



6 May 2008

Dr David Hemming
Greenhouse Gas Reduction Scheme Transition Review
Department of Water and Energy
GPO Box 3889
SYDNEY NSW 2000

By email: ggastransition@dse.nsw.gov.au

Dear Dr Hemming

Transitional Arrangements for the NSW Greenhouse Gas Reduction Scheme – Consultation Paper

The Australian Financial Markets Association (AFMA) is pleased to make this submission in response to the Consultation Paper.

AFMA has played a leading role in the development of spot and forward trading in NSW Greenhouse Abatement Certificates and other environmental product markets in Australia. As the national association for participants in the wholesale financial markets, we have established trading protocols and developed standard contract documentation, as well as providing data services, dealer accreditation, training and other services to facilitate the efficient operation and development of the markets.

In this submission, AFMA is critically concerned to ensure that no sovereign risk is inadvertently created through the transition process adopted by the NSW Government in managing its responsibilities during the closure of the GGAS scheme in preparation for the Australian Emissions Trading Scheme (AETS). Management of the transition process in a manner that treats the affected market participants fairly is important to engender confidence in the management of the emerging AETS market.

It is apparent from the Consultation Paper and in related discussions that the NSW Government acknowledges and accepts that commercial disadvantage will be incurred by some participants in GGAS due to its early termination. This clearly defines the purpose of the consultation process in establishing a fair outcome for business entities that have entered into contracts (including financial contracts) in good faith and in reliance on the NSW Government's statements and policies.

We think it is commendable and appropriate that the Minister has established this process to provide an equitable outcome for the business affected. It also follows that future deliberations should now focus solely on how the NSW Government intends to redress the commercial disadvantage that it acknowledges it has imposed on participants.

Australian Financial Markets Association

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Having reviewed the Consultation Paper, we cannot see a rationale to justify the argument that the responsibility to compensate affected businesses should shift entirely to the Commonwealth Government, simply because it is the owner of the successor scheme. Moreover, there is an important principle at stake here, given the looming AETS, which is a significantly larger scheme and will have serious and widespread economic impacts.

AETS is being designed to rely completely on the market mechanism to deliver the economic outcomes sought, whilst minimising the cost of the scheme to the community. The success of the AETS market depends on the absolute credibility of the scheme itself. In that context, a retrospective rule change in any precursor scheme that is not managed by the relevant authority to equitably address its impact on participants who acted in good faith would inevitably lessen confidence in the AETS (it being another 'government' scheme). This could impair the credibility of the AETS in the eyes of the market participants on whom its success depends. Therefore, since the NSW Government is the responsible authority for the GGAS, it should underwrite the compensation required to facilitate the closure of its market in an equitable manner for the participants involved in it.

We note that this principle is upheld at the highest levels of the NSW Government where the Treasurer is recently reported as saying "... if the federal government accepts Mr Garnaut's recommendation not to compensate industries adversely affected by carbon trading, it would damage the global perception that Australia was a country free of sovereign risk to investors".¹

In technical terms, AFMA does not find any particular defect in the theoretical definition of the NSW Government's compensation formulae for any particular participant. Though, quite simply, if any calculation outcome is of the quantity of AETS permits to be granted to a NSW GGAS participant, then the NSW Government should acquire that quantity and grant that quantity to that participant, regardless of the cost to the NSW Government of doing so.

AFMA believes termination of the GGAS should be contemporaneous with the implementation of the AETS. This would avoid duplication and any overlap, allowing financial markets to effect a smooth transition between schemes.

In conclusion, we note that the GGAS has worked well, both in terms of achieving emission reduction objectives and, importantly, in the efficient manner in which NGACs have traded. The Government's resolve to adopt a disciplined approach and not tinker with scheme design was demonstrated in September 2007, when then Minister Koperberg refused to countenance any regulatory intervention in the market simply because the NGAC price had fallen. The high standing of the Government as the responsible authority for the Scheme would be confirmed by it taking responsibility for bringing the Scheme to an equitable close.

AFMA appreciates the opportunity to comment on the Consultation Paper and would be happy to discuss any of the issues raised in this submission or to consider any other matters that you may wish to discuss with us. If we can be of further assistance, please contact Allen Young, Senior Policy Executive, on (02) 9776 7941 or ayoung@afma.com.au, and he will make the necessary arrangements.

¹ "Iemma wants business to get carbon cash" *Herald Sun* 4 April 2008

Yours sincerely

A handwritten signature in black ink that reads "Duncan Fairweather". The script is cursive and fluid, with the first letters of each word being capitalized and larger than the rest of the letters.

Duncan Fairweather
Executive Director

cc: Dr Martin Parkinson, Secretary, Department of Climate Change
Mr Blair Comley, Deputy Secretary, Department of Climate Change