AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr John Hawkins
Committee Secretary
Senate Select Committee on Climate Policy
PO Box 6100
Parliament House
CANBERRA ACT 2600
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Dear Mr Hawkins,

Policies relating to climate change

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments to the Senate Select Committee on Climate Policy on its inquiry into policies related to climate change.

1. Opening remarks

The ABA supports the Federal Government's three pillar climate change strategy:

- Reducing Australia's greenhouse gas emissions (GHGs);
- Adapting to climate change that cannot be avoided; and
- Helping shape a global solution.

Climate change is a global problem that requires a global solution. We believe it is important to encourage the development of a global carbon market, initially through the introduction of the carbon pollution reduction scheme (CPRS) and a carbon market in Australia. The CPRS and carbon market will be fundamental to changing the behaviour of governments, businesses and the community – which is critical to shifting the high-emissions global economy to a lower emissions global economy.

The ABA supports the need to implement effective policy frameworks to underpin and promote a cost-effective reduction in GHGs. We believe that introducing a CPRS administered and regulated by the Federal Government will be an important part of delivering the Federal Government's climate change strategy. The CPRS should provide a transactional space that allows price discovery to occur due to the exchange of units for value. Trading rules and operational arrangements for a carbon market will be required to ensure the exchange of emissions units takes place in a manner which is economically efficient.

It is the ABA's view that the CPRS should:

- Be a policy enabler to ensure that Australia meets its international legal obligations under the Kyoto Protocol.
- Be established around a clearly articulated objective to mitigate the adverse effects of climate change by limiting and reducing the release of GHGs into the atmosphere through a market-based mechanism which places a price on carbon.
- Be developed around a flexible, yet consistent framework, minimising market and policy changes over time, reducing regulatory uncertainty, managing transaction costs, minimising administrative complexities, and thereby encouraging confidence by participants.
- Be bound by uniform rules and be able to facilitate efficient and simple participation. Market efficiency must be supported by solid financial market conventions, trading and operating rules and regulatory and governance arrangements. Unnecessary regulation will adversely impact the efficiency and cost-effectiveness of emissions reductions.
- Improve investment and operational certainty while minimising artificial distortions on the economy and adverse impacts on the environment.

The ABA believes that the CPRS should be part of a comprehensive and multifaceted portfolio of policy responses to address climate change and achieve sustainable reductions in GHGs, along with practical strategies that assist businesses, individuals and the community as a whole transition to a future carbon constrained economy. The CPRS and carbon market is unlikely to be sufficient to advance low carbon technologies and clean development initiatives. It is important to provide a market incentive to encourage deployment of renewable technologies and foster the development of expertise in low emissions technologies, renewable energy technologies and emissions reduction practices.

Therefore, we believe 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. We believe market-based approaches are likely to be the most cost-effective and economically efficient way to achieve reductions in GHGs.

The ABA recognises that the CPRS will impact in different ways on different businesses, individuals and communities. We believe complementary measures should take into account the distributional impacts of structural adjustment and compensation strategies. This should be done in such a way as to limit artificial impacts on the price of carbon. In addition, complementary measures should target potential areas of market failure and address emissions reduction gaps that are not covered by the CPRS.

In January 2008, the ABA released its *Position on Climate Change* (see attached). The ABA and our member banks have been working closely with the Federal Government on various climate change policies, including the CPRS and carbon market, national Renewable Energy Target (RET), national greenhouse and energy reporting system (NGERS), national carbon offset standard and adaptation responses. We look forward to continuing to work with the Federal Government on the implementation of the CPRS, especially on areas as they impact on the products and services provided by the banking and finance sector and the exchange of emissions units with low transaction costs through an efficient functioning carbon market.

2. Specific comments

2.1 Role of the banking and finance sector

Participation by the banking and finance sector will be critical to the successful design and implementation of various climate change policies. Banks and other financial institutions are well placed to develop and deliver the necessary infrastructure and products and assist businesses and households understand their exposures and take appropriate actions to shift to a lower emissions economy.

The banking and finance sector has an important role to play in a number of crucial areas, including:

- Facilitating the trade of carbon assets on the carbon market, including financing the creation and trade of carbon assets;
- Intermediating between private sector participant buyers and sellers and making secondary and forward markets;
- Advising private sector participants on commercial risks and opportunities, including carbon risk management techniques and reduction strategies;
- Investing and providing capital funding for the development of clean technologies, renewable energy technologies and energy efficiency initiatives;
- Lending to private sector participants and individuals; and
- Developing products, services and incentives to support other climate change policies and mitigation and adaptation strategies, including retail products and services.

