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Senator Anne McEwen
Chair, Senate Standing Committee on Environment,
Communications and the Arts
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Dear Senator McEwen,

Renewable Energy Target

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments to the inquiry into the Renewable Energy Target (RET) legislative package.

The ABA notes that many of the areas of particular interest to the banking and finance sector are due to be addressed through regulations or legislative instruments and are currently unspecified.

Notwithstanding, the ABA provides to the Federal Government our initial views on the legislative package (see attached).

The ABA looks forward to continuing to work with the Federal Government on the implementation of the new RET, especially on areas as they impact on existing trading of renewable energy certificates (RECs) as well as products and services provided by the banking and finance sector.

Yours sincerely

Steven Münchenberg



Submission on the Renewable Energy Target legislation

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Submission on the Renewable Energy Target legislation

1. Introduction

1.1 Background

The ABA notes that the Federal Government announced changes to its environmental programs, including the Renewable Energy Target (RET) scheme on 26 February 2010¹. From January 2011, the existing scheme will be separated into two parts – the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET). There will be two categories of renewable energy certificates (RECs).

The enhanced RET scheme is being designed to:

- Encourage the deployment of large-scale power generation using renewable energy sources, such as wind, solar, biomass and geothermal energy through the LRET; and
- Support households, businesses and community groups looking to contribute to emissions reduction by installing renewable energy systems, such as rooftop solar panels and solar hot water systems through the SRES.

The two parts of the revised scheme are intended to ensure arrangements deliver on the Government's 20 per cent by 2020 target and build Australia's clean energy future.

1.2 ABA's views on climate change policy

The ABA and our member banks support the Federal Government's climate change objective to reduce Australia's greenhouse gas emissions, adapt to climate change that cannot be avoided, and help shape a global solution. Climate change is a global problem that requires a global solution. We believe that a comprehensive and multifaceted portfolio of policy responses is fundamental to changing the behaviour of governments, businesses and the community as a whole, which is critical to transitioning Australia to a future carbon constrained economy.

The ABA supports the need to implement effective policy frameworks to underpin and promote a cost-effective reduction in emissions. We believe that a RET should be part of this policy framework which contains practical strategies and measures that assist businesses, individuals and the community.

In our submissions on the Carbon Pollution Reduction Scheme (CPRS) and carbon market, we indicated that the CPRS is unlikely to be sufficient to advance low carbon technologies and clean development initiatives. Therefore, we consider that it is important to provide a market incentive to encourage deployment of renewable energy technologies and foster the development of expertise in low emissions technologies, renewable energy technologies and emissions reduction practices.

The ABA believes that practical strategies should include investment in and deployment of clean technologies (low to zero emissions technologies) and carbon capture and storage; development and commercialisation of renewable energy technologies and energy efficiency initiatives; implementation of a domestic offset regime and encouragement of voluntary actions; and development of complementary measures and adaptation responses.

¹ The ABA refers to Minister Wong's and Minister Combet's joint media release <http://www.climatechange.gov.au/en/minister/wong/2010/media-releases/February/mr20100226.aspx>

1.3 ABA's views on the design features of the RET

The ABA believes that overarching design features should be considered, including:

- RET should be designed to complement, and be consistent with, the CPRS. The success of both schemes is inter-related – that is, a failure with the RET would likely result in additional costs for liable entities within the CPRS.
- RET should be based on a quantitative generation capacity target. An annual target would provide certainty and simplicity as well as greater operational flexibility.
- RET should recognise other operating schemes and provide for as smooth a transition as possible to a single, national scheme for electricity retailers, other liable entities and market participants. Banking of RECs is an essential part of a smooth transition. Avoiding price distortions is an essential part of an efficient REC market.

In addition, the ABA believes that it is essential the governance arrangements underpinning the RET should be clear and robust. In particular, the SRES will involve many different parties, including liable entities, service providers, aggregators, registered agents, market participants, owners of RECs and consumers. The integrity and success of the scheme is reliant on credibility, accountability and informed participation of all participants, especially individuals.

2. Specific comments

2.1 Small-scale Renewable Energy Scheme (SRES)

The ABA supports the introduction of measures to encourage households, businesses and community groups to contribute to emissions reduction through small-scale energy efficiency projects and energy efficiency initiatives. We consider that market-based approaches are the most cost-effective and economically efficient way of achieving reductions in emissions. We also consider that small-scale technologies will be an important part of efforts to reduce emissions, and therefore incentives to encourage small-scale technologies should be supported.

The ABA believes that mechanisms should be provided to encourage innovation and provide flexibility to include other small-scale technologies that support take up of renewable energy, as these technologies become available. We consider that it is important to encourage development in the various renewable energy technologies, liquidity in the REC market, and growth in intermediary services (i.e. management and aggregation of RECs).

The ABA believes that infrastructure, governance and administrative systems and processes must be maintained to ensure SRES projects are viable and legitimate enterprises generating genuine household level renewable energy opportunities, and not focused predominantly on capitalising on revenue opportunities from the creation and sale of SRECs.

