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Finance and Expenditure Select Committee
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To the Finance and Expenditure Select Committee

Re: ASX Submission on the Climate Change (Emissions Trading and Renewable Preference) Bill

As a provider of trading, clearing and settlement services to the financial markets in New Zealand (NZ), the Australian Securities Exchange (ASX) welcomes the opportunity to make a submission concerning the above referenced Bill.

The attachment to this submission presents more information on ASX and our plans to provide market infrastructure to support the NZ Emissions Trading Scheme (ETS) and forthcoming Australian ETS.

ASX advocates the linking of ETSs in Australia and New Zealand into a 'trading bloc' at the earliest opportunity as this would create additional market liquidity and risk management opportunities for the benefit of firms in both countries. The key to a successful link will be for the domestically issued emission permits to be homogenous and fully fungible.

Given the importance of settlement systems to support the NZ ETS we submit that consideration be given to amending the Climate Change Response Act to remove the reference to emissions units being 'indivisible' (or alternatively expressly state that beneficial interests in emissions units may be created and transferred outside of the registry).

As per the attached Submission, we would be happy to appear before the Committee to emphasise the significance of what we are proposing and answer any further questions the Committee might have on the services we can provide to support the NZ ETS.

The undersigned is the appropriate contact person in relation to ASX's submission.

Yours sincerely

A handwritten signature in cursive script that reads 'Anthony Collins'. The signature is written in black ink on a white background.

Anthony Collins
General Manager – Emerging Markets



29 February 2008

ASX Submission on the Climate Change (Emissions Trading and Renewable Preference) Bill

To the Finance and Expenditure Select Committee

Introduction

This submission is from the Australian Securities Exchange (ASX). ASX provides trading, clearing and settlement services to support the financial markets in New Zealand (NZ), including futures and options contracts on NZ interest rate and equity securities. More detail on ASX is presented in the Attachment to this submission.

We would be happy to appear before the Committee to speak to our submission if clarification or more information is required.

Summary

We support the intent of the Bill to introduce an Emissions Trading Scheme (ETS). An ETS will enable firms to factor future carbon prices into their decision-making.

We do not have any general or specific comments on the proposed design of the NZ ETS other than to point out areas which could potentially impede the ability of the financial markets to:

- reduce transaction costs (the costs of buyers and sellers meeting each other);
- facilitate price discovery and risk transfer (underpinning investment decision making); and,
- minimise the prospect for counter-party and settlement default.

Our general observation is that nothing in the Bill would appear to prevent firms in NZ or elsewhere from providing OTC and exchange infrastructure to support the NZ ETS. Firms with liabilities under the NZ ETS, and the NZ economy more generally, will benefit from competition for the provision of these services.

More specifically, we note that provision in the Bill has been made for linkages to other ETS and Kyoto trading mechanisms. ASX strongly advocates linking the NZ ETS and forthcoming Australian ETS into a 'trading bloc' at the earliest opportunity as this would create additional market liquidity and risk management opportunities for the benefit of firms in both countries. The key to a successful link will be for the domestically issued emission permits to be homogenous and fully fungible.

ASX has consulted widely in Australia and New Zealand regarding the provision of futures contracts on emission units and Kyoto credits together with a clearing house and settlement service for forward and spot trades in the OTC market. ASX has also commenced the process of opening an account in the New Zealand Emission Unit Register so that it will be in a position to introduce its trading, clearing and settlement services at the earliest opportunity.

The feedback from ASX's consultation process is that NZ firms will be well serviced by intermediaries, including banks, brokers and screen-based OTC matching facilities, many of which reside in Australia. ASX also notes

that the forthcoming Australian ETS will have a likely emissions 'cap' approximately $\frac{1}{5}$ the size of the EU ETS, and that the NZ ETS will be approximately $\frac{1}{40}$ the size of the EU ETS (ie around $\frac{1}{8}$ that of the likely Australian scheme). In the absence of linking the NZ ETS to the Australian ETS, it is difficult to envisage the former having the critical mass to support the levels of exchange-based trading required to generate a robust and transparent forward curve.

Irrespective of how trades occur, an emissions trading scheme would benefit from efficient and systemically robust settlement services. Hence, it is important to ensure that the legislative framework for New Zealand's ETS facilitates the development of settlement services. In particular, the legislative framework should allow for the transfer of beneficial interests in emissions units, as discussed in the attachment to this submission.

Specific Comments on Clause 14 of the Climate Change (Emissions Trading and Renewable Preference) Bill

Section 18 of the Climate Change Response Act states that a unit recorded in the Register is indivisible and transferable, within the Register and between the Register and overseas registers. The reference to 'indivisible' may not prevent the creation or transfer of beneficial interests in units, but it does create some confusion in this regard. The proposed section 18E of the Climate Change Response Act (in clause 13 of the Climate Change Response Amendment Bill) states that 'Notice of a trust, whether expressed, implied, or constructive, may not be entered on the unit register.' Hence, beneficial interests in emissions units would not be recognised on the Register. However, but this does not seem to prevent those interests being transferred and recorded elsewhere.

Given the importance of settlement systems to support the NZ ETS we submit that consideration be given to amending the Climate Change Response Act to delete the reference to 'indivisible' in section 18. This term is not necessary to achieve the objective of the Register not recognising trusts, as this is already covered in section 18E. We note that the wording used in section 18E reflects the time-honoured way of dealing with this issue in corporate law and corporate law framers have not usually felt the necessity to talk about indivisibility (e.g. in the context of share registers).

