



Cabinet Economic Development Committee

Minute of Decision

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New Zealand Emissions Trading Scheme: Market Governance

Portfolio Climate Change

On 28 June 2023, the Cabinet Economic Development Committee:

Background

- 1 **noted** that in 2015, the review of the New Zealand Emissions Trading Scheme (NZETS) found that the Scheme could be improved, and identified that the market governance framework is not fit for purpose as it does not ensure market integrity, efficiency and confidence, nor address potential misconduct;
- 2 **noted** that in 2018 and 2022, the government consulted on improving the NZ ETS and identified seven market governance risks;

Prior Cabinet decisions regarding market governance

- 3 **noted** that on 29 August 2022, Cabinet agreed in principle, subject to further analysis, funding and further Cabinet decisions on the comprehensive package [CAB-22-MIN-0344], to progress:
 - 3.1 an exchange: the Ministry for the Environment (MfE), in consultation with the Ministry of Business, Innovation and Employment (MBIE) and the Ministry for Primary Industries (MPI), to undertake further analysis, and the Minister of Climate Change to report back to Cabinet with technical requirements and funding considerations in order to address governance of trading risks with an exchange;
 - 3.2 an education campaign: the education campaign is to be targeted to all people interacting with the New Zealand Unit (NZU) market, informing them of market risks in the NZ ETS and the benefits and implications of upcoming market changes;

Progressing an education campaign

- 4 **agreed** that MfE will work with MBIE, MPI, the Financial Markets Authority (FMA), and the Environmental Protection Authority (EPA) to establish an education campaign for all people interacting with the NZU market;

Progressing the procurement of an optional centralised exchange

- 5 **directed** officials to begin a Request for Proposal process, with a report back to Cabinet (paragraph 7 below), to procure a centrally cleared, optional to use exchange and associated market infrastructure;

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s 9(2)(f)(iv)

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invited the Minister of Climate Change and the Minister of Commerce and Consumer Affairs to report back to Cabinet in March 2024, to seek a decision on whether centralised clearing should be mandatory, considering:

7.1 MfE's preferred supplier(s);

7.2 the estimated costs for establishing the exchange;

7.3 the estimated costs of making the centralised clearing system compulsory;

7.4 the rationale and estimated costs to establish and operate centralised clearing for all NZU market users;

7.5 any disproportionate impacts of the optional exchange and centralised clearing for NZ ETS participants with compliance obligations;

7.6 implications for Treaty partners;

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s 9(2)(f)(iv)

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noted that implementing the exchange package is intended to assist transparency, monitoring and oversight of trades in the secondary market, and that publication of market information will assist with transparency and information asymmetry;

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noted that the EPA is currently exploring the impact of the proposed market governance approach on the Register and the ability to connect to and support the exchange;

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s 9(2)(f)(iv)

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noted that information will need to be shared between the Register/Registrar/EPA (as applicable), the exchange/market operator of the exchange, and the agency monitoring the exchange, which will require amendments to Climate Change Response Act 2002(CCRA) and other relevant legislation;

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noted that legislative changes may also be required to enable the clearing system and/or exchange to interface with the Register and connect into the existing arrangements in place for NZU trading;

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agreed that the necessary amendments be made to the CCRA and other legislation (such as the Financial Markets Authority Act 2011), to ensure that:

14.1 the clearing system and/or exchange can operate effectively and efficiently;

14.2 the EPA and the FMA have the ability to share and receive information in relation to the clearing system and/or exchange as necessary to fulfil their functions;

- 15 **noted** that the regulatory oversight of the clearing system and/or exchange needs to be considered, prior to the launch of the clearing system and/or exchange;
- 16 **agreed** to amend the CCRA and other relevant legislation to:
- 16.1 enable the Register/Registrar/EPA (as applicable) to have the ability to publish or share all information it collects with a future procured supplier(s) and the agency monitoring the clearing system and/or exchange;
- 16.2 provide that this information may be made available to market and/or the public;