The ABA believes that the Government should commission an independent review in 2012 of the SRES. A review should involve consideration of matters, including price setting mechanisms and interaction between specific parts of the RET scheme, setting of the future price of SRECs applied from 1 January 2014 in the context of making sure it provides the right incentive to installation/take up, functions of the Office of the Renewable Energy Regulator, changes in technologies and costs, the impact of the SREC price and the extent of small-scale technology deployment on the electricity market, including electricity prices, as well as demand for RECs, and the impact of compliance measures/fines and

demand for RECs. Importantly, any unintended consequences of interventions should be addressed. Having said that, we consider that it is important to establish the RET framework and rules upfront and minimise changes thereafter. Uncertainty has direct implications for market efficiency, transactions costs, and investment decisions. Therefore, certain aspects of the design of the scheme that should not be subject to review but identified upfront, such as options for national assistance by incorporating State and Territory assistance.

The ABA urges COAG to make decisions on the remaining design issues. Uncertainty with the operation of the scheme will have a direct and adverse impact on the effective and efficient functioning of the REC market. We note that the Communiqué from the COAG meeting held on 19/20 April 2010 outlines that remaining matters within the scope of the COAG review will be finalised for consideration at the next COAG meeting.

2.2 Large-scale Renewable Energy Target (LRET)

The ABA supports a LRET with minimal disruption to the current operation of the RET for liable entities and large-scale generators as well as banks and market participants trading in environmental products. The LRET should aim to increase the uptake of renewable energy by imposing a target on electricity retailers, allowing REC trading and imposing an enforceable penalty for non-compliance where retailers fail to meet their targets. We consider that all existing sources should be included in the scheme, including wind, solar, hydro, wave, geothermal and biomass sources. Efficiency of the scheme should be promoted, which means that there needs to be sufficient volume in the early years of the scheme.

The ABA believes that it is important that the LRET is managed and administered as a single, national model that eliminates opportunities for state-based discretions and provides certainty for entities engaging in long term electricity supply contracts. We consider that the Government should establish the rules for phasing out the scheme upfront.

The ABA believes that a review of the design and operation of the LRET, coupled with uncertainty regarding the cessation of the scheme, will lead to market inefficiencies and price distortions. Market speculation would likely have an adverse impact on liquidity and volume, and therefore a direct impact on REC pricing. We consider that a review should be conducted in a manner that provides a holistic consideration of the RET and the CPRS.

The ABA believes that, subject to analyses of Australia's energy generation mix and progress towards achieving the 2020 target, the Federal Government should consider increasing the target beyond 2021 to encourage increased renewable energy projects in Australia beyond 2020 as well as to de-carbonise energy generation in Australia. We consider that this will be an important part of Australia's contribution to a global solution.

2.3 Other issues

2.3.1 Use of existing/banked RECs and treatment of existing forward contracts

The ABA notes that the Federal Government has decided that existing banked RECs will be able to be used for LRET compliance obligations. The ABA also notes that the Government has indicated that it does not want to intervene in contractual arrangements entered to transfer RECs at a future date. We consider that the scheme should recognise pre-existing forward REC contracts.

The ABA believes that liable entities should be able to create or purchase RECs to meet annual targets, and bank RECs for future surrender or sale in later years of the scheme. Banking provides early mover incentives, and conversely, limiting banking pushes back generation. Furthermore, banking will ensure least disruption to the existing REC market by helping to maintain investor confidence. Therefore, we consider that the scheme should permit banking as a means to smooth price volatility and lower compliance costs. Tradeability of RECs will be important to enabling least cost adjustment.

The ABA believes that transitional issues must be closely considered and managed. Many transitional issues are not contained in the RET legislation, but are to be contained in regulations.

The ABA notes that while recognition of existing/banked RECs and pre-existing forward REC contracts is a sensible transitional design feature, there are differing views within the banking industry as to how to manage possible supply and demand dynamics during the transitional phase of the scheme. Therefore, we consider that further consultation with banks and market participants is required to avoid unintended consequences.

The following provides a summary of certain views and considerations within the banking industry:

- SRECs created up to 31 December 2010 should not be eligible to offset obligations under the LRET. There are concerns that oversupply of SRECs could impact the REC market. Constraining eligibility of SRECs to 30 June 2010 will create additional demand for RECs created by large-scale renewable projects².
- Imposing constraints on SRECs will have adverse consequences for the REC market. There are concerns that differential treatment will create unnecessary complexity and not allow existing RECs, existing supply and new supply to form a single price curve. Alternatively, oversupply concerns could be addressed by ramping up the target in the short term, and therefore encouraging greater demand for RECs.
- All existing RECs should be treated as RECs, not SRECs, so as to avoid unnecessary complexity in the transitional phase of the scheme.
- Any mandatory or sudden acceleration of redemption of banked RECs would place an undue downward pressure on short term REC prices, which would discourage investment in large-scale renewable energy projects.
- If a significant volume of pre-existing contracts for RECs from small-scale technologies were to be surrendered against the LRET it would potentially distort investment signals for additional large-scale generation.

