



Process to appoint interim auction monitor for the NZ ETS

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| | Action sought: | Response by: |
| To Hon James Shaw, Minister for Climate Change | Agree | |

| | |
|--------------------------------------|---|
| Actions for Minister's Office Staff | Return the signed report to MfE. |
| Number of appendices and attachments | Titles of appendices and attachments (ie separate attached documents): Nil |

Ministry for the Environment contacts

| Position | Name | Cell phone | 1 st contact |
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Process to appoint interim auction monitor for the NZ ETS

Key Messages

1. The purpose of this briefing is to inform you on the steps being taken to progress the appointment of an interim auction monitor for the New Zealand Emissions Trading Scheme (NZ ETS) as an internal role within the Ministry for the Environment (MfE) and to confirm your approval of this process.
2. Due to the importance of providing oversight for auctions and the deferral of development of regulations to appoint an auction monitor during the Covid-19 pandemic, you agreed to progress the appointment of an interim auction monitor to perform a limited auction monitoring role until a permanent appointment can be made [2020-B-06614].
3. In the interim period, we advise that the MfE will make a short term internal appointment to fill the role of an interim auction monitor. This role will provide oversight for the first few auctions during 2021 until a permanent appointment to the role of auction monitor can be completed later in 2021.
4. Final decisions have now been taken on the auction schedule for 2021. Auctions are scheduled to be held in March, June, September and December 2021.
5. The full regulatory process to appoint an auction monitor was delayed due to Covid-19 and is now expected to begin at the end of 2020, and will be complete during the third quarter of 2021. We expect to make a permanent appointment by September 2021.
6. As previously advised, we recommend the appointment of an interim auction monitor to report on up to three auctions during 2021, and contribute information to the annual auction report once the permanent auction monitor is appointed.
7. The process to appoint the interim auction monitor will run in parallel with the development of regulations to make a permanent appointment enabling the two processes to inform each other. For example, as appointment criteria are developed for the interim auction monitor within MfE, this work can inform the development of criteria to appoint the permanent auction monitor.

Recommendations

8. We recommend that you:
 - a. **Note** that due to the impact of Covid-19 the process to appoint the auction monitor by regulations will not be complete in time for the first NZ ETS auction in March 2021.
 - b. **Note** that due to this deferral, you have previously agreed to progress the appointment of MfE as an interim auction monitor until a final appointment can be made.
 - c. **Note** that MfE will appoint the interim auction monitor as a short term internal role and that this role is expected to be in place for less than a year to cover the first two or three NZ ETS auctions during 2021.

- d. **Note** that that the process to appoint an interim auction monitor will run in parallel with, and be informed by, the development of regulatory proposals to appoint the final auction monitor.
- e. **Agree** to approve the process described in this briefing to appoint the interim auction monitor as an internal role within the MfE with a view to establishing this role in early 2021.

Yes/No

- f. **Agree** that this briefing will be released proactively on the Ministry for the Environment's website within the next eight weeks.

Yes/No

Signature

Matthew Cowie
Acting Director, Climate Change

Hon James Shaw
Minister for Climate Change

Date

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Supporting material

Purpose

9. The purpose of this briefing is to inform you on the steps being taken to progress the appointment of an interim auction monitor for the New Zealand Emissions Trading Scheme (NZ ETS) as an internal role within the Ministry for the Environment (MfE) and to confirm your approval of this process.

Context

10. It is important that the reforms to the NZ ETS, as specified in the recently amended Climate Change Response Act 2002 (the Act) provide for an effective, efficient and robust auctioning system to enable auctioning of units to meet New Zealand's international and domestic climate change targets.
11. The Act specifies that regulations are required to define the process to appoint an auction monitor and to describe the functions of the role. Under normal circumstances, the regulatory policy process to enable the Government to appoint an auction monitor was expected to be underway now to ensure the appointment could take effect prior to the start of auctioning in early 2021.

Impact of Covid-19

12. In the Covid-19 response environment all non-essential consultation was postponed and, as the election approaches, Cabinet's availability to consider regulatory policy proposals is limited. The original timetable to develop regulations to appoint an auction monitor prior to the start of auctioning in the NZ ETS can no longer be met.
13. Consultation on the regulations required to appoint a permanent auction monitor can now begin only in late 2020, and the making of regulations and appointment process is expected to be complete by the third quarter of 2021.

Analysis and Advice

Full regulatory process to appoint a permanent auction monitor

14. Making regulations under the Act as amended by the Climate Change Response (Emissions Trading Reform) Amendment Act 2020 (the ETR Act) to appoint an auction monitor (new section 30GD) requires a full regulatory policy process, including consultation with persons likely to be affected by these regulations.
15. Setting regulations for the permanent appointment, including a four to six week timeframe for consultation with affected parties, is estimated to take approximately seven or eight months from development of proposals to regulations being notified in the Gazette. Under the Act, these regulations then come into force three months after their date of notification. A high level timeline is presented in Table 1.
16. Regulations, once set, specify a process to appoint and outline the role of the auction monitor. It may then take a period of time to confirm any appointment made under those regulations.