Improved regulation of over-the-counter trades

- 17 **noted** that the EPA/Registrar (as applicable), through the Register, currently does not collect certain information regarding the price of transacted NZUs or whether trades are being made between related or non-related accounts;
- 18 **noted** that there are limitations on the EPA's ability to report and publish some useful market information that would improve transparency for NZU market users;
- 19 **noted** that these restrictions on information limit transparency, monitoring and oversight of trades in the NZU market;
- 20 **agreed** that the necessary amendments be made to the CCRA and other relevant legislation to:
- 20.1 enable the Register, Registrar and EPA (as applicable) to publish or share certain market information already collected;
- 20.2 require account holders to provide the information listed below, and allow the EPA/Registrar/Register (as applicable) to collect, store, publish and share the following:
- 20.2.1 the price of NZUs in the transaction;
- 20.2.2 whether trades are being made between non-related accounts;
- 20.2.3 the transactor's primary reason for holding an account;

Applying Fair Dealing provisions under the Financial Markets Conduct Act 2013

- 21 **noted** that the appropriate regulatory response to the seven market governance risks at this stage is to increase regulatory oversight in NZU markets;
- 22 **noted** that the FMA is responsible for monitoring and enforcement of the 'Fair Dealing' provisions in Part 2 of the Financial Markets Conduct Act 2013 (FMC Act), which prohibits:
- 22.1 misleading or deceptive conduct, false or misleading representations, and unsubstantiated representations in relation to financial products and services;
- 22.2 offers of financial products in the course of unsolicited meetings;
- 23 **agreed** to treat NZUs as a financial product for the purposes of Part 2 of the FMC Act;
- 24 **noted** that paragraph 27 below means that the FMA will be responsible for overseeing the Fair Dealing provisions in relation to NZUs;

- 25 **agreed** that a regulation-making power be added to the FMC Act to enable other interests, such as other types of Emissions Units (certain types or classes) that are not NZUs, to be called in to regulation under Part 2 of the FMC Act via regulations;
- 26 **agreed** that the offences, penalties and regulatory tools arising from Part 2 of the FMC Act will apply to NZUs in the same manner as financial products and financial services under Part 2, with any necessary modifications;
- 27 **noted** that the offences and penalties for a contravention of this Part are:
- 27.1 a civil liability, of which penalties include \$200,000 for individuals and \$600,000 for non-individuals;
 - 27.2 a pecuniary penalty not exceeding:
 - 27.2.1 three times the amount of the gain made or the loss avoided; and
 - 27.2.2 \$1 million in the case of an individual; or
 - 27.2.3 \$5 million in any other case;
- 28 **noted** that the pecuniary penalty referred to in paragraph 27.2 above only applies to the offences of misleading or deceptive conduct, false or misleading representations, and unsubstantiated representations, and is not applicable to the offence of offers of unsolicited meetings;
- 29 **agreed** that the FMA, MfE, MPI, MBIE and the EPA may share and receive information to the extent that is necessary for those agencies to give effect to their regulatory responsibilities, and to make any necessary legislative changes to give this effect;

Establishing a market governance work programme for the trading and market misconduct risks

- 30 **noted** that further regulation may be warranted as NZU markets develop;
- 31 **invited** the Minister of Climate Change and the Minister of Commerce and Consumer Affairs to report back to Cabinet by June 2024 seeking final decisions on introducing comprehensive regulatory solutions for the following risks:
- 31.1 potential lack of transparency, oversight, and monitoring of trades in the NZU market;
 - 31.2 credit and counter-party risks;
 - 31.3 insider trading and information asymmetry;
 - 31.4 manipulation of NZU prices;
- 32 **noted** that the report to Cabinet referred to in paragraph 31 above should consider whether the way in which the above risks are regulated, as financial products, under the FMC Act would be practical and appropriate for regulating NZU markets;
- 33 **noted** that an effective insider trading framework for the NZU market requires ongoing disclosure of material market moving information;

