

AFSL requirements for carbon market participants

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Two recent updates, ASIC's Regulatory Guide 236 and the Corporations Amendment Regulation 2012 (No. 1), provide further information on whether a carbon market participant will need to hold an Australian Financial Services Licence (AFSL). McCullough Robertson's Tim Wiedman summarises ASIC's position and provides practical guidance to assist participants in determining whether they will require an AFSL for their intended activities.

Background

Carbon markets cover activities involving emissions units, including those generated through the carbon pricing mechanism and the Carbon Farming Initiative (CFI), as well as voluntary carbon markets where participants make voluntary commitments to offset carbon emissions.

Generally, a person is required to hold an AFSL where they are in the business of providing financial services. To determine whether an AFSL is needed requires consideration of the following questions:

- is there a financial product?
- if so, is a financial service being provided?
- if so, is an AFSL required or does an exemption apply?

The application of these questions to carbon market participants, in light of ASIC's Regulatory Guide and the recent amendments to the Corporations Regulations, is considered below.

Are emissions units a financial product?

The following emissions units (collectively, **regulated emissions units**) are characterised as financial products:

- carbon units issued by the Clean Energy Regulator
- Australian carbon credit union units (**ACCU**), including both Kyoto ACCUs and non Kyoto ACCUs, issued by the Clean Energy Regulator under the CFI, and
- eligible international emissions units (**EIEUs**), being emissions units issued and traded in international carbon markets which are recognised under the Clean Energy Legislative Package, including:
 - certified emission reductions (**CERs**), other than temporary CERs or long term CERs
 - emission reduction units (known as ERUs), and
 - removal units (known as RMUs).

However, Corporations Regulation 7.1.071 provides that ACCUs and EIEUs will not be characterised as financial products until 1 July 2012 (once the carbon pricing mechanism takes effect).

Derivatives created over regulated emissions units are also financial products.

If your business involves dealings in regulated emissions units or derivatives over regulated emissions units, then you will need to consider whether you are providing a financial service and in the business of providing financial services and, if so, whether you need an AFSL or an exemption applies.

The following internationally traded emissions units are not, at this stage, financial products:

- some Kyoto Protocol emissions units, such as assigned amount units, temporary CERs or long term CERs, and
- emissions units traded within other emissions trading schemes, such as European Union Allowances and New Zealand Units.

If your activities are limited to emissions units that fall within these categories you are unlikely to require an AFSL.

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What is a financial service?

If you are involved with regulated emissions units, you will need to consider whether you are providing a financial service. The types of financial services relevant for most carbon market participants are:

- providing financial product advice
- dealing in financial products
- making a market for financial products, and
- providing a custodial or depository service.

Each of these financial services is explained in further detail below. Future regulations may also be passed which prescribe particular conduct as constituting a financial service.

If your business does not involve providing financial services then you will not need an AFSL. If you are providing a financial service then the next step is to consider whether you are in the business of doing so, and, if so, whether you need an AFSL or an exemption applies.

What is financial product advice?

A recommendation or statement of opinion, or a report of either of those things, constitutes financial product advice if it is provided with the intention of influencing a person's decision on a financial product, or could reasonably be regarded as being intended to have such influence. Generally, simply providing factual information is unlikely to constitute financial product advice.

In the context of regulated emissions units, the following table provides examples of conduct which are, and which are not, likely to constitute financial product advice.

FINANCIAL PRODUCT ADVICE	NOT FINANCIAL PRODUCT ADVICE
Advice to liable entities (being entities who will incur a charge for their carbon emissions unless they acquire and surrender emission units) to assist them make a decision about acquiring or disposing of regulated emissions units.	Advice of a technical nature about an eligible offset project or international offset project, which is not directly related to regulated emissions units.
Advice to persons engaged in voluntary offsetting of their emissions about how to acquire or dispose of regulated emissions units for this purpose.	Advice about options for technologies that may be used for an offset project, or the technical feasibility of implementing the physical characteristics of an offset project.
Advice relating to an offset project in the context of the CFI, or to persons seeking to produce EIEUs through the development and operation of international offset projects, where the advice is about the potential commercial benefits of such a project.	Advice about the implementation, construction and cost of an offset project (e.g. advice about the site selection, site preparation, species selection, technology procurement, project design, costs and construction). Advice about the potential sequestration, avoidance or abatement of emissions that does not include advice about the income that may be derived from regulated emissions units generated by the offset project (e.g. advice restricted to a forecast of the potential physical performance of an offset project, including that it may be possible to generate emissions units through the offset project, but not including a prediction of the potential income from sales of the units).
Advice to any person about regulated emissions units or products associated with emissions units (e.g. derivatives).	Advice about the ongoing operations of a project (e.g. advice about a maintenance or asset management plan for a project).
	The following information about an offset project: <ul style="list-style-type: none"> • advice about the eligibility of a project to gain the requisite approval as an offsetting project • advice about the process of gaining such approval • advice about the monitoring of emissions sequestration, avoidance or abatement of the project, and • advice about, or the conduct of, a verification or audit of the emissions sequestration, avoidance or abatement of the offset project.

