

Regulatory Impact Statement: New regulations for an NZ ETS auction monitor

Coversheet

Purpose of Document	
Decision sought:	This analysis and advice has been produced for the purpose of informing policy decisions to be taken by Cabinet. The specific policy decisions sought are on outstanding details for regulations for an NZ ETS auction monitor.
Advising agencies:	Ministry for the Environment
Proposing Minister:	Minister Shaw, Minister of Climate Change
Date finalised:	28 July 2021
Problem Definition	
<p>Although a decision has been made to enable the making of regulations to appoint an auction monitor to provide oversight of NZ ETS auctions, and corresponding amendments made to the Climate Change Response Act 2002 (the Act), these regulations have not yet been made.</p> <p>The provisions in the Act for making these regulations include descriptions of what these regulations may or must include.</p> <p>This RIS addresses the distinct policy questions of:</p> <ul style="list-style-type: none"> • whether guidance on the entity to be appointed as auction monitor should be provided in regulation • what, if any, auction monitor functions should be prescribed beyond those that must be included. 	
Executive Summary	
<p>The Government introduced auctioning of New Zealand units (NZUs) to align the supply of units into the New Zealand Emissions Trading Scheme (NZ ETS) with New Zealand's emissions reduction targets. Cabinet agreed to establish an independent monitor to provide oversight for the NZ ETS auctions.</p> <p>Cabinet agreed that regulations can be made to prescribe the auction monitor appointment process and specify the monitor's functions. The power to make these regulations was brought into the Act via the Climate Change Response (Emissions Trading Reform) Amendment Act 2020.</p> <p>These regulations now need to be made. NZ ETS auctions have begun with an interim arrangement of MfE performing auction monitoring functions on behalf of the Minister.</p>	

Some items that must be included in these regulations are described in the regulation making powers in section 30GD of the Act. Further decisions on the content of reports published by the auction monitor have also been made [DEV-20-MIN-0047]. Some decisions are outstanding and were addressed during consultation on development of these new regulations in April and May 2021.

There are two key outstanding considerations in setting regulations for appointing an auction monitor:

1. whether there should be guidance on the entity to be appointed
2. what functions the monitor should carry out.

Consultation elicited a consensus view that an appointment method or process should prescribe that the auction monitor be independent of any auction agents or persons likely to be auction participants, as is required by the Act. There were mixed views on whether the auction monitor function should be carried out by government or the private sector. There was no strong comment on introducing functions additional to those suggested in the Act.

Limitations and Constraints on Analysis

The only limitations to the scope of the new regulations are the empowering section of the Act, and prior decisions on the minimum content on auction reports published by the auction monitor once appointed [DEV-20-MIN-0047].

Responsible Manager

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29 July 2021

Quality Assurance

Reviewing Agency:	Ministry for the Environment
Panel Assessment & Comment:	The Ministry for the Environment's Regulatory Impact Analysis Panel has reviewed this Regulatory Impact Statement. The Panel confirms that the level of information provided meets the quality assessment criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. The Government introduced auctioning of New Zealand units (NZUs) to align the supply of units into the New Zealand Emissions Trading Scheme (NZ ETS) with New Zealand's emissions reduction targets. A number of decisions were made before the first auction took place, including the detailed rules for auctions. Cabinet also agreed to enable the establishment of an independent monitor to provide oversight for the NZ ETS auctions.
2. NZ ETS auctions are managed and run on behalf of the Government by an auction operator appointed by the Minister of Climate Change. Auctions are run on dates advised in the prior year, at approximately three-month intervals during 2021. Bidders are required to register and lodge collateral to be able to bid at auctions. Bidding takes place during a bidding window on the day of the auction. Once bidding closes, the auction clearing price is determined and successful bidders are required to complete payment for the units won before receiving units.
3. It was agreed that the power to make regulations to appoint an auction monitor, including the power to prescribe the appointment process and specify the auction monitor's functions, be added to the Act. This power was added as part of the Climate Change Response (Emissions Trading Reform) Amendment Act 2020. An auction monitor is intended to complement the other oversight settings during the auction pre-registration phase (i.e. pre-registration checks). Section 30GD of the Climate Change Response Act enables the making of regulations for an auction monitor.
4. The regulatory impact assessment supporting these earlier decisions is available here: <https://www.treasury.govt.nz/sites/default/files/2019-05/ria-mfe-cci-t2-auction-oversight-may19.pdf>.
5. The intent had been to establish an independent auction monitor prior to the first NZ ETS auction. Delays due to COVID-19 meant that NZ ETS auctions have begun with an interim arrangement of MfE performing auction monitor functions. Regulations still need to be made prescribing the functions of the auction monitor and setting out the appointment process.
6. Until regulations are made, an independent auction monitor is unable to be appointed. Although the interim measure is acceptable, it is not what was intended or desired.
7. Additionally, consultation on work to improve market governance for the NZ ETS commenced in July 2021. In 2019, it was noted that the role of the auction monitor will be reassessed, and potentially expanded, as part of the broader NZ ETS market governance work programme [ENV-19-MIN-0018]. Policy decisions on NZ ETS market governance are expected in early 2022.