- 34 **directed** officials to design a disclosure mechanism for NZ ETS participants, including both emissions and removal activities, and persons that hold NZUs, for the purpose of insider trading prohibitions;
- 35 **noted** that as part of the report to Cabinet referred to in paragraph 31 above, officials will consider the impact on smaller NZU market users in NZU markets when developing the regime;
- 36 **noted** that the report back should also consider the wider ongoing work regarding the NZ ETS review;

Legislative implications

- 37 **noted** that the market governance proposals to impose the fair dealings proposals will require amendments to the CCRA and FMC Act and other relevant legislation;
- 38 **noted** that the introduction of an amendment Bill for the market governance proposals will require a legislative bid in the 2024 Legislation Programme;

Implementation and timeframes

- 39 **noted** that the Minister of Climate Change intends that:
- 39.1 work on the education campaign will begin immediately after funding is drawn down;
 - 39.2 s 9(2)(b)(ii), s 9(2)(f)(iv)
 - 39.3 the Fair Dealing proposals will be introduced by mid-2024;
 - 39.4 the changes will come into force soon after the Amendment Bill is passed;
- 40 **noted** that the Minister of Climate Change intends that:
- 40.1 the comprehensive Market Governance package will be introduced by the end of 2024, depending on the legislative priorities of the government;
 - 40.2 the changes will come into force within 24 months of the Bill being passed;

Financial implications

- 41 **noted** that as part of Budget 2023, the tagged contingency NZ ETS Market Governance was created with the following profile:

	\$m – increase/(decrease)					
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28 & Outyears
Tagged Operating Contingency	-	9.500	9.500	9.500	9.500	6.000
Tagged Capital Contingency	-	-	-	-	-	-

- 42 **noted** that as part of Budget 2023, Cabinet invited the Minister of Climate Change to include options to draw down the tagged operating contingency established above when reporting back to Cabinet on NZ ETS market governance;
- 43 **noted** that the proposals in the paper under DEV-23-SUB-0135 will have financial implications for the FMA, EPA, MBIE and MfE;
- 44 **noted** that the Minister of Climate Change intends to cover these costs through the tagged contingency established as part of Budget 2023;

- 45 s 9(2)(f)(iv)
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

- 46 **noted** that further work is required to finalise these costs and how they will be split across agencies;

- 47 **authorised** the Minister of Finance, the Minister of Climate Change and the Minister of Commerce and Consumer Affairs to draw down the tagged contingency referred to above (establishing any new appropriations as necessary) once these costs have been finalised;

- 48 **agreed** to extend the expiry date of the tagged contingency to 30 June 2024;

- 49 s 9(2)(f)(iv)
- [REDACTED]

- 50 s 9(2)(f)(iv)
- [REDACTED]

Next steps

- 51 **authorised** the Minister of Climate Change and the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to implement the decisions set out above through a Bill;
- 52 **agreed** that the Minister of Climate Change and the Minister Commerce and Consumer Affairs may share the paper under DEV-23-SUB-0135, drafts of further Cabinet papers on related issues, drafting instructions to the PCO, subsequent draft legislation or regulations, and related documents, with the FMA and the EPA;
- 53 **authorised** the Minister of Climate Change and the Minister of Commerce and Consumer Affairs to further clarify and develop policy matters relating to the above paragraphs in a manner not inconsistent with the policy proposals in the paper under DEV-23-SUB-0135.

Janine Harvey
Committee Secretary

Present:

Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon Willie Jackson
Hon David Parker
Hon Priyanka Radhakrishnan
Hon Kieran McAnulty
Hon Barbara Edmonds
Hon Dr Duncan Webb
Hon Rino Tirikatene
Hon Dr Deborah Russell
Hon Rachel Brooking
Hon Jo Luxton
Hon James Shaw

Officials present from:

Office of the Prime Minister
Officials Committee for DEV