2.2 CPRS and carbon market

The ABA makes a distinction between the CPRS and the carbon market. The CPRS should establish the scheme design parameters and supporting infrastructure as well as provide certainty in emissions reduction targets, trajectories, scheme caps, gateways and thresholds. A carbon market should deliver a credible price signal in a transactional space that enables the exchange of emissions units to entities that place the greatest economic value on them.

The ABA believes that market-based approaches, and specifically the 'cap and trade' scheme, is the most cost-effective and economically efficient way of achieving reductions in GHGs. Putting a price on carbon makes other policy responses achievable. Imposing a carbon tax would not be as economically efficient as it would hinder economic growth while not providing an incentive for industries to innovate and find cleaner ways of conducting their businesses.

The ABA and our member banks have been providing comments on various climate change policies giving consideration to the impact of such policies on the Australian economy as a whole. While we recognise the challenges presented by the global financial crisis and economic and market downturn, we believe that a delay in implementing the CPRS would compromise the effectiveness of the CPRS, create unnecessary uncertainty and additional costs and threaten our ability to mitigate the effects and adapt to the impacts of climate change.

The ABA believes that delaying the introduction of the CPRS will have adverse consequences – that is, uncertainty needs to be minimised through action to establish a price for carbon and how this will impact decisions of businesses and households. A gradual adjustment will allow businesses and households to plan their responses, manage the changes in technology, and take appropriate actions.

Climate change has considerable economic, social, environmental and business risks. Continuing uncertainty is disrupting the efficiency of existing markets as well as creating difficulties with regards to financing terms and investing decisions. Australia needs leadership and early action to provide business, investment and operational certainty. It is important for Australia to take action now and minimise the impacts of uncertainty. Delays in introducing the CPRS will result in market irregularities, pricing anomalies and a sharper adjustment to meet established emissions reduction targets.

However, climate change also presents considerable opportunities. Trading, product creation and ancillary services (including risk consulting, funds management, legal and accounting) should be developed as export services regionally and globally. The design parameters of the CPRS should keep in mind opportunities for technology advances and international linkages as well as innovation in the financial services industry. Structural inconsistencies, regulatory complexities, unnecessary administrative costs and delay in implementation will disadvantage Australia. It is important for Australia to take action now and take advantage of the opportunity to position itself as a 'carbon hub' within the Asia-Pacific region. Delays in introducing the CPRS will result in infrastructure and skills development opportunities going overseas.

The ABA supports the:

- Introduction of a 'cap and trade' scheme;
- 'Cap and trade' scheme based on principles that define a solid framework and design an efficient market including economic efficiency, flexibility, tradability, credibility, simplicity, integration and competition;
- Existing timetable for commencement of the CPRS on 1 July 2010; and
- Scheme enabling Australia to meet emissions reduction targets in the most efficient and cost-effective way as well as provide transitional assistance for the most affected businesses and households.

The ABA believes that the CPRS, carbon market and deployment of renewable energy technologies should form part of Australia's response to address the impacts of climate change and achieve sustainable reductions in GHGs in Australia and around the globe. It is vital for Australia to position itself to take advantage of the opportunities for innovation as well as contribute to the global solution to mange the risks and uncertainty of climate change. Taking early action, adopting a comprehensive policy response and building knowledge and capacity are the key principles in achieving a sustainable response to climate change that focuses on delivering both real economic outcomes and real environmental outcomes.

The ABA notes that the exposure draft CPRS legislation does not include details of the Climate Change Action Fund. We support the implementation of the Climate Change Action Fund as a transitional measure designed to encourage individuals to change their behaviour. The Federal Government should set up clear investment and funding guidelines structured around the central criteria of the intent of the Fund, i.e. what it is trying to do and how[1]. It is important that consumers and the community have the information they need to be able to identify the actions they need to take as well as the products, services and tools necessary to take those actions.

The ABA also notes that the exposure draft CPRS legislation does not include much of the detail of the CPRS framework. We are concerned with a number of practical and technical aspects of the CPRS framework. However, even though we believe that further consideration and consultation is required on some practical and technical aspects of the CPRS framework, this should not hinder the finalisation of the CPRS legislation in 2009 and commencement of the carbon market in 2010.

The following provides an overview of some of the practical and technical matters that we believe requires further consideration and consultation.

2.2.1 Scheme caps and gateways

The ABA believes that in determining scheme caps it is appropriate for the Minister to give consideration to factors, including Australia's national interests, progress towards comprehensive global action, the economic implications of the scheme cap and the price of carbon, voluntary action to reduce GHGs, and levels of GHGs that are not directly or indirectly covered by the CPRS. However, we believe the Minister should also give consideration to emerging climate change science, including targets and scenarios for stablisation of atmospheric GHGs. The design parameters which are critical to the credibility of the CPRS should recognise that economic efficiency and environmental integrity are both important outcomes of the CPRS.

