



8 April 2009

The Secretary  
Senate Select Committee on Climate Policy  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

### **Westpac submission: Senate Select Committee on Climate Policy**

Westpac is an active participant in ongoing public policy dialogue on the design and operation of a market-based response to climate change and welcomes the opportunity to provide a submission to the Senate Select Committee on Climate Policy.

Westpac accepts the scientific consensus on climate change. We believe that climate change will have significant economic, social and environmental impacts in the regions where we operate. Upon examining the projected economic impacts on Australia as a result of climate change, we formed the view that a precautionary approach to managing current and future risks is required.

Westpac supports the implementation of an emission trading scheme and the application of broad based market mechanisms as the most effective, affordable and flexible means of transitioning to a low carbon economy.

This must be implemented as part of a suite of policy responses aimed at tackling the various policy and market challenges associated with structural adjustment to a low carbon economy.

Emissions trading, and putting a price on carbon, is the mechanism which makes all other policy responses affordable and achievable.

Westpac has played an active role in participating to the development of an appropriate cap-and trade model for Australia, under both the current and previous Commonwealth governments, and at the state and regional level. We have worked closely with the Australian Bankers Association (ABA) and the Australian Financial Markets Association (AFMA). We provided a number of submissions to the Garnaut Review and have provided evidence for the Senate Economics Committee the Carbon Pollution Reduction Scheme draft legislation.

Westpac has also participated in a number of multilateral industry-led initiatives, aimed at promoting a better understanding of the challenges involved in implementing an effective policy response to climate change. This has included the 2006 Australian Business Roundtable on Climate Change ([www.businessroundtable.com.au](http://www.businessroundtable.com.au)), the 2007 Australian Business and Climate Group review of investment barriers for clean technology ([www.businessandclimate.com](http://www.businessandclimate.com)) and the 2008 Australian Agricultural Alliance on Climate Change (hosted at [www.climateinstitute.org.au](http://www.climateinstitute.org.au)). All of which have informed our views.

Westpac was also one of nine founding members of the United Nations Environment Program Finance Initiative (UNEPFI) in 1991, which now has 171 signatory financial institutes globally and an extensive work program focusing on carbon finance and related environmental, social and governance risk issues.

This submission also draws upon the bank's considerable experience in factoring environmental considerations into business policies, systems, and procedures as well as our practical participation in environmental markets to date. Westpac has been trading in the EU ETS since 2006 and undertook the first trade of Australian Emission Units (AEUs) under the Carbon Pollution Reduction Scheme (CPRS) in May 2008, agreeing to purchase 10,000 units at \$19 a tonne for delivery 2012.

### **Feedback on the Terms of Reference**

Westpac has not sought to respond to or comment on every aspect of the draft Carbon Pollution Reduction Scheme (CPRS) legislation or related climate policy. This submission has sought predominantly to raise a number of contextual arguments to the implementation of effective climate policy in Australia and sought to comment on the Terms of Reference for the Inquiry.

#### **(a) The choice of emissions trading as the central policy to reduce Australia's carbon pollution, taking into account the need to:**

- (i) reduce carbon pollution at the lowest economic cost;**
- (ii) put in place long-term incentives for investment in clean energy and low emission technology; and**
- (iii) contribute to a global solution to climate change.**

There is no doubt that putting in place a comprehensive global agreement to reduce greenhouse gas emissions is critical to effectively addressing climate change. Australia has a critical role to play, both in terms of achieving an equitable and effective international policy framework and in implementing domestic policy measures which assist Australia in meeting our national obligations under the Kyoto Protocol and support the effectiveness of global mechanisms to address climate change.

Meeting our international obligations will necessitate a suite of policy measures which supports the mobilisation of existing technologies and resources, provides strong market signals to invest in longer-term solutions, raises public awareness and promotes demand management to deliver cost-effective abatement by reducing emissions growth and driving a more energy-efficient economy.

Emissions trading, and putting a price on carbon, is the mechanism which makes all other policy responses affordable and achievable.

Westpac supports flexible, market-based policy instruments which facilitate reductions in greenhouse gas emissions while maintaining economic competitiveness. Westpac strongly supports a cap-and-trade emission trading scheme as the most effective means of achieving greenhouse gas reductions at least cost.