Alternatively, the bill could expressly state that beneficial interests in emissions units may be created and transferred outside of the Register.

These amendments could be introduced through clause 14 of Climate Change (Emissions Trading and Renewable Preference) Bill, which amends section 18 of the Climate Change Response Act.

We submit that there are two reasons for suggesting that the issue of beneficial interests is best dealt with explicitly within the Bill and not within any wider legislative changes underpinning the financial markets in New Zealand. First, there is no guarantee that any broader financial market reform (which we fully support in principle) will be passed prior to the commencement of trading pursuant to the NZ ETS. Second, the Climate Change Response Act appears to be the appropriate place to deal with the nature of emissions units.

Attachment - Summary of ASX Infrastructure for Emissions Trading

About ASX

As one of the world's top 10 listed exchange groups, measured by its market capitalisation, the ASX group of companies was created through the merger of the Australian Stock Exchange and the Sydney Futures Exchange.

ASX group operates under the brand, Australian Securities Exchange.

The Australian Securities Exchange spans the markets for corporate control, capital formation and price discovery and functions as an operator, supervisor, central counterparty clearer and payments system facilitator.

Of specific relevance to the NZ ETS:

- ASX provides exchange-traded and over-the-counter financial services to institutions throughout the Asia-Pacific region and globally through its operating subsidiaries Sydney Futures Exchange Limited, SFE Clearing Corporation Pty Ltd and Austraclear Limited.
- Subsequent to its acquisition of the New Zealand Futures and Options Exchange (NZFOE) in 1992, ASX subsidiary companies have operated the only futures and options exchange and clearing house servicing the interest rate, equity, foreign exchange, commodity and energy markets in New Zealand.
- For the 12 months ending 31 December 2007, the value of trade in the NZ markets operated by ASX averaged \$5.5bn a day – 40 times greater than the value of trade in the NZ equity market for the same period.
- The clearing house which supports the NZ futures and options markets, SFE Clearing Corporation (SFECC), facilitated over A\$42 trillion worth of derivatives trades in 2007, largely in Australian fixed interest futures, and at year-end participant margins managed by SFECC totalled A\$4.2bn. To put this in perspective, this annual transaction value is around 42 times Australia's annual GDP and 200 times New Zealand's GDP.
- In 2006/07, ASX Austraclear provided safe keeping for approximately A\$800 billion worth of securities and settled approximately A\$9 trillion in securities transactions.
- ASX Participants include all the major investment banks and brokerage houses and OTC brokers servicing the financial markets globally, including the EU ETS.

ASX Involvement in Environmental Markets

In 1999-2000 the Sydney Futures Exchange, now a wholly owned subsidiary of ASX, invested substantial resources in developing infrastructure to meet the needs of a domestic emissions trading system including that of a trading platform, registry function and settlement service. The Sydney Futures Exchange did not proceed with implementation of the market at that time given the absence of an Australian Government approved emissions trading scheme underpinned by legislation.

Subsequent to its earlier work on emissions trading, ASX has closely monitored the evolution and growth of the NSW Greenhouse Gas Abatement Scheme (NGACS) and Mandatory Renewable Energy Target (MRET) schemes in Australia. Neither of these schemes to-date have a critical mass to warrant the introduction of exchange-based trading or centralised clearing and settlement services. ASX also closely monitors international developments, including the Chicago Climate Exchange (CCX) and European Climate Exchange (EEX) with whom an on-going dialogue is maintained.

In parallel to monitoring international developments, a domestic focus of ASX over recent years has been the development and growth of its electricity futures market and over-the-counter (OTC) trade registration mechanisms for participants in the National Electricity Market (NEM). Over the past twelve months we have seen

significant growth in these activities. We expect there will be close links between the electricity and emissions markets, both in terms of market participants and the economic price signals they generate. For example, prices being set within the electricity futures market operated by ASX are already factoring in the expected costs associated with the forthcoming Australian ETS.

More information on ASX's plans to service mandatory emissions trading schemes, including submissions and discussion papers, can be found at http://www.asx.com.au/investor/emissions_trading/index.htm

ASX Settlement Services

ASX proposes to use existing Austraclear infrastructure to provide safekeeping and settlement services to support the settlement of emissions units (and eligible Kyoto credits) in Australia and New Zealand. Austraclear is Australia's primary wholesale Central Securities Depository (CSD) and offers participants DvP settlement, exchanging cash for securities irrevocably and in real-time.

The model proposed for Austraclear to provide settlement services is described below. We understand that other settlement service providers, such as Euroclear in Europe, are adopting similar models which leverage the infrastructure they currently provide for much larger interest rate and equity securities markets.

In summary:

- One of the NZ companies in the ASX group would have an account in the New Zealand Emission Unit Register.
- Parties who wish to use the Austraclear settlement system would become Austraclear participants.
- Each Austraclear participant has an account that records the instruments they have lodged with the ASX Austraclear CSD.
- Owners of emissions units could lodge these in Austraclear's account at the Register and in turn be issued with beneficial ownership of the same instruments within Austraclear.
- At any time beneficial owners could request lodgement of their emissions units back into their own names at the Register by withdrawing them from the Austraclear CSD. At no time do emission units leave the New Zealand Emission Unit Register.

Under this model, Austraclear would become the legal owner of the relevant emissions units on the Register with beneficial ownership transferred and recorded through Austraclear, in which each holder's interests are recorded and updated as those interests change. Hence, it is important that the legislative framework allows for the transfer of beneficial interests in the emissions units. This is also likely to be important for any other providers of settlement services for the New Zealand ETS.