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Clean Energy Regulator

Submitted via email: carbonmarkets@cer.gov.au



Enabling Carbon Markets

The Australian Financial Markets Association (AFMA) is responding to the Clean Energy Regulator's (CER) Discussion Paper on enabling deep, liquid, transparent and accessible carbon markets in Australia.

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 role is to provide a forum for industry leadership and to advance the interests of the markets and their respective participants. Our membership is comprised of over 130 of Australia's leading financial market participants, including many active in carbon and environmental product markets.

Key Points

- **A well-functioning registry is key to enabling carbon and environmental product markets**
- **CER senior management must ensure the registry replacement project has an appropriate governance framework to ensure its success**
- **A spot ACCU exchange should only be developed if there is a clear need for it and it is commercially viable to do so**

Environmental products will play a crucial role in meeting Australia's emissions reduction targets and environmental targets, it is therefore vital to ensure that appropriate infrastructure is in place to support these markets. We welcome the CER's decision to consult on the development of the market infrastructure as we think hearing from potential users of these services will contribute to them being developed in a way that best meets the market's needs, but consider that there is still much room for improvement in the way the CER engages with stakeholders.

AFMA considers that an appropriately designed registry is essential to enable the development of deep, liquid, transparent and accessible environmental product markets. But we remain unsure of the value of developing a spot ACCU exchange and consider that it should only be developed if there is a clear need for it and its operator considers it commercially viable without ongoing government support.

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1. Registry

1.1. Stakeholder engagement

AFMA has been critical of the CER's approach to stakeholder engagement on the registry replacement project and we do not consider that the governance framework for the project is appropriate or comparable to those in place for similar changes to critical market infrastructure such as the ASX's replacement of its CHES system.¹ We have been concerned that the CER has treated the registry replacement as an internal IT project and has failed to appreciate the impact replacing the CER's key external facing platform will have on users or the importance of engaging with stakeholders throughout the process. AFMA considers that CER senior management need to be more heavily involved in the project to ensure its governance framework is appropriate to ensure the project's success.

As far as AFMA is aware this consultation paper is the first time the CER has engaged formally with stakeholders on the registry replacement project. We were hopeful that this signalled a change in approach but were disappointed when, at an information session for AFMA members on 8 November, CER staff indicated that the new registry would be released without users being able to access API functionality and they were unable to give clear guidance about when it would be implemented. Allowing users to connect to the registry via API is one of the key features users have wanted to see in the new registry and the consultation paper describes the proposed CorTenX solution as API-first and discusses the benefits of the functionality at length but does not mention that the API functionality will not be part of the initial build.

While we appreciate that there can be legitimate reasons for prioritising different parts of an IT project, we consider that it is unacceptable that a change to the implementation timeframe for a core piece of functionality was not formally communicated to the market. We consider this decision is symptomatic of the problems with the management of the registry replacement project and that the risk of poor outcomes is being unnecessarily increased by the CER's failure to engage with stakeholders. AFMA considers that CER senior management need to be more heavily involved in the project to ensure that it has an appropriate governance framework, including by developing:

- a) a credible work program for incorporating the various certificates, including those related to the Guarantee of Origin (GO) scheme, into the registry; and
- b) a stakeholder engagement framework to ensure user input is considered as part of the project and that users are kept informed of the progress of the project.

For reference the CER should consider the ASX's approach to stakeholder engagement on the CHES replacement project. It is an example of ASIC's expectations regarding the governance arrangements for changes to critical market infrastructure that could serve as a model for the development of governance frameworks for this and future changes to the CER's critical market infrastructure.²

1.2. Account setup

While we appreciate that the regulatory framework for access to the ANREU registry is beyond the scope of this consultation, we want to repeat our member's concerns about the current processes and

¹ <https://www.asx.com.au/markets/clearing-and-settlement-services/chess-replacement>

² <https://www.asx.com.au/markets/clearing-and-settlement-services/stakeholder-engagement/chess-replacement-technical-committee>

encourage the CER to ensure that better processes are put in place for other products. Our members consider that the current process for setting up both new accounts and users is not fit for purpose.

The CER should have rigorous, efficient, processes for establishing new registry accounts but user access should be managed by the account holding firm. Under this approach the CER retains its role of determining which organisations are entitled to hold an account but gives account holders freedom to administer their accounts. We also consider that this approach is more appropriate as the registry moves to enabling access via API as, due to the nature of the technology, transactions conducted using an API will come through a single shared corporate account rather than individual named users. We understand that it is poor security practice for APIs to use named user accounts and encourage the CER to explore an appropriate approach.

