

10 September 2008

Carbon Pollution Reduction Scheme Green Paper Submission  
Department of Climate Change  
GPO Box 854  
Canberra, ACT 2601

Dear Secretary

The Australian Council of Superannuation Investors and the Australian Institute of Superannuation Trustees would like to thank you for the opportunity to comment on the Carbon Disclosure Reduction Scheme Green Paper (Green Paper) outlining the workings of the proposed Carbon Pollution Reduction Scheme (Scheme).

The member funds of the Australian Institute of Superannuation Trustees and the Australian Council of Superannuation Investors jointly manage over \$450 billion of retirement benefits for over 10 million Australians.

## **Introduction**

As significant investors across all parts of the Australian economy and indeed the global economy, our members take a keen interest in issues that will affect long-term retirement savings. The risks from climate change affects all sectors of the economy and its costs cannot be avoided for diversified long-term portfolios.

As institutional investors, our members have a fiduciary obligation to address long-term risks for their beneficiaries. As long term investors, any risk that is not managed effectively creates uncertainty that is detrimental to investment markets.

The Australian Council of Super Investors (ACSI) represents the interests of 42 not for profit superannuation funds. ACSI provides its members with advice and information on the impact of corporate governance, environmental and social issues on the long term performance of companies. On behalf of its members ACSI discusses these issues with Australian listed companies. ACSI members collectively manage over \$250 billion of Australians retirement savings.

The Australian Institute of Superannuation Trustees (AIST) is a national not-for-profit organisation representing funds which operate with a representative Trustee Board of Directors. AIST's members manage \$450 billion on behalf of Australian workers. AIST supports superannuation funds to advance the interests of their fund members.

Our members are significant owners of Australian companies. We recognise that businesses are major contributors to carbon pollution, although the degree may vary depending on the nature of a particular business. However, we also recognise that Australian businesses have operated and made strategic decisions within an existing regulatory environment, and therefore transitional arrangements will be required to enable them to adapt to this new environment. We also accept that households will need assistance to adapt to a low-carbon economy.

This submission comments on specific parts of the Green Paper which we feel are in the interests of long term investors and will broadly follow the same structure as the Green Paper.

## **Climate change risks for Australia**

AIST and ACSI accept the broad scientific consensus that the global climate is changing, and is likely to continue to change in the future, which will result in higher temperatures, more drought, rising sea levels and more extreme weather. We agree that these changes are very likely due to increased levels of anthropogenic carbon pollution in the earth's atmosphere. We recognise research that identifies climate change as posing social, environmental and economic risks that could create severe social and economic disruption, particularly within the Australian context.

We believe this situation warrants urgent action to limit the amount of carbon that is released into the atmosphere.

## **The Government's climate change strategy**

We accept the Government's "three pillars" approach to addressing climate change:

- reducing greenhouse gas emissions,
- adapting to climate change that we cannot avoid; and
- helping to shape a global solution.

We accept that a cap and trade emissions trading scheme is an economically responsible mechanism for driving desired behaviour towards reducing greenhouse gas emissions, and that it is the accepted international standard. However, we believe that an emissions trading scheme alone will not be sufficient to drive the required structural and behavioural changes throughout the economy and society. We welcome the Government's inclusion of positive assistance measures, and recommend some extension of these.

We believe that decisive, early action to combat climate change is less costly than the economic consequences of delayed or ineffective action. Delayed or diminished action increases the risk that further, more severe intervention will later be required, at greater cost to the economy, to investors and to our member funds' beneficiaries. In this regard we acknowledge and accept the government's election commitment to a target of 60% reduction by 2050. We observe that the central purpose of this Scheme, and the international scheme or schemes to which it will hopefully be allied, is to achieve the level of global abatement necessary to avoid the disastrous consequences outlined in the Green Paper. In circumstances where deeper cuts become manifestly necessary, we would support Australia revising the above commitment.

As long term investors, the start date of 2010 is optimal, balancing the urgency of emissions abatement with the need to get the Scheme design right, and achieve community buy-in. Commencing the Scheme at the earliest practical opportunity will allow business to adjust more easily over time. We strongly recommend that the Government does not delay the commencement of the scheme beyond 2010.

The fact that a relatively small number of entities will be directly subject to the Scheme suggest that it should be administratively possible to achieve the target implementation date.