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[1] The ABA notes that the Fund could include projects that provide capital investment in clean technology, new, innovative low emissions practices, and energy efficiency projects; disseminate best practice and consumer information to businesses and individuals; and provide support for those industry sectors and companies not receiving other forms of financial assistance.

The ABA believes that it is appropriate not to include the specific scheme caps and gateways in the CPRS legislation. It is a reality that the CPRS will need to be able to respond to reflect evolving climate change science and developing international negotiations and arrangements. Uncertainties of climate change should be dealt with appropriately by enabling flexibility to adapt. However, flexibility needs to be balanced with providing businesses, households and the market with certainty regarding the design parameters.

Therefore, the CPRS legislation must:

- Require the Minister to set the scheme caps and gateways in a timely manner, giving consideration to key issues.
- Ensure the scheme caps and gateways are prescribed by regulations.
- Make provision for a default cap setting mechanism in the event that there is no agreement or decision or a delay in identifying future scheme caps and gateways.

However, the CPRS legislation should not include a power to amend the scheme caps and gateways once set. We believe the CPRS legislation should be able to accommodate changes reflecting emerging climate change science and international negotiations and arrangements, without compromising clarity with regards to the stabilisation of atmospheric GHGs. It is important that the CPRS legislation ensures independence, transparency and accountability of decision making.

2.2.2 Price cap

The ABA does not support price controls. Price controls distort the operation of the market. However, if the Government continues to deem it necessary to impose a price cap for a transitional period, the price cap should be set in the legislation and such that it has a "very low probability of use", as foreshadowed by the Government in the CPRS Green Paper. We consider that the price cap contained in the exposure draft CPRS legislation has been set at a conservative level and therefore is not set at a level with a "very low probability of use"[2].

Too low a price cap will substantially undermine the objective of emissions reductions – that is, adjustments through technology will be weakened, GHG abatement activities will be hindered, price signals will be stifled, market development will be distorted, and market forces of supply and demand will be adversely affected. Furthermore, too flat an escalation could result in a sharp adjustment at the end of the transitional period.

A review mechanism should be included in the legislation to ensure that the price cap remains appropriate during the initial five year period, having regard to parity of international prices and international linkages as well as readily observable behaviour and outcomes in the carbon market. This will ensure that the price cap is not unduly prohibitive in managing extreme price volatility. In addition, it will assist in minimising the likelihood of pricing irregularities at cessation of the price cap as well as adverse consequences for importing eligible international units during the period of the price cap.

[2] Section ^89 of the CPRS Bill contains a price cap mechanism for the first five years, where the price cap is initially set at $40 per tonne in 2010-11, but rising at 7.5% per year to $53.42 per tonne in 2014-15.

While the ABA recognises the challenge in setting a price cap during a period of difficult market conditions, and thus the price cap provides business certainty by establishing a maximum cost of compliance, too low a price cap undermines market certainty and transfers risks to the Government. Therefore, we believe that further consideration is required, especially with regards to the quantum of the price cap, the rate of escalation and the application for units at a fixed price. We suggest the price cap mechanism needs to be adjusted.

2.2.3 International linkages

The ABA supports in principle including a provision that enables a liable entity to import non-Kyoto units issued in accordance with international agreements other than the Kyoto Protocol. A provision that allows for non-Kyoto units to be prescribed by the regulations as eligible international units means that other types of emissions units can be added without amending the legislation. The ability to recognise other international units will provide flexibility to respond to emerging international agreements and bi-lateral agreements, where an independent review finds that establishing a bi-lateral linkage will not significantly impact the price for AEUs and will enhance domestic and regional emissions reductions.

The ABA believes that further consideration and clarification is required, especially with regards to international linkages and implications for innovation in domestic GHG abatement activities, triggers and criteria for the basis of a decision not to recognise an international unit for compliance purposes or a decision to disallow the future transfer of certain types of international units, provisions allowing future exporting of AEUs, and international linkages and implications of proposed taxation arrangements and regulatory structures. The ability to import eligible international units is critical to the operation of the scheme and the efficiency of the market. The future ability to export AEUs will be critical to establishing a global carbon market.

2.2.4 Auctions

The ABA notes that the CPRS provides for a progressive shift towards 100% auctioning. We believe allocation should encourage the market forces of supply and demand, where AEUs are limited, the value of AEUs is enhanced, and companies are provided with an incentive to cut down on their need for units with the excess available to trade. Auctions should enable universal participation, subject to the lodgment of any required security deposit.

