EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer

Corporations Act 2001

Corporations Regulations 2001

The *Corporations Act 2001* (the Act) provides for the regulation of corporations, financial markets, products and services, including in relation to licensing, conduct, financial product advice and disclosure.

Subsection 1364(1) of the Act provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed by regulations, or necessary or convenient to be prescribed by such regulations for carrying out or giving effect to the Act.

The amendments aim to align the financial services provisions of the Act with the Government's policies to reduce Australia's carbon emissions and therefore ensure that the regulatory burdens associated with those provisions remain appropriate.

The Emissions Reduction Fund (the Fund) is the centrepiece of the Government's Direct Action Plan to address climate change. It will purchase the lowest cost emissions reductions as identified through a reverse auction process.

Specifically, the amendments:

- exempt certain aggregation arrangements involving proposed transactions with the Clean Energy Regulator from the definitions of 'managed investment scheme', derivative, and 'financial product';

- exempt contracts with the Clean Energy Regulator from the definitions of 'derivative' and 'financial product'; and

- exempt carbon service providers from the financial product advice provisions of the Act in certain circumstances.

Australian Carbon Credit Units (ACCUs) were specified as financial products by *Corporations Amendment Regulation 2012 (No 1)*. Participants would continue to be required to hold an Australian Financial Services Licence (AFSL) if they provide financial services in respect of ACCUs not covered by the exemptions. For example, brokers who deal in ACCUs on behalf of others would require to be licenced. As such services are similar to financial services provided in respect of other financial products, it is appropriate to subject brokers in ACCUs to the same regulation as other brokers. It is likely that existing brokers in other financial products will offer broking services for ACCUs.

Under the Corporations Agreement 2002 (the Agreement), the State and Territory Governments referred their constitutional powers with respect to corporate regulation to the Commonwealth. The Legislative and Governance Forum for Corporations (meeting as the Ministerial Council for Corporations) has been consulted about the proposed Regulations as required by the Agreement. However, subclauses 507 and 511(2) of the Agreement provide that approval of the Council and the usual public

exposure period are not required for amendments to regulations relating to financial products and services or managed investment schemes.

The Regulations will commence the day after it is registered on the Federal Register of Legislative Instruments.

Item 1 ensures that certain definitions used in the Regulations are consistent with those used in the *Carbon Credits (Carbon Farming Initiative) Act 2011*.

Item 2 inserts a new paragraph 5C.11.01(1)(e), which provides that certain aggregation arrangements are not managed investment schemes. The exemption provided to aggregation arrangements provides a safe harbour for aggregators in certain circumstances.

In an aggregation arrangement, an aggregator makes a bid in a Fund auction as a project proponent on behalf of other site owners. The aggregator acquires a legal right to undertake the project from each site owner. The site owners may, for example, be landholders or business owners who permit the aggregator to enter their land to undertake the project or who are contracted by the aggregator to undertake the project (or parts thereof).

The policy underlying the regulation of managed investment schemes as financial products is that they are generally facilities through which, or through the acquisition of which, a person makes a financial investment. The nature of aggregation arrangements is different in kind from the nature of other managed investment schemes in that the underlying purpose of the arrangement is to reduce emissions.

Whilst it may be feasible to structure an aggregation arrangement so that it is not considered a managed investment scheme, the inclusion of certain desirable features may bring those arrangements within the definition of managed investment scheme.

These features may, for example, allow members of aggregation arrangements to share risk and profit between them more effectively. The regulatory burdens associated with financial services regulation may discourage aggregators from adopting these desirable features. This is inconsistent with the Government's policy of enabling aggregation so that smaller scale activities to reduce emissions can be implemented in the most cost-effective way.

The intensity of regulation associated with financial products is also disproportionate to the benefits and risks associated with such arrangements.

For these reasons, the Government considers it appropriate to provide a well-defined carve-out from MIS regulation for certain aggregation arrangements and to provide alternative protections. The Department of the Environment, in consultation with the Department of the Treasury and the Australian Securities and Investments Commission, is developing a best practice aggregation contract, which would include protections for parties to the contract and a best practice disclosure document that informs parties of the risks generally associated with aggregation.

Item 3 inserts paragraphs 7.1.04(8)(c) and 7.1.04(8)(d), which clarify that certain aggregation arrangements and carbon abatement contracts are not derivatives.

Prior to this amendment, aggregation arrangements and carbon abatement contracts are likely to be considered derivatives for the purposes of section 761D of the Act where the amount of the consideration or the value of the arrangement is derived from or varies by reference to the value or amount of ACCUs. However, most aggregation arrangements are likely to fall within the exception for contracts for the future provision of services in paragraph 761D(3)(c).

The regulations applicable to derivatives are not appropriate for most aggregation arrangements or carbon abatement contracts. For example, because each party to a

derivative contract is taken to be an issuer of a product in accordance with sub-section 761E(5), an aggregator may be required to hold an Australian Financial Services Licence in some circumstances if it regularly enters carbon abatement contracts with the Clean Energy Regulator, even though aggregators pose minimal risks to the Regulator.

This item provides further certainty by clarifying that aggregation arrangements should not be subject to financial product regulation because they are considered derivatives.

Item 4 inserts regulation 7.1.07J which provides that interests in aggregation arrangements and carbon abatement contracts are not financial products.

Item 5 inserts subregulations 7.1.08(5) and 7.1.08(6) which exempts financial product advice which is provided in relation to a Fund bid and is incidental to technical advice and which is provided to a project proponent or a proposed project proponent or site owner or a proposed site owner from obligations relating to financial product advice.

Carbon service providers assist Fund participants in making a bid into Fund auctions by providing certain information and advice. This includes technical advice, which is not regulated under the Act, and regulated financial product advice. Carbon service providers generally only provide financial product advice which is incidental to the technical advice they provide. However, without amendment, even providing incidental financial product advice to retail investors may trigger corporations act regulatory burdens which are disproportionate to the risks posed by that advice.

It is likely to be commercially impractical to disentangle the regulated and non-regulated advice. For example, a carbon service provider may provide technical advice in relation to the costs of a project, the number of ACCUs that the project may generate, and the operational risks associated with the project. Such advice requires specialist expertise that financial advisers would not have, including in relation to methodologies for calculating how many emissions reductions would be generated by a project. It may constitute financial product advice for that provider to conduct further analysis and calculate the cost of producing each ACCU or recommend a price to bid into a Fund auction. It would generally be more cost-effective for the carbon service provider to give this minor financial advice in the course of giving its more substantive technical advice.

REGULATION IMPACT STATEMENT

This regulation does not require a separate Regulation Impact Statement as it is covered by the Regulation Impact Statement for the Emissions Reduction Fund.

The Department of the Environment certified the Emissions Reduction Fund White Paper as a Regulation Impact Statement for initial decisions on the Emissions Reduction Fund, including the Emissions Reduction Fund crediting and purchasing arrangements, Carbon Farming Initiative arrangements incorporated into the Emissions Reduction Fund, and coverage of the Emissions Reduction Fund safeguard mechanism in accordance with the Australian Government Guide to Regulation. The Regulatory Impact Statement will be finalised after consultation with business on the remaining aspects of the safeguard policy.

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Corporations Amendment Regulation 2014 (No.)

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The regulation:

- exempts aggregation arrangements involving proposed transactions with the Emissions Reduction Fund from the definitions of 'managed investment scheme', 'derivative' and 'financial product';

- exempts contracts and other forms of arrangement with the Clean Energy Regulator from the definitions of 'derivative' and 'financial product'; and

- exempts carbon service providers from the financial product advice provisions of the Act in certain circumstances.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.