## **Coverage of the scheme**

The members represented by both ACSI and AIST hold investments across the Australian economy and therefore we do not have a sectoral interest but an interest in the both the maintenance and growth in value across all investments.

For our members comprehensive coverage of sectors and of greenhouse gases is desirable in order to maximise abatement opportunities and efficiencies, to minimise the costs of a scheme to all scheme participants and to avoid unintended distortions. Therefore, we agree with the Government's preference that the Scheme have maximal coverage of industry sectors, but also recognise that there are practical constraints on this.

Although a carbon emissions trading scheme will involve costs for some companies, a scheme that fails in its objective of significantly reducing carbon emissions will expose the portfolios of long term investors to greater costs in the medium and longer term. These include climate adaptation costs, opportunity costs, and the probability of further, and more intrusive regulatory action (with attendant economic uncertainty, disruption and transition costs).

Shielding companies from a carbon emissions trading scheme does not support their longer term value, as it limits their development of effective carbon mitigation and climate adaptation strategies that are suited to the realities of a domestic and international carbon-constrained economy. We agree that the more sectors that are excluded from the Scheme, the higher the cost faced by the covered sectors and, ultimately, consumers.

### **Transport**

We support the inclusion of transport emissions in the Scheme. In normal circumstances we would expect the full pass-through of increased fuel prices arising from the carbon price to be the prime signal for greater efficiency and abatement. However we accept that recent rapid increases in petrol prices have delivered consumers and business powerful signals for increased fuel and transport efficiency. For this reason, we accept the cent-for-cent reduction proposal. We support the proposed review of this measure after the first 3 years, and are strongly of the view that this concession could be removed at that time.

We are disappointed that the Green Paper does not mention the positive role public transport can play in abatement, and in helping consumers manage the cost of rising petrol prices. In particular, we note that electrified public transport systems will be subject to some Scheme costs arising from coal-fired electricity, whereas motorists will be effectively insulated for the first three years.

### **Agriculture**

AIST and ACSI support the inclusion of agriculture in the Scheme within the medium-term time frame. We believe that excluding emissions from agriculture on a permanent basis would place an unfair burden on other parts of the economy, and would blunt Australia's development of emissions abatement technologies in agriculture.

We agree with the arguments put forward in the Green Paper against imposing compliance on the hundreds of thousands of small farms. In the event that the metrics required for sophisticated measurement are not available for deployment by 2013, we would support the introduction of the upstream and the downstream measures suggested within the Green Paper, together with the option for large holdings with a high enough estimated emission level to elect to manage their own emissions subject to verification.

## **Forestry**

ACSI & AIST believe forests have a crucial role to play in emissions abatement, both within Australia and internationally. Long term investments can drive development of forests both for harvest and sequestration. We also note that sustainable forest management is an industry that reduces emissions. Further, we believe Australia is well-placed to develop the kinds of legal and financial instruments through which investment might be applied toward the protection of sustainable management of tropical rainforests and other forests as carbon sinks. Once developed, this model of financial instruments could then be replicated elsewhere including in developing countries. It is also our understanding that such models are under development with particular emphasis on developing countries and meeting sustainable development objectives as well as carbon management objectives.

We agree that only emissions sources and sinks that count toward Australia's international commitment be included in the Scheme on a voluntary basis.

We agree with the Government's arguments in favour of excluding deforestation from the scheme and note that whilst deforestation is generally related to agricultural activities, we are conscious of the other positive environmental benefits afforded by mature forests, in particular protection of biodiversity and water catchments. We note that these forests are generally held by state and territory governments and are subject to some of the world's most stringent land use regulations and controls. Inclusion of mature forests without special treatment (covered under Kyoto protocol Article 3.4) within the Scheme would expose landholders to unpredictable and potentially catastrophic carbon risks arising from bushfires, and could in a small number of instances where they are privately held, lead to perverse incentives to exploit forests and incur carbon costs before suffering such an event. However, we strongly support measures to reduce emissions and safeguard sinks within mature forests through regulation outside the Scheme.

We also agree with the Government's position that only sinks which count towards Australia's Kyoto inventory should be included. In relation to the Kyoto accounting rules for forest emissions, we agree with the Government's position that emissions for harvested timber be counted at the time and in the location that carbon in the timber is actually released, rather than at the time of harvesting. This approach would improve the competitiveness of Australian forest industries over the current Kyoto approach.