The ABA believes that the RET framework will need to contemplate the implications for banked RECs. The transitional provisions will need to contemplate the implications of transfer of RECs created before 31/12/10 and SRES to LRET after 01/01/11. Transitional issues will have impacts on generation, contractual obligations, REC prices and efficiency of the REC market.

² The ABA understands that there is significant stock of large-scale renewable energy projects in development, which could be unduly impacted, undermining the objective of bringing forward investment in renewable energy.

2.3.2 Assistance for EITEs

The ABA notes that the Federal Government has decided that a single partial exemption for both LRET and SRES will be provided for each EITE activity and site. We consider that assistance measures for EITEs should be given consideration in the context of the CPRS. We note that an assistance methodology for EITEs was reached after extensive consultation and should continue under the new RET scheme.

2.3.3 Assistance for households

The ABA notes that the Federal Government has decided that the SRES will provide assistance for households, businesses and community groups to install small scale solar, wind and micro hydro generating systems. We consider that it will be essential for consumers to understand the implications of their participation. For example, support under the 'solar credits' mechanism will depend on a number of factors, including the price of RECs, the deeming period selected by the applicant, the location of the solar PV system, and the size of the system.

2.3.4 REC registry

The ABA believes that RECs will need to be managed through a central registry. We consider that a REC registry is essential as a means of creating secure property rights and promoting the credibility of the REC market. Without property rights, RECs would generally not be recognised as assets.

2.3.5 Compliance and enforcement

The ABA believes that compliance and enforcement arrangements will need to be contained in the RET framework. We consider that penalties and other remedies should be part of this regime. However, we note that liability provisions, coupled with community expectations regarding the fixed price of \$40 for SRECs, could discourage aggregation activities, which could have implications for participation by individuals.

2.3.6 Taxation

The ABA believes that taxation policy settings and implications must be taken into account as part of the design of the scheme and defined upfront. Furthermore, we consider that taxation incentives could improve funding of renewable energy projects and bring forward investment in renewable energy projects.

2.3.7 Regulation

The ABA believes that the Office of the Energy Efficiency Regulator should maintain registers, accredit eligible renewable energy generation power stations, register RECs and monitor compliance.

2.3.8 Duration and phase out of the RET

The ABA notes that scheme duration and phase out will impact the cost of electricity and cost of renewable energy. Furthermore, certainty of the scheme duration and phase out is critical to the effective and efficient functioning of the REC market. We consider that appropriate arrangements will need to be identified upfront, for example, so that unwind is known in advance and as part of the scheme design.

3. Concluding remarks

The ABA notes that prior to the Federal Government's recent RET announcement, there was a well-functioning and liquid REC market. We are advised that the Government's announcement, release of the discussion paper, and introduction of legislation contributed to significant disruption in the existing REC market, which ultimately has implications for REC pricing, market efficiency, investment decisions, financing terms and investor confidence. Similarly, any future consideration of the RET framework or rules, such as pricing of SRECs, will also have an impact on market efficiency, transaction costs and investment decisions (e.g. NPV of renewable energy projects). Therefore, it is essential that banks and market participants are consulted.

The ABA understands that the RET is intended to bring forward investment in renewable energy. To achieve this outcome, the REC market must be able to continue to function in a manner which provides pricing signals via a deep and liquid market. Regulatory uncertainty creates destabilisation, which ultimately undermines a smooth transition to the new RET arrangements. Additionally, the more complicated the scheme becomes, the more difficult it is for the market to function efficiently.

Therefore, the ABA believes that it is essential for the Federal Government to ensure:

- New RET arrangements are able to be readily adapted to the existing REC market.
- Infrastructure, governance and administrative systems support appropriate regulatory controls and rigor and foster legitimacy of the scheme and efficiency in the market. For example, disclosure around project registration and governance of small-scale renewable energy projects. This will also enable improved analysis around the forecast and projected supply of SRECs, in order to better support planning horizons for LRET. Similarly, disclosure of aggregated data of the total volume of supply that will be fed into the LRET from pre-existing contracts.
- Uncertainty is minimised by establishing the RET framework and rules upfront. For example, the COAG review and absorption of State-based assistance must be resolved, consideration of the fixed price for SRECs must be transparent, and phasing out of the scheme must be defined.
- Adequate consultation with all stakeholders. Banks make markets in RECs. Banks also provide finance and working capital for liable entities and other participants in the REC market. The regulatory risk aspect of compliance markets impedes banks' ability to participate as market makers. We consider that banks and market participants must be consulted before changes are determined or announcements are made regarding any proposed changes.

The ABA looks forward to continuing the constructive dialogue with the Federal Government to resolve the outstanding practical and technical matters associated with the introduction of the new RET scheme in Australia.