We do not believe that a carbon tax would support effective emissions reduction across the economy while supporting continued economic growth. A carbon tax would not incentivise

Australian industry to innovate and find smarter, cleaner and more cost effective ways of running their business. We do not believe that a carbon tax would ensure that Australia meets its legal obligations under the Kyoto Protocol in the most cost effective manner or provide regulatory certainty for business.

Westpac supports the introduction of a 'cap and trade' emissions scheme as the central policy response to climate change because we believe it will deliver positive environmental and economic outcomes across a number of fronts.

The introduction of the CPRS will have significant impacts on:

- Market demand to increase energy efficiency and reduce emissions intensity;
- The level and speed of uptake for existing low emission technologies;
- Market confidence and pricing of risk into market decisions; and
- The confidence of private investors to support R&D of new technologies and their willingness to bring first-of-a-kind technologies to commercial scale within Australia.

By establishing the price signal through an emissions trading mechanism, the carbon market will operate much like any other commodities market where varying price signals alternate between incentivising companies on both sides of the market (buyers and sellers). The price of carbon will adjust to market conditions and supply and demand factors, allowing companies to invest in carbon abatement opportunities as they arise.

From a financing perspective, having a price on carbon means investors who might hesitate to take on an uncertain liability are better able to price the risk, determine the actual level of liability, and estimate whether they can earn an adequate return for that risk. Once carbon risk can be actively managed, low emissions projects will appear increasingly attractive to investors since the carbon liability is lower than for high emissions projects.

Finally, Westpac supports the prompt and timely introduction of emission trading. Lack of an appropriate policy framework encourages the status quo, while additional investment in emission-intensive infrastructure has the potential to lead to future stranded assets, imposing a significant cost to the national economy. Without a clear policy framework that matches investment horizons, Australian business has little incentive to invest now in newer, cleaner technologies.

Failure to implement an effective and comprehensive policy response at this stage will increase the amount of regulatory uncertainty currently hindering investment in both existing emissions-intensive infrastructure as well as clean technology and the structural adjustments required to de-carbonise the Australian economy.

Practically speaking, business responds to issues when they need to. If the Government delays the introduction of the scheme, business will delay implementing an effective response, and Australia's emission reductions targets will become more difficult – and more expensive - to achieve.

Therefore, Westpac does not support delaying that start date of the scheme and strongly supports industry calls to finalise the policy framework and introduce the Carbon Pollution Reduction Scheme (CPRS) by July 2010.

**(b) The relative contributions to overall emission reduction targets from complementary measures such as renewable energy feed-in laws, energy efficiency and the protection or development of terrestrial carbon stores such as native forests and soils;**

Achieving national emission reductions across the economy will require a comprehensive policy package including emissions trading, support for a comprehensive global agreement, a practical strategy for accelerating the commercial deploying of low emission technology, support for investment in renewable energy, adaptation strategies for impacted communities and awareness raising across the community to promote behavioural change.

Policies and programs in these areas will need to be addressed in parallel to the development of the Australian CPRS.

Transforming the way Australia produces and uses energy is a critical component of our national climate change response and Australia must explore complementary policies to accelerate the commercial uptake of breakthrough low emission technologies. The rate of technology improvement and subsequent adoption must be faster than the usual commercial timeframes if these technologies are to be available at scale, performance and at an acceptable cost when required to meet challenging emission trajectories.

Westpac supports the proposed Renewable Energy Target (RET) increase to 20% or 45,000 GWH by 2020. Re-invigorating the RET scheme for the medium term will provide the additional financial incentive required to accelerate investment in renewable energy infrastructure at an affordable cost, while the CPRS is still in its early stages. The combination of both the CPRS and RET will be required to support increased financing in the renewable energy sector.

In 2007, the Australian Business and Climate Group released the report *Stepping Up: Accelerating the deployment of low emission technology in Australia*. This included specific recommendations for addressing investment barriers to the rapid development and deployment of low emission technology. Westpac would recommend this report to the Committee for further consideration.

Westpac is also a founding member of the Agricultural Alliance on Climate Change (AACC). The AACC has commissioned research from the CSIRO examining how rural communities can promote climate change resilience and prosper from harvesting clean energy and farming carbon.

The resulting report, *Rural Australia Providing Climate Solutions*, focuses on the prospects for rural Australians becoming valued service providers in three important areas of Australia's low carbon future:

- providing clean energy and electricity;
- mobilising agricultural mitigation and greenhouse gas offsets; and
- supporting environmental stewardship on private land.