## **Overall coverage and offsets**

We agree with the Government's preferred position regarding offsets, and note that the voluntary inclusion of reforestation schemes will have the effect of establishing a regulatory framework, which has been lacking in the offsets market up to this time.

## **Carbon market**

The Government's preferred position is that carbon pollution permits be a financial product for the purposes of the *Corporations Act 2001* and some adjustments to that regime may be required to fit the characteristics of permits.

We strongly support inclusion of permits under the Corporations Act. Trading permits will become an important activity within the treasury departments of major corporations. Thus regulation under a framework with which most analysts are already familiar, will assist a smooth transition into the Scheme, and help mitigate against price volatility in the early years of operation.

### **Banking, borrowing and price caps**

We support the proposal for unlimited banking of permits. The Government's preferred position of limited short-term borrowing is acceptable, and we strongly urge the Government to maintain a borrowing limit of less than 5% of the following year's permits.

We believe that any price cap must be set at such a level that it is extremely unlikely to be reached, as to do otherwise would risk undermining the integrity of the Scheme. We also support the imposition of a price cap only in the initial stages of the Scheme and it should be reviewed in the first review period.

Because the price cap should be a temporary measure, we do not think it should be linked to the penalties for non-compliance. The Scheme should impose sufficiently high penalties for non-compliance to ensure that the integrity of the Scheme is maintained, together with make-good provisions. This would be similar to the penalty structure of the income tax regime.

### **Emissions targets and scheme caps**

We support the Government setting an indicative national emissions trajectory for a minimum of five years, which is extended every year by one year. Investment certainty is better facilitated by as long a trajectory as possible and we therefore encourage the Government to extend the trajectory beyond five years once an international emissions regime is agreed.

In addition, we agree with the concept of a notional allocation of permits for uncovered sectors, which should enable a smoother transition of these sectors into the Scheme.

We also support the use of gateways of at least 10 years ahead to promote investor certainty. On balance, we prefer continuous gateways over periodic gateways.

We agree with the position that the Government should quarantine the Scheme from external shocks to provide investors and others with certainty about short-term caps. That is, the short-term scheme caps should not be adjusted if they are incompatible with internationally negotiated national targets.

We note that the Government proposes to announce the approach to setting the national emissions and the Scheme caps at the end of 2008 with the actual caps for the first five years of the Scheme being announced in early 2010. We encourage the government to provide this information as early as possible so that business can prepare for the new regime and so that investors can assess the investment potential or otherwise.

## **Reporting and Compliance**

We agree that the *National Greenhouse and Energy Reporting Act 2007* (NGERS) reporting regime would be the starting point for monitoring and reporting under the Scheme to minimise multiple reporting for companies.

As allowed for under the *National Greenhouse and Energy Reporting Act 2007*, we encourage the publication of entity-level information. Publication of facility-level data alone would potentially make it difficult to calculate the emissions data of a large corporation, which may have multiple sites.

A major reason for this is that superannuation funds are substantial owners of large listed companies and, in ACSI's case, we engage with them on governance issues including their environmental and social performance. For that engagement to be effective in relation to climate change, we need to be able to identify the ownership of entities and facilities, particularly when they are shared.

However, we note that under Section 24 of the NGERS Act, there is discretion for the Greenhouse and Data Energy Officer to determine to publish either entity level, or facility level data. We encourage the Government to mandate publication of both entity level, and facility level data, to ensure the best possible valuations of liable entities.

## **International linking**

We support the design of a Scheme that allows it to link to international markets. We recognise that short-term restrictions on international trading may be necessary in the early years of the Scheme, but support measures to have full international trading of Kyoto units and credible non-Kyoto units as soon as practicable.

Appropriately structured early linking to developing countries in the Asia Pacific region could provide sustainable development opportunities that could improve the livelihoods of some of Australia's neighbours.

## **Assistance for households**

AIST & ACSI strongly support the Government's commitment that revenue from the Scheme will be used to assist households meet the costs imposed, and to assist them in achieving emissions abatement. We agree that the cost impacts of the Scheme will fall disproportionately on low-income households, and strongly urge the government to concentrate assistance to those households. Middle and high income households will have greater capacity to respond to energy pricing signals, particularly where household debt is lower. Recognising historically high levels of household debt, we believe financing assistance for energy efficient appliances and home modifications should play a large part in the assistance package.