The ABA believes that auctioning should be consistent with norms of economic markets (i.e. take place via issuance of parcels of units at monthly intervals and via ascending clock auctions). Advance auctioning of a percentage of future year's vintage will create supply to enable any "5% shortfall" to be satisfied. Auctioning of an additional three vintages will provide an efficient price discovery mechanism, therefore, assisting liquidity in the forward market. We do not support the withholding of a portion of current year vintage for an auction after the end of the eligible compliance period. We also do not support double-sided auctions.

The ABA notes that the Federal Government has stated that further consultation is required on auction rules. Auction rules are to be prescribed by regulations.

2.2.5 Personal property rights

The ABA notes that the CPRS provides for the establishment of personal property rights. We believe that AEUs should represent personal property rights. Carbon assets with distinguishable and tradeable rights will be a key to establishing a secondary market and promoting the forward market. Carbon assets will improve the efficient functioning of the CPRS, by reducing transaction costs, facilitating price discovery and transferring risk, and minimising counterparty and settlement default.

The ABA believes that legal ownership should only be transferred by entry into the national registry. (However, we note that there is no explicit provision that an entry in the national registry is sufficient evidence of legal title.) The creation of equitable interests in emissions units should be permitted. Taking security over emissions units should be permitted. Carbon assets with distinguishable and tradeable rights will better assist financial institutions to extend credit against the value of the underlying asset, and include its value in cash flow and balance sheet projections.

The ABA notes that the Federal Government has stated that further consultation is required on property rights. We believe that further consideration and clarification is required, especially with regards to the implications of deferred payments for auctions and the ability to take security over emissions units, carry-over restrictions for eligible international units, equitable application amongst unit holders, and provisions allowing future exporting of AEUs.

2.2.6 Assistance program

The ABA recognises that transitional assistance is necessary to facilitate a smooth transition to a lower carbon economy. However, the level of free allocation will have implications for the efficiency of the market in terms of reduced liquidity. It is important that the assistance program does not have unintended consequences for the carbon market or unduly undermines the credibility of the CPRS.

2.2.7 Transfer of liability

The ABA believes that a number of the key definitions contained in the exposure draft CPRS legislation and the *National Greenhouse and Energy Reporting Act 2007* require clarification. A liable entity should be defined as the entity with operational control over the facility and responsible for GHGs emitted directly from the facility. However, in certain circumstances it may be difficult to identify 'operational control' (i.e. trust, partnership and joint venture arrangements), and in certain circumstances it may be appropriate for an entity with 'financial control' to transfer liability to another entity.

The ABA notes that the obligation transfer mechanism will allow emissions liabilities to be transferred, enabling flexibility to downstream the point of obligation – that is, liable entities, in relation to direct emissions from a covered facility, can be a controlling corporation of a group, a non-group entity, or a holder of a liability transfer certificate. There will only be one liable entity at any point in time.

While the ABA recognises that the liability transfer certificate is intended to address incidences where financial control may infer a liability in certain circumstances, it is currently unclear how the proposed changes to the NGER Act with regards to an entity nominating to take on the liability of operational control under the NGER Act intersect with the CPRS. Therefore, we believe that further consideration and clarification is required, especially with regards to multiple partner arrangements, incorporated entities versus non-incorporated entities, guarantee arrangements and implications for project financing, 'passive' financing arrangements by banks and other lenders, credit defaults and companies in administration/receivership, investments by fund managers, and the operation of anti-avoidance provisions in light of potential ambiguities.

2.2.8 Regulatory framework

Financial products

While the ABA supports ensuring market integrity in relation to transactions in emissions units and ensuring market manipulation and misconduct is prohibited, we do not believe that this is best achieved by regulating emissions units as 'financial products'. Treating emissions units as financial products brings with it the myriad of legal obligations and, in the absence of regulatory relief, will impose unnecessary compliance costs on liable entities and other scheme participants. Over-regulation of the carbon market will stifle participants, unnecessarily increase transaction costs and lead to unintended consequences for the CPRS and other domestic markets.

The ABA identifies a number of problems with treating emissions units as financial products, including:

- Emissions units being designated as financial products for the purposes of the *Australian Securities and Investments Commission Act 2001* and the *Corporations Act 2001* carries with it regulatory and compliance obligations regarding the provision of financial services (including licensing, conduct, advice and disclosure), increasing the costs of participating in the scheme and market;
- Adjustments made through regulations will result in a mixture of legislative instruments, create unnecessary legal complexities and hinder understanding of the CPRS framework, making the CPRS framework unwieldy thereby increasing the costs of participating in the scheme and market and potential regulatory uncertainties and risks with the operation of the scheme and market;
- Administrative burden for participants (i.e. licence variations for existing holders of Australian Financial Services Licences or new licences for other liable entities) and regulators (i.e. new processes, procedures, relief instruments) will increase the implementation and ongoing costs associated with the introduction of the scheme and market – this is likely to also create additional challenges for smaller entities and will likely create delays in commencement;
- No other jurisdiction has taken the decision to regulate emissions units as financial products – this could present problems in terms of international linkages, competitiveness, international trade and establishing Australia as a regional 'carbon hub'[3]; and
- Barriers to international trade as exemptions available for foreign-regulated entities are limited to particular types of financial products – this is likely to present problems in terms of international linkages.