The report presents the best available information on the potential supply of each of these services from rural Australia, assesses key challenges or impediments that need to be overcome in order to realise this potential, and estimates the associated benefits for Australia rural businesses and communities.

Finally, Westpac has independently supported new innovative initiatives aimed at exploring the opportunities presented by bio sequestration through avoided deforestation and

aforestation. One example is Westpac's funding for the development of Landcare's CarbonSMART program. CarbonSMART is an enterprise launched as a subsidiary of Landcare Australia Limited (LAL) to pool carbon rights from landholders for on-selling as carbon credit offsets to corporations.

**(c) Whether the Government's Carbon Pollution Reduction Scheme is environmentally effective, in particular with regard to the adequacy or otherwise of the Government's 2020 and 2050 greenhouse gas emission reduction targets in avoiding dangerous climate change;**

Westpac has been examining and addressing the impact of climate change on our business for well over 15 years. In that time, Westpac has reduced its own emissions by over 40%, begun trading in environmental markets, launched a number of environmental products and services, promoted the application of ESG issues in risk assessment and investment considerations and publicly advocated for greater certainty in climate change policy and awareness in the wider community.

In 2008, Westpac was recognised in the global Climate Disclosure Leadership Index for the fifth year in a row. As recently as March 2009, Westpac was ranked global co-leader on overall climate change strategies in a detailed review of 114 global listed banks by Sustainable Asset Management (SAM), Worldwide Fund for Nature (WWF) a, ETH Zurich and ZHAW Zurich University.

Westpac's submission draws upon the bank's considerable experience in factoring environmental considerations into business policies, systems, and procedures as well as our practical participation in environmental markets to date.

There is no doubt that carbon markets and related policies to achieve emission reductions across the community are strengthening in the jurisdictions where we operate. So Westpac is looking to work hand in hand with our customers to understand what we can do to assist them in managing emerging carbon risks and pursuing new commercial opportunities.

Throughout the policy engagement process, Westpac has not sought to comment directly on what the most appropriate target or emission reduction trajectory Australia should adopt over the medium and longer term. We believe this is a matter for government to decide. Instead we have sought to comment on what design factors and technical elements we consider critical to ensuring a deep, liquid and efficient financial market for carbon.

Westpac would advocate that any emission reduction trajectory strongly references the climate change science, minimises the amount of complexity and politicking around ongoing adjustments to the trajectory to ensure maximum market certainty and that any changes to the trajectory are telegraphed well in advance to avoid market volatility.

Australia has a very carbon intense economy and there is a case to be made for turning around emissions growth in the short term before moving more rapidly towards robust medium and longer-term targets. There is no doubt that the impact of the introduction of a price on carbon under a 5% reduction target to 2020 will be felt across industry and across the economy. Westpac is already seeing evidence of behavioural change across our client base as companies position themselves to respond to the introduction of the CPRS.

The impact of the upper range of the target band (15%) will be depend upon the ability of the global community to reach a comprehensive agreement for the Second Commitment Period following the Kyoto Protocol. If there is an appreciable move towards the introduction of

global carbon pricing, Australian industry would be in a better position to move towards increased national emission reduction targets without being competitively disadvantaged.

However, Westpac would re-iterate that for Australia to meet national emission reduction targets in the most cost effective manner, it is vital that the CPRS is introduced in 2010 and allowed to ramp up over time to facilitate the structural adjustment required to transition to a low carbon economy.

Economic modelling undertaken both domestically and internationally, consistently demonstrates that delaying an effective policy response increases the economic costs and provide a significant shock to the economy.

**(d) An appropriate mechanism for determining what a fair and equitable contribution to the global emission reduction effort would be;**

It is clear that Australia has a role to play in ongoing international negotiations around a global emission reduction agreement, driven by our vulnerability to climate impacts and our economic reliance on greenhouse-intensive fossil fuels.

Westpac is not in a position to comment to any great degree of detail on what a 'fair and equitable' contribution to global emission reductions would be and believes that this is a topic which will be subject to ongoing policy and community debate within Australia, as well as at the International level.