Timeline for setting up an auction monitor

17. Table 1: Timeline for Regulatory process to set up auction monitor

| Approximate Timing | Policy Process |
|--------------------|--|
| Before 1 Nov 2020 | Development of policy options, engaging with other agencies if required |
| November 2020 | Consultation Document goes to Cabinet for approval |
| November 2020 | Four to six week consultation |
| January 2021 | Summary of Submissions published and development of final policy |
| March 2021 | Final policy decisions taken to Cabinet |
| June 2021 | Drafted regulations brought back to Cabinet and gazetting of new regulations |
| September 2021 | Regulations come into force |
| Third quarter 2021 | Appointment of auction monitor under new regulations |

Appointment of an interim auction monitor

18. In the short term, due to the deferral of the regulatory process, you agreed to progress the appointment of MfE as an interim auction monitor to oversee the first auctions beginning in March 2021 [2020-B-06614].
19. The interim auction monitor will report on the first few NZ ETS auctions until the permanent auction monitor is appointed by regulations. At this stage we expect the interim auction monitor will provide oversight for the auctions in March, June and September 2021.
20. Since the interim auction monitor will be a short term role with clearly defined responsibilities, we advise that the Ministry for the Environment will appoint someone to this role internally. The process to appoint someone to this interim role can also then help inform the process to define regulations for final appointment.
21. The role of interim auction monitor within MfE would be a short term appointment or contract position that:
 - sits outside of the policy team responsible for the NZ ETS to provide a degree of independence
 - would require no more than 0.5 FTE for a period of approximately 9-12 months.
22. While this will be an internal appointment, it is crucial to ensure that there are appropriate processes in place to ensure that commercially sensitive information received by the interim auction monitor in the course of their role is treated confidentially even within the Ministry.

Role of the interim auction monitor

23. The purpose of the interim auction monitor is to mitigate auction integrity risks by providing independent oversight of auctions. The functions of the monitor are to review the outcome of each auction and publish a report on auction outcomes, before the next auction occurs.
24. The interim auction monitor within MfE will have at minimum the following competencies
 - understanding of markets
 - report writing skills
 - impartiality and objectivity
 - demonstrable pertinent transferable skills

Further consideration may be required to develop specific technical or professional capacities required for this role.

25. This role will be established in early 2021, to have enough time to prepare for the first auction in March 2021 and would have the following responsibilities:
 - pre-auction: Establish relationship with platform provider, develop processes and report templates
 - post-auction: Produce the monitoring reports that will feed into the public annual NZ ETS auctions report.
26. Regulatory policy decisions state that the auction monitor must publish a report on the outcome of each auction, before the next auction occurs. The report will contain at least the following information [DEV-20-MIN-0540]:
 - detailed volume statistics, e.g average volume per bidder
 - average volume won per bidder
 - detailed statistics on the number of bids, e.g. average number of bids per bidder, number of bids submitted, number of successful bids
 - relevant aggregate information (eg, largest bids as a percentage of total volumes sold)
 - relevant distributional information (eg, number of units awarded to which winner, with bidder names withheld)
 - distribution of successful bids among market participants with and without mandatory compliance obligations
 - relevant information on resolved tied bids.
27. The report should also comment on the auction operation, compliance of auction rules and participant behaviour.
28. The interim auction monitor within MfE will receive relevant information from the auction operator as soon as practicable after each auction has closed to use as a basis for their report.
29. Detailed information relating to individual bids at auction will be anonymised. Details of the information required to be shared will be covered in the contract between MfE and the auction operator.
30. Auctioning reports from the first auctions will feed into the first public annual report. The latter is expected to be produced by the permanent auction monitor during 2022.
31. This initial monitoring of the market will contribute to ongoing work on market governance to help to identify market risks and issues, their magnitude and prevalence.

Risks and mitigations

Information sensitivity

32. The Act provides for information to be shared with the appointed auction monitor and further specifies that any information provided to the monitor is subject to confidentiality requirements (section 30GF) with certain exceptions (for example if the information is already in the public domain, or is required to be disclosed by the Act).
33. The interim auction monitor will be not subject to the information sharing or confidentiality requirements under the Act because they will not be appointed under regulations, as those regulations are yet to be developed. However, the information required to be shared will be covered under the terms in a contractual agreement between the auction operator and the Ministry for the Environment. Furthermore, there will be processes put in place internally to ensure any information that could be considered commercially sensitive will be treated

confidentially and independence from policy processes will be maintained.

Concerns regarding process to appoint

34. Concerns may be raised regarding the process to appoint an interim monitor outside of regulations. To address these concerns, as much as possible, this appointment process will be informed by the ongoing work to develop final regulations; for example utilising criteria developed for the final appointment process.
35. Furthermore, finalising the regulations and formalising a permanent appointment to the role of auction monitor remains a high priority for the Ministry, so we will work to ensure that the interim auction monitor remains a short-term appointment.
36. As work progresses around the appointment of the interim auction monitor role within MfE, we recommend proactively releasing all our advice to ensure the process is transparent.

Legal Issues

37. 9(2)(h) [REDACTED]

Financial, regulatory and legislative implications

38. The costs associated with the interim auction monitor are a part of the wider auctioning project budget for the NZ ETS, and this interim appointment has no further financial implications.

Next Steps

39. Officials will proceed to appoint the interim auction monitor within MfE, in parallel with developing proposals for regulatory consultation between now and late 2020. If you agree, no further decisions will be required from you to make the interim appointment.
40. The Ministry for the Environment will be responsible for establishing the role of the interim auction monitor by December 2020, to begin in early 2021.