consult Treasury and ASIC on the application of the *Corporations Act* to ACCUs.
- 5.4. The panel should recommend that work on the Australian Carbon Exchange is paused to allow policy makers and market participants to consider how to provide retail customers access to ACCUs, this could include OTC products or simpler retail platforms.
- 5.5. The panel should review the appropriateness of the supervision and accountability arrangements for intermediaries dealing with landholders regarding the creation of ACCUs. This should include consultation with Treasury and ASIC on the application of the *Corporations Act* to their activities.

6. ANREU

- 6.1. ANREU should be reviewed to ensure that it is fit for purpose, particularly regarding ease of use, availability of information and ability to accommodate a large increase in accounts.

7. CER's role in the market

- 7.1. To ensure confidence in the market, the CER should manage its activity to minimise similar disruptions to the market in future. This could be facilitated by the CER providing clear long term guidance about its intended activity in the market.
- 7.2. Assess whether there is any conflict within the CER's operational model that might influence their independence when issuing and validating ACCUs