We are aware that the Government plans to link the outcomes from the Henry Tax Review to the assistance measures for the Scheme. During the Howard Government era, changes to the tax system favoured higher income households, and we believe the Henry Tax Review should redress this imbalance. Our view is that in relation to the Climate Change Action Fund assistance measures, lower income households should receive some compensation through easing of the tax burden, with assistance for middle income households coming primarily from energy efficiency assistance.

## **Assistance for business, regions and workers**

We note that the Government has indicated a willingness to examine various measures outside the Scheme to achieve its Climate Change policy objectives.

We believe that in combination with the tax system, revenue from the Scheme can be used to accelerate investment in climate solutions of all kinds. Most early-stage development occurs in the private equity area, where access to capital can be difficult.

Superannuation Funds, particularly Industry, Public Sector and not for profit funds represent a very large source of available capital subject to investible opportunities with risk and return profiles consistent with the best interests of our members.

We note that the Government intends to create a Climate Change Action Fund and that this Fund would concentrate on areas that are not eligible for free permits. Clear guidelines for the operation and allocation of the Fund are required. Additionally, the Fund should be used to promote energy efficient measures for households and businesses along with retrofitting programs as reducing demand is a key factor in emissions abatement.

## **Emissions intensive trade-exposed industries**

ACSI and AIST recognise that emissions-intensive trade-exposed (EITE) industries will require assistance to prevent carbon leakage and to support and maintain the significant employment and investment in many EITE industries.

We note that the primary filter for assistance under the proposed EITE support regime is emissions intensity. In our view the primary filter should be trade exposure. This would better reflect the potential need for assistance. That is, the impact on a business and the people who rely on it, of the additional cost borne by them but not by their international competitors.

Emissions intensity per se does not create a need for assistance as we outline below in the ‘Strongly Affected Industries’ section.

We also note that under the proposed assistance regime, many businesses that will be obliged to purchase permits but fall below the assistance threshold are in the trade exposed sectors, particularly manufacturing. We further note that many of these are employment intensive industries.

We are concerned that these features, coupled with the use of the revenue denominator – and we note that revenue will be higher for value adding businesses like manufacturing but their margins may be extremely low and highly sensitive to any additional costs relative to their international competitors – may lead to unintended outcomes, including significant employment, investment and carbon leakages.

Any assistance that is given to EITE industries must be given in a way that provides incentives to these industries to reduce their emissions and pursue energy efficiency measures over time. There are of course many other reasons to preserve those industries operating in Australia, including their contribution to wealth creation, industry development, skill formation, job creation, R&D and Australia’s defence and security.

For all of those reasons, as well as to prevent carbon leakage, we support the provision of permits on a basis which encourages abatement, which we believe the quote “90% and 60%” levels suggested in the Green Paper will achieve.

The Green Paper’s view on assistance for EITE industries might be characterised as “wait and see” what international cooperation emerges on climate change abatement. We support this approach, but we believe the Government should link the review of EITE assistance more closely to the process through which global agreement is likely to evolve – most pressing through the 2009 United Nations Climate Change Conference in Copenhagen.

Some quarters have advocated a “carbon tariff” as a means of bringing EITE industries fully within the Scheme, while protecting the Scheme from carbon leakage through emissions intensive industries moving offshore. We do not now advocate a carbon tariff being put forward as an essential condition for reaching agreement in Copenhagen. We accept that there is sufficient difficulty in reaching an agreement already, without adding complexity.

However, if in the future an international consensus begins to build in support of such a measure, and such a measure is equitable, we will encourage the Australian Government to support it.

### **Strongly-affected industries**

AIST and ACSI accept that Coal Fired Generators are strongly affected to the extent that they may be unable to pass through the full cost to production of their permits, that their pollution amelioration opportunities are limited or already exhausted and that Carbon Capture Storage Technology is not yet available for commercial deployment.

Whilst increased electricity prices resulting from the Scheme are likely to induce more efficient consumption and substitution of coal in generation, neither is likely to occur so quickly as to produce very rapid retirement of coal fired assets (except those whose economic life was already coming to an end). Accordingly, we do not believe that energy security is at risk.

We accept that an argument can be made for compensation on fairness grounds and to avoid the unfair imputation that Australia’s investment market is subject to sovereign risk.

We believe that some compensation of a capital nature is warranted.