What is the policy problem or opportunity?

8. Although amendments have been made to the CCRA to enable the making of regulations to appoint an auction monitor, these regulations have not yet been made.
9. The provisions for making these regulations include descriptions of what these regulations may or must include. Decisions on the content of these regulations are required to make these regulations.

10. The two key outstanding considerations in making regulations for appointing an auction monitor are:
 - a. whether there should be guidance on the entity to be appointed
 - b. what functions the monitor should carry out.

What objectives are sought in relation to the policy problem?

11. The objectives of NZ ETS regulations are to ensure the efficient and accurate operation of the NZ ETS. In the context of making new regulations for an auction monitor, this can be considered as:
 - a. that any prescribed method or process to appoint a person¹ as an auction monitor is appropriate
 - b. that any prescribed functions of the auction monitor allow the function to be performed effectively.

Section 2: Deciding upon an option to address the policy problem

What criteria have been used to compare options to the status quo?

12. The criteria for this decision are the same as those used for consultation, and consistent with other changes to NZ ETS regulations.
13. NZ ETS regulations contribute to the objectives of the NZ ETS and SGG levy, and must be accurate, efficient and clear. Each option in this document is assessed against the status quo, using the following four criteria:
 - a. **Alignment** with the objectives of the NZ ETS. The objectives are to support and encourage global efforts to reduce the emission of greenhouse gases by assisting New Zealand to meet the:
 - i. international obligations under the Convention, the Protocol, and the Paris Agreement
 - ii. 2050 target and emissions budgets.
 - b. **Accuracy** in this context concerns enhancing certainty that the auctions are run accurately and correctly.
 - c. **Efficiency** concerns administrative and compliance costs for participants and the Government.
 - d. **Clarity** means the regulations must be unambiguous and consistent, so the obligations and costs imposed on regulated parties are equivalent and unavoidable.
14. The criteria have been assessed as described in the assessment key below.

¹ Note that “person” in this context here and elsewhere in this RIS means legal person, and can include any type of legal entity

Key for assessing criteria

++	much better than doing nothing/the status quo
+	better than doing nothing/the status quo
0	about the same as doing nothing/the status quo
-	worse than doing nothing/the status quo
--	much worse than doing nothing/the status quo

What scope have options been considered within?

15. The scope of this work is deciding on the content of regulations made for an auction monitor. This scope is narrow as the Act provides tight guidance on the auction monitor regulations that may be made, including on the auction monitor functions that must be prescribed.
16. Additionally, some decisions on the content of reports produced by an appointed auction monitor have already been made.

What options are being considered?

17. As described in the scope section above, there are two key considerations in making regulations for appointing an auction monitor:
 - a. whether there should be guidance on the entity to be appointed
 - b. what functions the monitor should carry out.
18. These considerations are described and assessed separately below.