[3] For example, the ABA notes that New Zealand and the United Kingdom do not regulate units as financial products.

The ABA notes that the banking and finance sector is currently consulting with the Department of Climate Change and Treasury on specific Chapter 7 obligations that should be adjusted so that regulation does not impose unnecessary administrative burdens or compliance costs as well as does not act as a barrier to entry. A thorough review of the Chapter 7 obligations will be required to make appropriate adjustments and remove the many unnecessary obligations that come with treating emissions units as financial products. It is essential that the scheme effectively interacts with the financial services laws, yet does not have broader implications that will adversely impact the efficiency and cost-effectiveness of emissions reductions.

Taxation

The ABA believes that the proposed taxation and accounting arrangements need to be given further consideration. The tax rules should seek to minimise complexity and compliance costs and be based on simplicity, efficiency and equity – that is, effective tax rules will be essential to the success of the scheme. We believe that the Federal Government should reconsider the tax treatment of CPRS transactions, including direct and indirect impacts as well as the uncertainty regarding the application of State taxes.

The ABA identifies a number of issues with the proposed taxation arrangements, including:

- Income tax deductions for expenses for the acquisition and disposal of eligible emissions units will need to be clarified, including implications for assessable income of proceeds of a sale or banking of emissions units, allocation of emissions units free of charge, and anomalies that may occur due to timing differences.

- GST rules applying to eligible emissions units (AEUs and Kyoto units) will create pricing discrepancies across international schemes and markets and taxation and infrastructure complexities (i.e. spot and forward trading; domestic and foreign traders; emissions units and other traded instruments).

Anti-money laundering

The ABA believes that the proposal to capture the acquisition and disposal of emissions units by agents as a 'designed service' under the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* needs to be given further consideration. This amendment may have far reaching implications for liable entities and other scheme participants and could substantially increase the regulatory burden and compliance costs associated with the scheme. The administrative burden for liable entities and other scheme participants will increase the implementation and ongoing costs associated with the introduction of the scheme and will likely create delays in commencement. We believe that the Federal Government should consider whether the potential compliance costs to business would be inconsistent with the scheme objective of imposing the least possible administrative burden on business and the overall objective of reducing the regulatory burden on business.

3. Concluding remarks

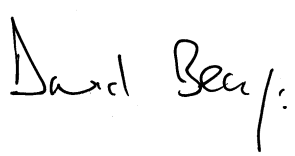
The ABA believes that significant and immediate action to reduce GHGs and adjust to the effects of climate change will go to minimising the impact of climate change on Australia's economy, society and environment. The CPRS, carbon market and national RET will impact on how decisions are made throughout Australia's economy and therefore efforts towards abatement of GHGs.

The ABA believes governments, businesses and the community must take action to mitigate, abate, prepare and adapt to the consequences of climate and weather-related changes due to global warming. It is in the long-term interests of the Australian economy, society and environment to take early action so that Australia can make a smooth transition to a lower carbon economy as well as address the vulnerabilities and take advantage of the opportunities presented by climate change.

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 CPRS and a carbon market in Australia.

If you have any queries regarding the issues raised in our submission, please contact me or Diane Tate, Director, Financial Services, Corporations, Community on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely



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David Bell

Attachment

AUSTRALIAN BANKERS' ASSOCIATION INC.

Position on Climate Change

The Australian Bankers' Association (ABA) recognises that climate change is a global problem that requires a sustainable global solution. Australia's economy and environment are particularly vulnerable to the impacts of climate change. Governments, businesses and the community all have a role in driving changes in behaviour and responding to the challenges posed by climate change.

Introduction

The Australian Bankers' Association (ABA) accepts the broad scientific and economic consensus that global warming resulting from greenhouse gas (GHG) emissions from human activities is contributing to changes in our climate. Failure to reduce GHG emissions and stabilise the world's climate will have widespread implications for Australia – not just for our environment, but for our economy, national security and public policy.

Climate change and the observable effects of global warming are widely recognised by the scientific community with expected impacts including: increases in global average air and ocean temperatures, widespread melting of snow and ice and rising global average sea levels[1]. Climate change is also predicted to have a devastating impact on the global economy, and more broadly society, with hundreds of millions of people suffering coastal flooding, hunger, water shortages, displacement and exposure to diseases[2].