We believe that compensation should be:

- of a capital nature only, and should not affect the price or revenue of generators. In particular, there should be no free allocation of permits;
- offered on a “once and for all” basis, with the quantum calculated prior to the commencement of the scheme;
- calculated by reference to the medium term caps, and also the degree to which the facility is “strongly affected”.

In relation to this last point, and noting our comments above, compensation should take into account the efforts made by the facility owner to reduce emissions which produce their own reward in addition to the benefit gained from the reduced permit purchase obligations.

## **Scheme governance**

We agree that Parliament and the Government should have responsibility for policy decisions that affect Australia's ability to meet its international commitments, or which have significant or far-reaching implications. We recognise that many of the decisions the Parliament and the Government would be required to make (for example, the setting of future emissions trajectories, scheme caps and gateways) would be beyond the timeframe of an election cycle. However, we strongly support a completely independent regulator having control of decisions about individual cases.

In addition we support the proposal for an independent expert review every five years, or more often if necessary.

## **Complementary measures and transitional measures**

We support the Government's proposed approach to the following transitional measures:

- Encouragement for State and Territory Governments to discontinue their abatement schemes once the CPRS commences; and
- Establishment of a program for allocating early action credits.

ACSI & AIST strongly support reform of the retail electricity market to ensure carbon costs are passed through, and consumers receive a clear price signal in relation to carbon intensive electricity generation.

However, we note that the reform of the retail electricity sector is currently in the hands of the Ministerial Council on Energy, and separate from the work of the Department of Climate Change in addressing the findings from the Green Paper. Given the central importance of retail energy market reform in the success of the scheme, and the significant interests State Governments hold in electricity generation assets, we believe potential conflicts between the Council and the Department will need to be carefully managed by the Federal Government.

## **Conclusion**

Climate Change is one of the risk factors that our members consider in the selection of investments. We support therefore early and effective action by the Australian Government in tackling climate change on an economy-wide basis. As institutional investors in listed and unlisted companies and in assets across all sectors of the Australian economy, with a focus on long as well as short-term returns, it is important that the long-term costs to the economy of taking action to tackle climate change are minimised.

ACSI and AIST support the Government's election commitment to increase the Mandatory Renewable Energy Target to 20 %. Contrary to any criticism that this policy is inconsistent with an emissions trading scheme, we believe the mandated increase in non-fossil energy is warranted so as to allow time for the Scheme to send a price signal resulting in the deployment of new technology.

The members of AIST and ACSI are significant owners of Australian companies and whilst we recognise that businesses are major contributors to carbon pollution, we also recognise that Australian businesses have operated and made strategic decisions within an existing regulatory environment. Therefore transitional arrangements are required to enable them to adapt to this new regulatory environment. We also accept that households will need assistance to adapt to a low-carbon economy.

The outcome of action or inaction on climate change will be borne out in the returns that are generated for members of the superannuation funds we represent. We are firmly of the view that the costs of early and effective action will be less than the costs of delayed or insufficient action. We recognise that comprehensive coverage of industry sectors and of greenhouse gases are desirable in order to maximise abatement opportunities and efficiencies, while also minimising the costs of the scheme.

The design of the Carbon Pollution Reduction Scheme should facilitate certainty, market efficiency and integrity, and minimise the economy wide costs of reducing emissions. Given the central role of emissions data to the Scheme, a strong monitoring, reporting and assurance regime will ensure that emissions reported under the scheme are accurate and transparent. Reporting at the entity level is essential for investors.

Australia is well regarded in the region for the strength of its regulatory institutions and overall high level of market integrity, the introduction of the CPRS places Australia in an excellent position to develop into a regional hub for carbon trading activities and we welcome the Government's commitment to linking the Scheme with international markets and schemes, with a preference for open trade.

Appropriate governance and transparency must be an essential tenet of the operation of the Scheme. We fully support the stated commitment from Government that "every cent raised from the selling of permits will be used to help households and businesses as they make the move to a clean energy future." To satisfy this commitment an appropriate disclosure regime must be put in place.

The Australian investment community is very much aware of the impact of carbon on investments and the economy and it is the view of both organisations that we must move forward on this issue to ensure that carbon risk is managed effectively.

Yours sincerely



Ms Ann Byrne  
Chief Executive Officer  
Aust. Council of Superannuation Investors

Yours sincerely



Ms Fiona Reynolds  
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Aust. Institute of Superannuation Trustees