*Regulations prescribing method or process for appointing an auction monitor***Option One – Status Quo, No Regulations**

19. Although amendments have been made to the CCRA to enable the making of regulations for an auction monitor, these regulations have not yet been made.
20. Until regulations are made, an independent auction monitor will not be able to be appointed. The interim arrangement of MfE performing auction monitoring functions on behalf of the Minister will continue.

Option Two – Regulations prescribe appointment process, including reference to the type of entity to be appointed.

21. Regulations may prescribe a method or process by which the Minister may appoint a person as auction monitor. If this is prescribed, it must require independence of the auction monitor.
22. This option proposes to include a method or process as outlined above. Further, this option proposes that the type of entity to be appointed to the role also be prescribed.

Option Three – Regulations include guidance on appointment process without reference to the type of entity to be appointed.

23. Regulations may prescribe a method or process by which the Minister may appoint a person as auction monitor. If this is prescribed, it must require independence of the auction monitor.
24. This option proposes to include a method or process as outlined above. This option proposes that the type of entity to be appointed to the role is not prescribed.

Regulations specifying the auction monitor's functions

Option One – Status Quo, No Regulations

25. Although amendments have been made to the CCRA to enable the making of regulations for an auction monitor, these regulations have not yet been made.
26. Until regulations are made, an independent auction monitor will not be able to be appointed. The interim arrangement of MfE acting as a monitor on behalf of the Minister will continue.

Option Two – Regulations do not specify additional auction monitor functions

27. Regulations may specify functions of the auction monitor additional to any that must be included. The functions that must be prescribed are:
 - a. validating auction results
 - b. publishing reports on the results of auctions.
28. This option proposes no auction monitor functions beyond those that must be prescribed.

Option Three – Regulations specify additional auction monitor functions ²

29. Regulations may specify functions of the auction monitor additional to any that must be prescribed.
30. This option proposes including the specific functions suggested in the Act as functions that may be included. Consultation responses were generally silent on including other functions. These additional functions identified as functions that may be included are:
 - a. monitoring the conduct of any auction agents and auction participants
 - b. providing periodic assessments of the auction system and making recommendations for improvements
 - c. calculating additional specified metrics in respect of the auction process and auction results (such as bid volume statistics and relevant aggregate information).

² A fourth option, adding functions additional to those already listed in the Act was considered, but discarded after initial analysis, and noting the lack of suggested additional functions coming out of consultation.

How do the options compare to the status quo/counterfactual?

Regulations prescribing method or process for appointing an auction monitor

	Option One – Status Quo	Option Two – Regulations include guidance on appointment process, including reference to the type of entity to be appointed.	Option Three - Regulations include guidance on appointment process, without reference to the type of entity to be appointed.
Alignment with NZ ETS objectives	0	<p style="text-align: center;">+</p> <p>Prescribing the appointment process is useful. Prescribing the type of entity that can be appointed narrows options further than is appropriate.</p>	<p style="text-align: center;">++</p> <p>Prescribing the appointment process is useful. Retaining options for the type of entity that can be appointed is useful to allow alignment with future decisions on market governance.</p>
Accuracy	0	<p style="text-align: center;">0</p> <p>No impact on certainty that the auctions are run accurately and correctly.</p>	<p style="text-align: center;">0</p> <p>No impact on certainty that the auctions are run accurately and correctly</p>
Efficiency	0	<p style="text-align: center;">+</p> <p>Allows for the auction monitoring functions to be performed outside of the interim arrangement. Reduces options available in the appointment process, potential increased costs for Government.</p>	<p style="text-align: center;">++</p> <p>Allows for the auction monitoring functions to be performed outside of the interim arrangement. Reduces options in the appointment process, but not as much as specifying the type of entity to be appointed does.</p>
Clarity	0	<p style="text-align: center;">+</p> <p>Prescription will clarify the appointment process.</p>	<p style="text-align: center;">+</p> <p>Prescription will clarify the appointment process</p>
Overall assessment	0	+	++