1.3. Functionality

AFMA appreciates the CER's engagement with our members to date in developing the functionality for the new registry. Some of the key functionality our members consider the register should include are:

- a) Improved search and reporting functionality
- b) Ability to set up sub-accounts to allow the segregation of certificates to individual clients or transactions
- c) Read only user access to support segregation of duties within firms
- d) Improved surrender functionality, including creating records of who certificates are surrendered on behalf of
- e) Introduce improved controls to reduce the chance of transactions being made in error
- f) API access to allow firms to interact with the registry through an API rather than only through the portal

We understand the registry will contain the majority of this functionality for SMCs and ACCUs and consider that similar functionality will be valuable for other certificates. We encourage the CER to conduct detailed consultation on the functionality for other certificates, including the GO scheme, prior to their incorporation into the registry to ensure it is appropriate for the relevant certificate.

1.4. Data in the registry

Having high quality, useful information in the registry is essential to the functioning of all environmental product certificate schemes. As the proposed registry is going to contain a number of different types of certificates with quite different characteristics and data requirements, we think it is import for the CER to conduct detailed consultation on the data requirements for each type of certificate prior to them being incorporated into the registry.

Other than SMCs, the certificates that are proposed to be included in the registry will be supported by significant amounts of information to substantiate their characteristics, such as methodologies, co-benefits and emissions intensity. AFMA considers that all of this information should be easily available to the market but, given that some of it may consist of large amounts of project specific text, we are unsure if it is appropriate for all of it to be held in the registry or if it may be more appropriate for some of it to live in other locations, such as the existing project registry, with appropriate linkages to allow users to locate it. We particularly consider this is likely to be the case for Nature Repair Market and GO certificates which we understand are likely to contain quite a lot of descriptive project specific information that may be unsuitable for a register, but it will also be an issue for ACCU methodologies and co-benefits.

1.5. Access to the registry

Improving connectivity to the register is one of the key reasons to replace ANREU. It will greatly improve the user experience and facilitate the development of a range of new services to support the market such as exchanges and trading platforms. The discussion paper has proposed a range of factors that will need to be considered before granting access to the register's API, we agree with most of them and consider that it is essential for the CER to ensure that anyone with access to the register meets appropriate IT capability and security requirements and can satisfy the CER that they are a fit and proper person to access it.

The one proposed factor that we are concerned about is "strategic fit" to ensure the user is aligned with the "objectives of the CER and the broader carbon market." We do not consider that, other than in the case of misconduct, it is the role of the CER to determine who should have access to the register or what activities are in the best interest of the market. We think the CER's role should be limited to assessing if someone is fit and proper to access the registry and if they can meet the technical requirements to use it without being an unacceptable risk to the registry or other users.

1.6. Fees

The discussion paper does not provide any detail about any fees that will apply for use of the registry. AFMA would appreciate it if the CER could clarify what fees will apply. We encourage the CER to consider what charges should apply to third parties who want to access the registry to offer commercial products particularly if they require additional services from the registry. Charging cost reflective fees for additional service is also likely to mitigate concerns around "strategic fit" of an activity as the person benefiting from the service will bear the cost of it.

1.7. Exclusion of LGCs and STCs

AFMA supports the CER's decision not to include LGCs and STCs in the registry at this stage. Our members consider that the REC registry remains fit for purpose and given the expected end of these schemes in 2030 it seems unlikely that the cost of moving them to a new registry would be justified for the CER and the industry. We consider LGCs and STCs should only move to the new registry if it becomes impractical to support the REC registry and there is a net benefit to the industry in moving to the new registry.

AFMA Recommendations

- i. CER senior management should ensure appropriate governance arrangements are in place for the registry replacement project and future changes to market infrastructure
- ii. The CER should develop a project plan setting out how each type of certificate will be incorporated into the registry, including a plan for engaging stakeholders
- iii. Implementation of API functionality should be prioritised
- iv. The processes for ANREU account and user setup should be improved
- v. The CER should conduct detailed consultation on the appropriate functionality and data requirements, for each different type of certificate prior to it being included in the registry
- vi. Strategic fit should not be a relevant factor for accessing the registry

- vii. The CER should provide detail about any fees for use of the registry, including by third parties looking to use it to offer for profit services
- viii. LGCs and STCs should only move to the new registry if it becomes impractical to support the REC registry and there is a net benefit to the industry

2. Exchange

2.1. Business case

AFMA welcomes the CER's development of a detailed proposal for the exchange. We consider that while a facilitated spot market for ACCUs may be of benefit to the market it is not essential, and it remains unclear to us which class of users will want to use it. We therefore think the CER should engage with potential users of the exchange to gauge their interest in it and the exchange should only be developed if the market operator considers it is likely to be commercially viable without ongoing government support.

While AFMA appreciates the operator's business case is likely to be confidential we would appreciate information about the proposed fees and charges for using the exchange and the extent of any government funding.

2.2. Proven model

While AFMA is unsure of the merits of introducing a spot carbon exchange we consider that the proposal presented in the discussion paper for the exchange is operationally sound. The proposed model developed by the ASX and CER is based on a proven approach that has been used successfully for other products for a number of years, and which appears to be well suited to ACCUs. The approach also benefits from being able to rely on the well-established Australian regulatory framework for listed products, which will simplify the establishment of the exchange and ensure appropriate rules are in place to govern market conduct and operations.