In summary, advice which involves recommending, or is designed to encourage persons to acquire or dispose of regulated emissions units or which comments on potential commercial benefits which may arise from undertaking an offset project will likely constitute financial product advice.

Facts and information about an entity's obligations under the Clean Energy Legislative Package or advice on the requirements for establishing and operating an eligible offset project or international offset project is unlikely to constitute financial product advice.

What is dealing in a financial product?

You will be dealing in regulated emissions units if you acquire, vary or dispose of regulated emissions units (or derivatives over regulated emissions units) or arrange for another person to do so (for example, you act as an intermediary broker). However, where you are dealing on your own behalf, for example selling regulated emissions units issued to you or purchasing regulated emissions units in order to meet your obligations, then your conduct is generally exempt from being a financial service. The following table summarises various types of dealing conduct and identifies whether or not the activity is dealing in a financial product or exempt.

TYPE OF DEALING	TYPE OF ENTITY		
	Carbon offsetters (liable entities and voluntary offsetters)	Persons responsible for an offset project under the carbon farming initiative	Intermediaries (brokers, specialist emissions unit traders, financial institutions)
Dealing in regulated emissions units			
On own behalf	An AFSL exemption applies.	An AFSL exemption applies.	An AFSL exemption applies.
On behalf of a related or associated entity	An AFSL exemption will apply if dealing is for the purpose of managing a financial risk in relation to the surrender, cancellation or relinquishment of regulated emissions units, and dealing in regulated emissions units is not the principal purpose of the entity's business. An AFSL exemption will also apply if dealing in regulated emissions units is done on behalf of a related body corporate that is a liable entity, or on behalf of an associated entity that is a liable entity.	No exemption.	No exemption.
On behalf of any other person	No exemption.	No exemption.	No exemption.
Dealing in derivatives over regulated emissions units or foreign exchange contracts			
On own behalf	An AFSL exemption will apply if dealing is for the purposes of managing a financial risk in relation to the surrender, cancellation or relinquishment of regulated emissions units, and dealing in derivatives or foreign exchange contracts is not the principal purpose of the entity's business. An AFSL exemption will apply if the dealing is done for the purpose of managing financial risk, and dealing in derivatives or foreign exchange contracts is not a significant part of the entity's business.	No exemption.	No exemption.

TYPE OF DEALING	TYPE OF ENTITY		
	Carbon offsetters (liable entities and voluntary offsetters)	Persons responsible for an offset project under the carbon farming initiative	Intermediaries (brokers, specialist emissions unit traders, financial institutions)
On behalf of a related or associated entity	An AFSL exemption applies if dealing is for the purposes of managing a financial risk in relation to the surrender, cancellation or relinquishment of regulated emissions units, and dealing in derivatives or foreign exchange contracts is not the principal purpose of the entity's business.	No exemption.	No exemption.
On behalf of any other person	No exemption.	No exemption.	No exemption.

Therefore, if you are buying or selling regulated emissions units on your own behalf and, for carbon offsetters only, on behalf of a related or associated entity for risk management purposes then you will not need to hold an AFSL for the activities.

However, if you are buying or selling regulated emissions units on behalf of another entity or assisting someone to buy or sell regulated emissions units (or derivatives over such units) then you may need to hold an AFSL. Entering into derivatives over regulated emissions units will also necessitate an AFSL unless you are a carbon offsetter and the derivatives are for hedging purposes.

What is making a market?

