Emissions Trading Summit

Examining carbon trading prior to the introduction of the New Zealand ETS

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Introduction

- Kyoto-related carbon trading pre-NZ ETS
- Early trading in ERUs (JI) and CERs (CDM)
- Banking perspective on carbon markets and hedging
- Exchange traded, OTC carbon trading and derivatives

Why trade pre-commencement of NZ ETS?

- Early mover advantage in anticipation of short supply
- Selling units from PRE mechanism internationally
- Hedging against future price rises before compliance obligations start

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Early sales of emission units from PRE projects

- Up to 10 million units available from PRE projects
- Buyers include EU ETS participants and banks for carbon trading
- TrustPower sale of 300,000 units for approx. NZ$8 million

Case study: sale of units from PRE wind farm

- AAUs or ERUs available to PRE participant
- Participant sells units under emission reductions purchase agreement (ERPA)
- Key issues and risks concern:
    - what type of unit is being sold?
    - how many units will be available from the project?
    - how and when are the units to be delivered?
    - what are the consequences of failure to deliver – and on time?

What type of unit is being sold?

- Approval as JI project required to generate ERUs
- “Track 1” approval
- PRE projects qualify as JI once foreign buyer found for units
- Check approval position

How many units will be available from the project?

- Number of units being sold cf maximum available from project
- Priority between multiple buyers
- Confirm available units and priority

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How and when are the units to be delivered?

- Seller's and buyer's national registry accounts
- Linkage to international transaction log (ITL)
- Overseas company account in NZ registry
- Account in registry of third country linked to ITL
- Payment before or after delivery
- Firm timing for delivery

What are the consequences of failure to deliver – and on time?

- Financial exposure if late delivery – penalties, high spot market price
- Replacement units satisfactory to buyer (ERUs, CERs, AAUs)
- Liquidated damages

Price

- Price reflects risk allocation between parties
- Higher price for greater assurance of delivery in full/on time
- Better understanding of NZ risks could lift prices offered

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Buying CERs from CDM projects

- Similar contractual issues for CERs as ERUs
- CERs a key source of overseas units for NZ ETS compliance
- Primary v secondary CERs

Buying CERs from CDM projects continued

- Lower primary CER price for direct CDM project participation
- Higher secondary CER price reflects lower risk
- Price/risk trade-off for NZ businesses

ANZ – Global Reach

* Pacific Islands include: Solomon Islands, Vanuatu, Kiribati, Samoa, American Samoa, Fiji, Tonga, New Caledonia, Cook Islands

Australia / New Zealand

- Established in 1835
- ANZ National Bank HQ in Wellington
- ANZ Group HQ in Melbourne
- Leading bank and largest company in New Zealand
- One of the 10 largest and most successful companies in Australia

Asia / Pacific

- Australia/NZ's leading bank in Asia
- The leading bank in the South Pacific

Europe / United States

- Offices in New York, London, Paris and Frankfurt

ANZ – Australia/NZ's Leading Bank in Asia

Greater China
- Beijing since 1986
- Shanghai since 1993
- Hong Kong since 1972
- Taiwan since 1980
- Australia's only fully licensed foreign bank in China
- Only Aus/NZ bank in Taiwan

Philippines
- Manila since 1990
- Only Aus/NZ bank in Philippines

Malaysia
- Kuala Lumpur since 1971 (Representative office)

Cambodia
- Phnom Penh since 2005
- ANZ Royal Bank JV

South Korea
- Seoul since 1978

600 specialists on the ground in 15 Asian locations

■ *ANZ's Asian Network*

Providing integrated solutions across Trade Finance, Foreign Exchange, Debt Capital Markets, M&A, Structured Debt, Personal and Private Banking

Singapore
- Singapore – since 1974
- ANZ Asian HQ

Japan
- Tokyo – since 1969
- Osaka – since 1990
- Leading Australian/NZ bank in Japan
- Top 10 foreign bank

Vietnam
- Hanoi since 1993
- Ho Chi Minh City since 1993
- Leading foreign bank in Vietnam

Indonesia
- Jakarta since 1970
- Leading Australian/NZ bank

Thailand
- Bangkok since 1985 (Representative office)

ANZ credentials – As a leading bank in Asia, ANZ is well placed to identify CDM opportunities

The carbon “fit” for ANZ National Bank

- ANZ currently trades several global commodities running both proprietary and sales books, carbon products are another derivative that should fit in this suite of commodities
- ANZ National Bank has relationships with over 80% of NZ’s corporates and services over 40% of NZ’s rural network. Many of our clients will have exposure to the NZ ETS
- Like interest rate and foreign exchange risk management, ANZ National Bank needs to position itself to assist its clients manage their emissions liabilities and assets
- We see these risks being managed in a similar hedging manner to traditional fx and IRS exposures and that its ownership should ultimately sit within companies’ treasury divisions
- ANZNB’s rural network and international footprint ideally position it to identify smaller scale CDM opportunities throughout the Asia Pacific region and build a significant CER/NZU portfolio
- As the only bank in NZ trading electricity, ANZNB also see opportunities in the renewable energy field to provide one stop funding, electricity offtake and carbon purchase agreements

Areas of concern

- Traders can measure, manage and price most risks apart from regulatory risk, unfortunately this seems to be the most prevalent risk in carbon derivatives at present
- Other risks that require close attention are
  - deliverability risk inherent in CDM/JI developments
  - CER deliverability risk associated with ITL delays
  - long term viability of CDM/JI post 2012 (especially after the EU Commission January statement)
  - the potential for NZ to breach its AAU compliance period reserve
  - potential "legislative" risk surrounding the evolution of voluntary credits VER's versus VCS CCX for example
- Forestry is currently the only NZU creation scheme in NZ, this alone will provide limited liquidity, other compliance credit creation schemes will need to evolve

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Markets, products and documentation

Market	Products	Documentation options
Exchange -traded	• spot • futures • options	Standardised exchange terms
OTC	• spot • forwards • options • structured products	• ISDA/IETA/EFET other ERPA/ bespoke • master agreement vs single trade agreement

Documentation pros and cons

Issue	Standardised approach (eg, ISDA)	Bespoke approach
Negotiation – time and cost	Minimal	Potentially large
Basis risk (risk of documentation mismatch with other trades)	Minimal	Potentially high
Potential applicability to other products	Yes	No
Ability to cross-product net	Yes	No
Ability to create seller/buyer favourable documentation	Difficult	Simple

Legal Issues in New Zealand

- How is an emissions unit classified under NZ law?
  - a “security” under the Securities Act?
  - a “futures contract” under the Securities Markets Act?
  - an “investment security” under the PPSA?

- How do you take ownership of, or security over, an emissions unit?

Thank you

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