2.3. Retail participation

One of AFMA's main concerns with the development of the exchange is that it is unclear which class of users it is intended to serve. A possibly unintended feature of the current proposal is that it appears likely that retail customers will be able to trade ACCUs on the exchange through retail brokers in a similar way to how they currently trade shares. To date retail participation has not been a significant part of the ACCU market and AFMA thinks the Commonwealth should consider if it is appropriate to promote the sale of ACCUs to retail clients. There are limited reasons for retail clients to buy ACCUs as they are unlikely to be using the exchange to meet safeguard obligations so would probably only be using it to achieve voluntary emissions reductions or for speculation.

Our observation is that successful exchanges typically develop to meet the needs of the wholesale market. Markets that develop predominantly for retail participants, such as unregulated cryptocurrency exchanges, or even listed penny stocks, are prone to high volatility and market manipulation. As a result, we think one of the key policy considerations in establishing the exchange should be if it is likely to be used by the wholesale market or if it is likely to be dominated by retail

participation. We caution that if it is the latter, it may end up being a highly volatile market that it would be inappropriate for government to encourage retail participation in.

2.4. Single ACCU

AFMA's experience is that starting new markets is challenging as it is difficult to bring enough buyers and sellers together in the one forum for the market to be successful. A key requirement to encourage the development of a market is to agree a product specification that is suitable for a large number of buyers and sellers. Our experience is that this typically requires a degree of compromise from market participants as the specification is unlikely to be anyone's preferred one as it has to be generic enough to appeal to a wide range of players. We consider that settling on a single initial ACCU specification for the exchange will give it the greatest chance of success. We acknowledge that this will mean that the exchange will not be suitable for all market participants, particularly buyers and sellers of premium ACCUs, but we feel the OTC market is more appropriate for buyers and sellers of premium or non-standard products. We also note that if the exchange is successful there will then be opportunities to develop additional, more specialised products, in the future.

Our view is that, at least initially, the exchange should offer a single ACCU product with a specification that appeals to the largest group of market participants. We suggest the CER should consider either a generic ACCU specification, as the ASX uses for the futures market, or a specification that excludes avoided deforestation. The generic specification has the benefits of alignment with the futures market and including all ACCUs, but the disadvantage that some potential buyers who do not want to buy avoided deforestation ACCUs may choose to stay away from the exchange entirely. We understand that currently ACCUs that exclude avoided deforestation are the most liquid class, therefore this specification may be the best to encourage participation on the exchange.

We encourage the CER and ASX to engage with potential users of the exchange to determine which specification of ACCUs is most likely to be successful on the exchange.

2.5. Cycling

AFMA is unclear to what extent cycling is likely to be a problem for the exchange. As discussed above we consider that, at least initially, the exchange should only list a single type of ACCU. If this is the case we would expect the vast majority of ACCUs traded on the exchange to be reasonably generic products generated using methodologies that do not attract a premium and without significant other co-benefits. As a result, we would expect the exchange to mostly appeal to buyers who are agnostic about the type of ACCU they receive and we would expect buyers with more specific requirements to buy ACCUs through other mechanisms.

To the extent that there may be some buyers who are content to buy generic ACCUs but want to avoid specific methodologies, we think the risk of cycling would be largely eliminated by imposing even a very modest charge to convert a Chess Depository Interest (CDI) into an ACCU. We would expect these buyers to be price sensitive and the prospect of incurring additional charges to convert the CDIs multiple times is likely to make using the exchange unattractive to them.

We do not support imposing any further restrictions to prevent cycling at this time. Particularly we do not think there should be any attempt to regulate what buyers may do with ACCUs once they have

purchased them as this would be detrimental to the development of the exchange and the broader secondary market.

2.6. Surrender

Under the proposed model the only way for a buyer to actually take delivery of an ACCU is for the CDI to be transmuted into an ACCU and delivered into the buyers ANREU account. AFMA's experience from the OTC market is that there are a significant number of buyers who do not have ANREU accounts and who take delivery by having the seller surrender the ACCUs on their behalf. AFMA's OTC documentation has been updated to accommodate sellers surrendering ACCUs on behalf of the buyer and we encourage ASX and the CER to consider if the exchange could support similar functionality, possibly by putting in place processes to allow the buyer to ask the nominee account holder to surrender the ACCUs as an alternative to taking delivery in an ANREU account.

AFMA Recommendations

- ix. Development of the exchange should only proceed if there is a clear need for it and its operator considers it commercially viable without ongoing government support
- x. The Commonwealth should consider the merits and risks of promoting retail participation in the ACCU market
- xi. There should be a single ACCU product, with a specification that appeals to the broadest group of users
- xii. We are not convinced that cycling is a material risk and do not support any restrictions on what buyers can do with ACCUs after they have purchased them
- xiii. The ASX and CER should consider if the model could support surrender of ACCUs

AFMA would welcome the opportunity to discuss this submission. Please contact me on 02 9776 7994 or by email at lgamble@afma.com.au.

Yours sincerely



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