A person will make a market for regulated emissions units if:

- they regularly state the prices at which they propose to buy or sell regulated emissions units on their own behalf, and
- other persons can reasonably expect they are able to regularly buy and sell at the stated prices.

For example, if you maintain a website or other facility where you quote prices at which you are prepared to buy ACCUs to assist to meet your surrender liability, you will be making a market and need to hold an AFSL. However, if you undertake individual negotiations to purchase ACCUs, this conduct is unlikely to constitute making a market even if you have agreements with the sellers of those ACCUs.

What is a custodial or depository service?

A custodial or depository service will generally exist if a person holds regulated emissions units or a beneficial interest in regulated emissions units in trust for or on behalf of another (usually for a fee).

This is unlikely to apply to most persons participating in carbon markets as they will hold their emissions units in their own Australian National Registry of Emissions Units (**ANREU**) account. However, if a nominated person holds regulated emissions units on trust for others in a single ANREU account in accordance with the *Carbon Credits (Carbon Farming Initiative) Act* then this may constitute providing a custodial service, requiring the nominated holder to hold an AFSL.

Though, if the nominated person has 20 or less clients for all custodial services that they provide (i.e. they are not holding regulated emissions units on trust for more than 20 people), then an exemption will apply and they will not require an AFSL to perform this activity.

What constitutes carrying on a business?

A business will exist if you are providing the relevant service with system, regularity and continuity. Generally, if your activities are more than a 'one-off' arrangement, then a business will exist and, if this business relates to the provision of financial services and no exemption applies, an AFSL will be required, even if the provision of financial services is not your main business, or a significant part of your main business.

Timeframes for obtaining AFSL

If your activities with regulated emissions units will constitute a business of providing financial services requiring you to hold an AFSL (and no other exemption applies, such as operating as an authorised representative of an appropriately-authorised AFSL holder) then you must adhere to the following steps and timeframes in order to continue your business post-1 July 2012.

DEADLINE	ACTIVITY	CONSEQUENCE
1 May 2012	ASIC registration period opens.	You must be registered with ASIC in order to continue to provide financial services in relation to regulated emissions units post 1 July 2012. You can apply to ASIC for registration from 1 May 2012.
30 June 2012	ASIC registration period closes.	If you are not registered by this date, you will not be able to continue to provide financial services in relation to regulated emissions units unless you hold an AFSL authorising you to do so.
1 July 2012	Be a member of an approved external dispute resolution scheme and obtain professional indemnity and fraud insurance which meets ASIC's requirements if financial services are provided to retail clients in relation to regulated emissions units.	You must not provide financial services to retail clients in relation to carbon emissions units after 1 July 2012 unless these requirements are met.
31 October 2012	Apply for an AFSL covering the provision of financial services for your regulated emissions unit activities.	To continue providing financial services in relation to regulated emissions units, you must apply for an AFSL by this date. If you have not applied for an AFSL by this date, you must cease providing financial services.
31 December 2012	Registration ceases.	You must hold an AFSL in order to provide financial services in relation to regulated emissions units after this date.

The above steps are designed as an interim measure to enable providers of financial services in relation to regulation emissions units to continue operating post-1 July 2012 whilst they are obtaining an AFSL. Once an AFSL is obtained with the necessary authorisations, the interim measures discussed above cease to apply.

Summary

Persons involved in:

- advising others on buying or selling regulated emissions units (or derivatives of regulated emissions units)
- advising other on the commercial benefits of an offset project, or
- buying or selling, or arranging for others to buy or sell, regulated emissions units (or derivatives over regulated emissions units),

should review their activities in light of ASIC's guidance and seek legal advice on whether they will need to hold an AFSL.

Generally, if you are buying or selling regulated emissions units on your own behalf or using regulated emissions units derivatives for hedging purposes then no AFSL will be required. However, if you are performing these functions on behalf of another person, assisting another person to buy or sell regulated emissions units, advising on the sale or purchase of regulated emissions units or recommending the establishment of an offset project to generate regulated emissions units, then you may need to hold an AFSL.

Given the carbon pricing mechanism will commence on 1 July 2012, persons requiring an AFSL must register with ASIC by 30 June 2012, apply for an AFSL by 31 October 2012 and hold an AFSL by 31 December 2012.

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