However, we would note that Australian business is looking to the Government to implement a policy framework that will accommodate the fine balance between regulatory uncertainties about future international agreements and advancing scientific knowledge of climate change. Getting the framework right will be critical. Broadly, we would recommend that Australia develop domestic robust policy measures which support international efforts to:

- Design a long, loud and legal framework to establish a price signal and promote behavioural change across the global economy;
- Encourage innovation and investment in both the development and deployment of emerging and breakthrough technologies; and
- Build environmental and social resilience to the impacts of climate change.

Westpac also believes that Australia is also in a good position to make many positive contributions in terms of technology development, research and development and advancing our understanding of the placement of carbon in agricultural and land use and forestry frameworks.

**(e) Whether the design of the proposed scheme will send appropriate investment signals for green collar jobs, research and development, and the manufacturing and service industries, taking into account permit allocation, leakage, compensation mechanisms and additionality issues; and**

Westpac supports the majority of the design and implementation detail set out in the exposure legislation for the CPRS. We believe it will support a market which is sufficiently broad and deep to promote least cost carbon abatement across liable entities and the broader Australian economy over time.

We also acknowledge there are a number of outstanding technical details to be finalised and continue to work with the government in engaging around specific aspects of market design to ensure that the CPRS is efficient.

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. However, there are four key areas we can address in further detail.

- ***The \$40 price cap***

Westpac has continuously argued against the application of price control mechanisms on the carbon market, on the basis that it distorts behaviour and undermines the price signal, thereby diluting the incentive for investing in emission reductions. If a price cap were to be applied, it must be sufficiently high as to avoid any likely possibility of being hit. Our opinion is that \$40 is not sufficiently high to meet these criteria.

While we note that the CPRS exposure legislation has increased the annual adjustment of the price cap from 5% to 7.5%, we would argue that the starting figure for the price cap should at least \$50 a tonne, rising by 10% per annum.

We would note that all market participants (and governments) have historically failed to predict future economic conditions with any great certainty. Therefore, if a price cap were to be applied, we would also strongly recommend that it be applied as a short term transitional measure only, and be phased out in a specified period of time.

- ***The designation of permits as financial products***

Westpac supports the argument that market manipulation and market misconduct in relation to transactions in the CPRS should be prohibited. This will be fundamental to the operation of an orderly and efficient market. However we do not believe that the current proposal to treat permits as financial products is necessary to address this issue.

Westpac believes that the primary trading of permits will be adequately covered by the market conduct provisions of the Trade Practices Act, while any derivatives products would already be considered a financial product and therefore covered by existing financial market provisions.

Over-regulation of the market will limit the number of participants, unnecessarily increase transaction costs and will introduce a significant number of legal obligations and compliance costs.

We further note that no other jurisdiction have sought to designate carbon permits as a financial product and have instead regulated carbon derivatives markets via existing financial market provisions.

- ***The GST treatment of trading activity***

Westpac does not support the application of the Goods and Services Tax (GST) to CPRS transactions.

Westpac believes that applying the GST to carbon transactions will unnecessarily add to the compliance costs for liable emitters and will create pricing differentials between permits and offset credits traded in the Australian CPRS and with other international markets. This would unnecessarily limit the appetite of foreign players in the Australian scheme and damage any early-mover advantage to becoming a regional carbon hub.

We would also note that the New Zealand government recently reached a similar conclusion on this matter, and decided not to apply this approach to the New Zealand Emissions Trading Scheme.

- ***The auction process***

Westpac notes that there are a number of technical aspects of the auction process yet to be finalised, and we are continuing to engage with the government on the auction procedures, policies and rules of operation.

While we are broadly in agreement with the 'ascending clock' auction model proposed, Westpac is strongly opposed to the proposal for delayed settlement (allowing exchange of permits and payment at an agreed future date to limit cash flow impacts).

Westpac believes that allowing liable emitters to delay settlement for permits acquired at auction, would severely undermine the development of secondary markets for future vintages and reduce liquidity in the market, for limited benefit.

More broadly, Westpac believes that the current design for the CPRS, as set out the draft legislation, will provide an appropriate carbon price to promote behavioural change across the economy.

Internationally, business is anticipating tighter constraints on GHG emissions. Investment decisions for major infrastructure, particularly for long-lived assets such as power stations, require strategic assessment of policy and market drivers.

Growth in carbon markets is a global trend and is expected to continue to deepen in terms of the volume and value of trading activity. Last year the global carbon market was worth US\$118 billion and is expected to reach US\$150 billion in 2009. Market expectations are that once the North American market comes online, the global carbon market will be worth more than US\$3 trillion by 2020.