Regulations specifying the auction monitor's functions

	Option One – Status Quo	Option Two– Regulations do not specify additional auction monitor functions	Option Three - Regulations specify additional auction monitor functions
Alignment with NZ ETS objectives	0	<p style="text-align: center;">+</p> <p>Limiting the auction monitor functions specified in regulations to only those that must be prescribed may limit the ability of an auction monitor to ensure and enhance the integrity of auctions in the NZ ETS.</p>	<p style="text-align: center;">++</p> <p>Prescribing auction monitor functions specified additional to those that must be prescribed furthers the ability of an auction monitor to ensure and enhance the integrity of auctions in the NZ ETS.</p>
Accuracy	0	<p style="text-align: center;">+</p> <p>Limiting the auction monitor functions specified in regulations to only those that must be prescribed will enhance certainty that the auctions are run well.</p>	<p style="text-align: center;">++</p> <p>Prescribing auction monitor functions specified additional to those that must be prescribed significantly enhances certainty that the auctions are run well.</p>
Efficiency	0	<p style="text-align: center;">+</p> <p>Narrower functions will limit the value received from a similar amount of cost and effort.</p>	<p style="text-align: center;">++</p> <p>Wider functions will increase the value received from a similar amount of cost and effort.</p>
Clarity	0	<p style="text-align: center;">+</p> <p>Some limitations in the clarity of what the auction monitor is expected to achieve.</p>	<p style="text-align: center;">++</p> <p>Greater clarity of what the auction monitor is expected to achieve.</p>
Overall assessment	0	<p style="text-align: center;">+</p>	<p style="text-align: center;">++</p>

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

- 31. The preferred option is to:
 - a. prescribe a method or process by which the Minister may appoint a person as auction monitor without reference to the type of entity that can be appointed to this role
 - b. prescribe additional functions to those that must be included as functions of the auction monitor.
- 32. Further, the additional functions to be prescribed are those three that are specifically identified in the Act:
 - a. monitoring the conduct of any auction agents and auction participants
 - b. providing periodic assessments of the auction system and making recommendations for improvements
 - c. calculating additional specified metrics in respect of the auction process and auction results (such as bid volume statistics and relevant aggregate information).

What are the marginal costs and benefits of the option?

- 33. This analysis of costs and benefits is assessing the option to make the regulations per the preferred option. The costs and benefits of an auction monitor once appointed are not assessed here as there are too many dependencies on whether to appoint an auction monitor and, if so, the decision about who to appoint as auction monitor.

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups: Auction participants	None.	There are effectively no real costs of the preferred option relative to the status quo other than costs to MfE and the Minister.	High
Regulators	None.	There are effectively no real costs of the preferred option relative to the status quo other than costs to MfE and the Minister.	High
Crown	Low.	The costs of an auction monitor once appointed are unclear,	Medium-low – until decisions are made on the appointment

		but expected to be low.	process and the type of entity to be appointed, the costs remain unclear.
Total monetised costs		NA	
Non-monetised costs		Low.	
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Confidence that an auction monitor can be appointed.	Low – the interim auction monitor arrangement is up and running, addressing any related concerns.	Medium.
Regulators	Confidence that an auction monitor can be appointed.	Low - the interim auction monitor arrangement is up and running, addressing any related concerns.	Medium.
Crown	Ability to appoint an auction monitor.	High – the ability to move beyond the interim auction monitor arrangement provides desired flexibility and greater options for auction monitoring.	High.
Total monetised benefits			
Non-monetised benefits		Medium	

Section 3: Delivering the option

How will the new arrangements be implemented?

34. The option will be implemented by the drafting of new regulations for an auction monitor. These regulations will be made under section 30GD of the Climate Change Response Act.
35. The appointment of an auction monitor can occur once the regulations are in place.

How will the new arrangements be monitored, evaluated, and reviewed?

36. The Ministry for the Environment will work to align the implementation of these regulations with the broader work underway on NZ ETS market governance.

37. The Ministry for the Environment will seek and consider feedback from the auction operator, other Crown Agencies involved in the NZ ETS, stakeholders and the auction monitor to evaluate the performance of the function, and to identify any modifications that might be required.