The science and economics of climate change are converging. Governments, businesses and the community need to manage and adjust to the changes that are inevitable and mitigate the effects that are not yet a reality, with changes in behaviour, a reduction in GHG emissions and a stablisation of climate.

[1] The Intergovernmental Panel on Climate Change (IPCC) Fourth Assessment Report highlights that it is very likely or likely that over the last century climate change has, among other things, resulted in areas affected by drought increasing, precipitation levels decreasing, and heat waves, tropical cyclones, other extreme weather related events and weather instability increasing. http://www.ipcc.ch/

[2] The Stern Review on the Economics of Climate Change warns that climate change is a serious global threat which demands an urgent global response. Using economic modelling the overall costs and risks of climate change could be equivalent to losing 5% of global GDP each year, now and forever, whereas, the costs of taking action now to reduce GHG emissions can be limited to around 1% of global GDP each year.
http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/sternreview_index.cfm
This was supported by economic modelling undertaken by the Australian Business Roundtable on Climate Change in 2006. www.businessroundtable.com

<u>The Problem – it's global</u>

The ABA recognises that climate change is a global problem that requires a sustainable global solution. Australia's economy and environment are particularly vulnerable to the impacts of climate change. Governments, businesses and the community (individuals) all have a role in driving changes in behaviour and responding to the challenges posed by climate change.

The physical impacts and the regulatory responses to climate change will present both risks and opportunities for the banking and finance sector. The physical impacts of climate change for Australia over the next century and beyond will manifest in a number of areas including: impacts on natural ecosystems, water resources, forestry and agriculture, public health, settlements and infrastructure and extreme weather related events[3].

Physical impacts will affect the assets that banks invest in and lend against. Banks will need to understand the impact of potential business interruptions in some industries which are their customers, implement credit risk management techniques for both carbon emitters and carbon credit creators and price investment and lending risk. The banking and finance sector will also play an important role in decisions about agribusiness and other industries most exposed to the physical impacts of climate change.

Regulatory responses to climate change and a price of carbon, and the subsequent shift in financial projections, the uncertainty of risk modelling, the shift in lending volumes and revenues, the possible impacts on asset quality, the changes to the capital and financial markets and profitability of banks will all have direct and indirect costs and risks for banks, their customers and the broader economy.

New carbon market dynamics and impacts will also create technology innovation, new streams of revenue and operational efficiency opportunities for banks and their customers. Banks will have a significant role in facilitating the transition of companies and individuals to a future carbon constrained economy by mitigating economic risk and stimulating a lower carbon economy by providing new products and services and developing and participating in Australia's emissions trading scheme (ETS) and a global carbon market. The banking and finance sector will also play a vital role in facilitating and promoting low carbon technologies, clean development initiatives and financing the required adaptation measures due to unavoidable climate change.

<u>The Solution – it's a shared commitment</u>

The ABA recognises that planning for the future properly means that Australia must anticipate weather variability, different climate patterns and changed economic structures and understand how to respond to the impacts of climate change. Government, businesses and the community (individuals) must all contribute to responses that address the challenges and impacts of climate change.

The Australian Government will have a significant role in establishing a clear legal and policy framework underpinned by credible regulatory and governance arrangements for Australia's response to climate change. An effective policy response must include a suite of policy responses, incorporating global cooperation, emissions trading, adaptation measures and a renewable energy and clean technology strategy, as well as a number of complementary initiatives to support behavioural change in the wider community.

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[3] Preston, B and Jones, R (2006). *Climate Change Impacts on Australia and the Benefits of Early Action to Reduce Global Greenhouse Gas Emissions.* A consultancy report for the Australian Business Roundtable on Climate Change. CSIRO. February 2006. http://www.csiro.au/resources/pfbg.html

Businesses will have a significant role in managing their climate and carbon risks and taking advantage of opportunities to support the transition to a lower carbon economy through new technologies, markets and business enterprises. As well as addressing their own emissions, banks will assist companies and individuals manage the uncertainty of climate change and understand how carbon may be an asset or a liability. Banks will also need to prepare themselves for the various risks and opportunities of climate change and impacts on the financial and non-financial performance of their business operations as well as those of their customers.

All members of the community will have a significant role in responding to carbon price signals in the market, education initiatives of the Government and products available to assist them reduce their own carbon footprint. The community will be critical in shifting behaviour from short-term to long-term strategic decision-making about the economic, social and environmental performance of Australia.

The banking and finance sector supports the case for early action as a more cost effective response to the challenges posed by climate change. Early action must take place via a comprehensive and multifaceted policy response which balances economic and environmental outcomes.

Global cooperation will be needed – but Australia must advance its own response to the challenges of climate change through a shared commitment. It is vital that Australia position itself to take advantage of the opportunities for innovation as well as contribute to the global solution to mange the uncertainty of climate change.