There is already a carbon market in Australia and it is growing. Market activity includes forward trading around permit allocations (AEUs), preparation for offshore credit trading (CERs) and the incorporation of carbon price considerations into existing markets which will be correlated to the carbon market.

Policy uncertainty is causing increased volatility in all these markets.

- **AEU trading:** To date there have been up to 20 trades in AEU's, mostly energy companies and brokers and predominantly starting out from 2011-12 or 2012-13 with an average volume of around 10,000 units traded OTC. Prices have ranged from \$18 to around \$24. In early February 2009, the first-ever trade in the 2010/11 AEU contract was reported, when 50,000 permits changed hands at A\$21.
- **CERs:** Australian businesses are increasingly looking to secure a pipeline of Certified Emission Reduction credits (CERs) from international markets, with many already having established an inventory. This is for two reasons: Firstly, the CPRS allows unlimited use of CERs for compliance purposes and secondly, because the price of sCERs in international markets has halved in the last six months (currently at around ten euro) making them a more affordable option for Australian companies.

The price of a CER is predominantly influenced by the EU ETS and standard supply and demand factors. The unlimited use of CERs in the CPRS means that the price of Australia permits, or AEU's, will be set by the price of CERs from offshore markets. This



is currently placing downward pressure on the forward price of AEU's, and is expected to keep them below, or close to, the \$20 level for the foreseeable future.

- **Electricity trading:** Prices in the Australian National Electricity Market already reflect inclusion of the price of carbon from mid-2010. This is a live market in which participants and corporates are making real, irreversible, long term investment decisions. Regulatory uncertainty around the start date of the scheme exacerbates the volatility of these prices. In addition, other factors such as the carbon intensity of particular states and generators, as well as the level of compensation or free permits accessible to particular companies, are also influencing market movements today.

As an indication of the immediate market impact of the current political debate, when Prime Minister Rudd accidentally stated in a radio interview (5 March) that the scheme would commence at the end of 2010 and not mid-year, over the 15 minutes it took for a correction to be made, the 2011 forward market immediately and violently traded down before moving back to its original starting price after a public correction was made.

As the regulatory regime has firmed up in Australia, Westpac has witnessed a significant increase in the levels of awareness and active management of carbon liabilities in the businesses we have spoken to. In addition, companies are investing significant amounts of capital into preparing for the advent of the scheme.

Clearly, different companies are at different levels of development, depending upon their industry, the view they are taking on the political outcome and their particular state of preparedness. However, we have seen a significant uptake in business response to carbon management through client engagement to date, involving moving beyond undertaking carbon inventories to formulating an investment and trading response.

Westpac does not believe that the overall design of the scheme should be significantly re-cast to respond to short term and immediate economic considerations. The current design of the CPRS, as a market based mechanism and in other design elements, has significant safety valves and price buffering measures in place to respond to current economic conditions.

There is no doubt that the impact of the introduction of a price on carbon will be felt across industry and across the economy. This is the intent of a market-based mechanism aimed at achieving greenhouse gas emission reductions. There is also clearly a case for a number of adjustment support mechanisms to be established with the introduction the scheme to allow business and members of the community to transition into a carbon-constrained economy.

Westpac notes that the CPRS is explicitly designed for a slow start which ramps up over time in response to changing market and regulatory conditions. It also includes a broad range of price buffering mechanisms and transitional assistance support measures for liable entities.

It is easily forgotten amidst the fear of change and the challenges of the unknown that the financial incentive provided by a cost on carbon will result in innovation and a growth industry for Australia as the world economy stabilises. Westpac is already seeing the seeds of such endeavours.

#### **(f) Any related matter**

Westpac is well known in the market for adopting strong risk management practices and a forward looking progressive approach to identifying emerging material risks and opportunities

for our business. We recognised a number of years ago that climate change is ultimately a business issue requiring the same approach.

As markets and policy frameworks develop as a means of taking greenhouse gas emissions out of everyday lives, financial institutions have a critical role to play in partnering with customers across all areas of our business to help transition to a low-carbon future.

We would be happy to comment further on any information or commentary provided in this submission. Please do not hesitate to contact us directly, if we can provide any additional information or be of any further assistance.

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