Our Principles on Climate Change

Climate change has the potential to have a significant impact on global economic stability, financial market growth, international competitiveness, the availability of resources, industrial performance, the price of energy, the value of companies and individuals' prosperity and safety. These widespread financial and social ramifications will have a major impact on global banking, finance and insurance.

However, while climate change is inevitable, the extent of the impact of climate change in Australia will depend not just on the rate and extent of global warming and the response to changes by the climate system and the environment, but on the capacity of Australians to respond and minimise its impact through mitigation and adaptation as well as the resilience of our economy and society. We believe that Australians can mitigate the effects and adapt to the impacts of climate change despite the uncertainty inherent with the impacts of climate change.

The ABA and our member banks believe that the following principles should guide Australia's response to the challenges of climate change:

- Leadership – taking early action;
- Policy – applying flexible market mechanisms and policy support; and
- Practice – building knowledge and capacity.

The ABA's *Position on Climate Change* sets out our views on the critical role of the banking and finance sector in assisting all Australians manage their exposure to climate change. However, the banking and finance sector can only act as quickly as other sectors – it will take Governments, other businesses and industries and the community to drive changes in behaviour, collaborate and coordinate sustainable responses to climate change.

<u>Leadership – taking early action</u>

The ABA supports Australia taking early action in the global response to the challenges of climate change. Early action to reduce GHG emissions will increase the effectiveness of our response and reduce the costs of actions over the long term.

Australia needs leadership and early action to provide business, investment and operational certainty. Climate change has considerable economic, social, environmental and business risks that require significant and immediate action to reduce GHG emissions, minimise adverse impacts and adjust to the effects of climate change. Urgent responses will go to minimising the impact of climate change on Australia's economy and society.

Governments, businesses and the community must take early action to mitigate, abate, prepare and adapt to the consequences of climate and weather related changes due to global warming.

Governments will need to provide consistent leadership and long-term guidance to companies and individuals, so that the market and the community understand the actions they must take to contribute to Australia's response to climate change. Adopting clear transition and long-term national emissions targets will be required to facilitate a sustainable reduction in GHG emissions as well as provide greater investment certainty for long-term assets and support the appropriate pricing and management of carbon risk into the future.

Banks will need to understand that climate change considerations should be integrated into all decision making processes, as the effects of climate change will impact all business units and all customers. Products and services offered by the banking and finance sector will be critical in shifting Australia from a high-emissions economy to a lower emissions economy – including strategies for large corporations through to products for individual consumers.

The community will need to understand their exposure to unavoidable climate change and the actions they can take to reduce the effects of climate change on their lives and livelihoods.

<u>Policy – applying flexible market mechanisms and policy support</u>

The ABA supports Australia pursuing a market-based solution as part of a comprehensive and multifaceted policy response to control and reduce GHG emissions, facilitate innovation and investment and adapt to changed market conditions.

The banking and finance sector needs a clear, cohesive, consistent, long-term and balanced policy framework. Sustainable reductions in GHG emissions should be promoted through the design and introduction of an ETS for Australia. The ETS should be equitable, efficient, effective, transparent and flexible so that it may integrate with international schemes.

The ETS should be a 'cap and trade' scheme that includes a broad range of industrial sectors and GHG emissions and enables price signals to reflect the market forces of supply and demand. An efficient and liquid market should involve the trading of carbon assets based around the creation and existence of secure property rights and supported by standardised documentation. Allocation of permits should include a proportion of free allocation and auction in the beginning years of the scheme. Regulation of the scheme should be via an independent regulator that monitors the governance of the market and the effectiveness of the scheme in meeting its economic and environmental objectives[4].

[4] The ABA supports the broad policy principles and key elements of an ETS for Australia as outlined in the *Report of the Task Group on Emissions Trading.*

Around this market-based solution, complementary and practical strategies should also be identified to develop and deploy low emissions technologies, encourage renewable and efficient energy initiatives, promote water infrastructure and sustainable forestry projects and other mitigation and adaptation responses to assist companies and individuals transition to a future carbon constrained economy.

Transition from a high-emission global economy to a lower emission global economy will require a comprehensive and multifaceted policy response that provides business, investment and operational certainty, while minimising artificial distortions on the economy and adverse impacts on the environment.

<u>Practice – building knowledge and capacity</u>

The ABA supports Australian companies and individuals having access to the knowledge and skills required to build capacity and capability to respond to the challenges of climate change.

Countries with financial, technological and educational capacity will be better placed to adapt to the vulnerabilities of climate conditions and variability. The banking and finance sector will play a critical role in assisting all Australians manage their exposure to climate change. Consequently, banks will have to adapt their policies and processes to meet the changing demands of the market and their customers and to maintain and preserve their own viability in the changing market conditions.

Governments and businesses must assist individuals to understand climate change risks and opportunities and the actions available to them to contribute to Australia's response. Information will assist Australians better understand how the banking and finance sector will facilitate and contribute to the transition to a future carbon constrained economy.

Banks recognise that decisions taken now will have a major impact on Australia's ability to adapt to unavoidable climate change and mitigate the further effects of climate change. For example, banks will need to understand the products and services that their customers need to address the challenges and impact of climate change now and into the future.

Individual banks will pursue actions suitable for their business, their customers and their stakeholders. Some areas that banks believe may be pursued in their response to climate change include:

- Integrating climate change into their business strategy and building capacity to assess the implications of climate change, so the effects are understood and incorporated into their decision making processes.
- Developing and delivering products and services to assist their individual customers take action to manage their exposures, including offering specialist 'green' banking, insurance and managed investment products as well as carbon offset products.
- Reviewing, adapting and incorporating climate and carbon risk management techniques and reduction strategies into mainstream banking practices as well as building expertise to assist their business customers better manage their exposures, including carbon risk reduction, carbon finance, hedging and market strategies.
- Facilitating and promoting innovation and investment in low carbon technologies and clean development initiatives, through venture capital, structured loans and project finance.
- Facilitating and financing the trading of carbon permits and credits initially via the ETS and then via a global carbon market.

- Identifying investment and lending practices to facilitate the reduction in GHG emissions and stablisation of climate.

- Developing tools and practices to assist individuals and businesses manage their exposures and assess the risks and opportunities of climate change, so that the financial and social implications of climate change can inform decisions about business, investment and shareholder ownership.

- Developing tools and practices to manage their exposures and reduce their own carbon footprint, including environmental and carbon performance criteria, risk identification modelling, controlling and reporting structures and supply chain management.

- Adopting climate change disclosure and reporting practices to enhance the availability of information about material business risks due to effects of climate change that relate to the operations of the bank, such as reductions in GHG emissions, abatement actions, energy production and energy consumption.

- Promoting information sharing among the banking and finance sector and with Government, other businesses and industries and community groups as well as encouraging the standardisation of carbon risk disclosure, reporting practices and internal governance structures.

- Supporting research and development and analysis and assessment of the risk and opportunities of climate change for the banking and finance sector, its customers and the broader economy.

- Influencing sound policy development, raising awareness of how bank customers can manage their exposures and reduce their carbon footprint, and contributing to a shift from a high-emissions economy to a lower emissions economy so that the market, companies and individuals can react in an orderly manner and reduce investment uncertainty.

To assist the banking and finance sector in its responses to climate change, Governments should adopt a comprehensive and multifaceted policy response that includes the provision of research, education, prevention strategies and performance assessment relating to the banking and finance issues that arise from climate change.

Glossary[5]

Adaptation – Adjustment in natural or human systems in response to actual or expected climatic stimuli or their effects, which moderates harm or exploits beneficial opportunities.

Certified Emission Reduction (CER) – A Kyoto Protocol unit equal to 1 metric tonne of CO2 equivalent. CERs are issued for emission reductions from CDM project activities.

Clean Development Mechanism (CDM) – A mechanism under the Kyoto Protocol through which developed countries finance GHG emission reductions or removal projects in developing countries, and receive credits for doing so which they may apply towards meeting mandatory limits on their own emissions.

Carbon finance – Finance involved in projects or activities connected to the carbon market.

Carbon risk – The primary risks posed by climate change are often categorised as regulatory, physical, market and reputational risk, resulting from both the impacts of climate change and the introduction of regulatory and market frameworks to reduce emissions.

Clean energy – Forms of energy which do not result in the release of GHGs, including renewable energy. Some also include nuclear and geothermal power.

Emission Reduction Unit (ERU) – A Kyoto Protocol unit equal to 1 metric tonne of CO2 equivalent. ERUs are generated for emission reductions or emission removals from JI projects.

Joint Implementation (JI) – A mechanism under the Kyoto Protocol through which a developed country can receive ERUs when it helps to finance projects that reduce net GHG emissions in another developed country.

Greenhouse Gas (GHG) – Atmospheric gases responsible for causing global warming and climate change. The major GHGs are carbon dioxide (CO2), methane (CH4) and nitrous oxide (N20). Less prevalent --but very powerful -- greenhouse gases are hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF6).

Mitigation – Efforts to reduce GHG emissions, but not to actions to deal with the impacts of the changing climate.

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[5] Definitions of key terminology taken from the UN Framework Convention on Climate Change (http://unfccc.int/essential_background/glossary/items/3666.php) and UN Environment Programme (UNEP) Finance Initiative (http://www.unepfi.org/).