

28 February 2020

Reforming the NZ ETS: Proposed Settings
Ministry for the Environment
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NZX–EEX Joint Submission, Reforming the New Zealand Emissions Trading Scheme: Proposed Settings

NZX Limited (**NZX**) and European Energy Exchange AG (**EEX**) are pleased to jointly submit this response to the Ministry for the Environment's (**Ministry**) consultation document 'Reforming the New Zealand Emissions Trading Scheme: Proposed settings' (**Consultation Document**).

We thank the Ministry for the opportunity to make this submission and are happy to contribute to the Government's work of further developing the policy settings for the New Zealand Emissions Trading Scheme (**ETS**) in general, and for auctioning within the ETS.

We support giving the market certainty about how auctions will be run and ensuring that processes are clear and transparent.

Nothing in this submission is confidential.

About NZX and EEX

NZX is a New Zealand registered and licensed exchange. NZX operates New Zealand's equity, debt, funds, derivatives and electricity markets. To support New Zealand's capital markets, NZX provides trading, clearing, settlement, depository and data services.

EEX is the leading energy exchange in Europe which develops, operates and connects secure, liquid and transparent markets for energy and related products. As part of EEX Group, a group of companies serving international commodity markets, EEX offers contracts on Power, Emission Allowances as well as Freight and Agricultural Products. EEX Group provides market platforms for energy and commodity products across the globe. The group portfolio includes regulated markets in Europe (EEX), North America (Nodal Exchange) and Asia (EEX Asia), a registry

provider (Grexel Systems) as well as two clearing houses (European Commodity Clearing and Nodal Clear). EEX Group is part of Deutsche Börse Group.

On the 10th December 2019, NZX and the EEX announced a Co-operation Agreement with a focus on offering new emission products and services to the New Zealand market.

It is from this perspective and with this background that NZX and EEX are making this joint submission.

Introductory comments

The ETS plays a pivotal role in enabling New Zealand to transition to a low-emission and sustainable economy. We fully support the comprehensive reform process undertaken by the Government, including the introduction of auctioning of NZUs within the ETS.

We do not have a view as to the appropriate emissions budget for 2021-2025, the emissions cap, or the annual number of New Zealand Units (**NZUs**) to be made available via auctions.

As exchange operators, we have deep experience in operating fair, orderly and transparent markets. Our joint submission focuses on the design of the auction settings, which must be certain and robust to enable the efficient allocation of NZUs and effective emissions pricing. Given the nature and merits of an ETS, we suggest that price control measures be applied very cautiously.

We acknowledge the challenges of transitioning from a fixed price option to an absolute cap (with a cost containment reserve) and hence the proposals around the fixed price option for an interim period. In the long run, however, price controls such as a price floor should be avoided, as this may distort the operation of the ETS. The Government should rather look at alternative ways to manage the supply side, if price levels are deemed as too low (e.g. by tightening the emissions budget during regular reviews).

Exchange operators are experienced in operating and regulating markets to maximise transparency, fairness, efficiency and competitiveness, and to promote confidence among all participants. In this vein, the use of an exchange as an auction operator can also facilitate the transition to a more efficient and effective ETS.

Response to consultation questions

In this section of our submission, we provide our joint response to the specific questions raised in the Consultation Document.

The provisional emissions budget

Q1. Do you agree with the proposal to set a provisional emissions budget of 354 Mt CO₂-e for the 2021–25 period? If not, why not? Please include your views on: using a straight-line approach towards the 2050 target, and the considerations that were included in proposing the provisional emissions budget.

No specific preference.

We remain guided by the views of the Climate Change Commission and other relevant bodies with the relevant expertise to comment on the emissions budget.

Unit supply settings

Q2. Do you support the decisions made regarding the technical volume adjustment decisions? If not, why not?

We consider that technical volume adjustments are currently necessary due to the macro-environment in which the ETS operates, and legacy ETS settings, and might be needed for the reasons outlined by the Government.

We support the Government's continued monitoring of participants' compliance with their surrender obligations and the intention to further strengthen those efforts.

Q3. Are there other adjustments that need to be considered?

No

Q4. Do you agree with the proposal to address the NZ ETS unit stockpile by reducing the annual volume of NZUs available for auction? If not, why not?

Yes

We consider that the current stockpiles should be reduced to enable the ETS to operate as intended, as it ensures the necessary scarcity of NZUs within the scheme.

Q5. Do you agree with 27 million NZUs being removed from auction volume between 2021-25? If not, why not?

No specific preference.

We have no preference on the proposal to remove 27 million NZUs as this is outside our area of expertise.

Q6. Do you agree with the steps and calculations taken to reach the proposed annual auction volumes?

No specific preference.

We remain guided by the views of the appropriate agencies and stakeholders who have the necessary expertise to comment on the annual auction volumes.

Q7. Do you support the proposal to auction 80 million NZUs over the 2021-25 period plus 2 million NZUs for auctioning trial in 2020? If not, why not? Please include your views on the process for adjusting auction volumes.

We do not support an auctioning trial of 2 million NZUs.

We fully support the introduction of auctioning as a fair, transparent and efficient tool for allocating NZUs onto the market. We have no preference on the overall amount of NZUs proposed to be auctioned over the 2021-25 period.

While we support appropriate testing of the auction to ensure the auction's integrity, we are opposed to a trial being conducted through the allocation of an additional 2 million NZUs. As exchange operators, we are familiar with testing trading environments for novel financial products and new financial markets. We commonly engage with participants to ensure the market will operate as intended in a 'dummy' test environment, before allowing a market to 'go-live'. We recommend that testing should be conducted without the transfer/settlement of NZUs and money, to ensure that there is no effect on the ETS or its participants. This will further preserve the integrity of the auction.

Price controls

Q8. Do you agree with the proposal to set an auction reserve price floor at \$20 for 2020-25? If not, why not?

We recommend the application of a technical reserve price based on a pre-determined and undisclosed methodology instead of the proposed \$20 floor.

As noted above, price controls may lead to market distortion and limit the effectiveness of an ETS.

However, the establishment of a technical reserve price for the auction is a reasonable measure, to protect for the unlikely event that the auction clearing price falls significantly below the secondary market price level at the time of the auction. We therefore recommend the application of a technical auction reserve price, based on a pre-determined methodology. Keeping this methodology confidential is of utmost importance to avoid bidding behaviour that is purely targeting the lowest possible price level.

Q9. Do you agree with the proposal to increase the fixed price option to \$35 for obligations arising from activities over 2020?

Yes, until the auction is fully operational.

We support the proposals around the use of a fixed price option in the period before the auction is fully operational, to enable a smooth transition to an ETS with an absolute cap (cost containment reserve).

Q10. Do you agree with the proposal to set the price ceiling trigger of the cost containment reserve at \$50 for the 2020–25 period? If not, why not?

No specific preference.

We support the principle of a cost containment reserve as an appropriate tool to avoid 'shocks' in the broader economy, should prices reach levels deemed as excessive. We do not have any opinion on the quantum of the price ceiling.

Once the price trigger in the cost containment reserve is hit, the volume of units from the reserve should be sold in a separate reserve auction, open to all registered participants. The reserve NZUs should come from outside of the ETS cap and must be backed by other legitimate emissions reductions.

Q11. Do you agree with the proposed annual cost containment reserve volumes to be released if the price ceiling trigger is hit? If not, why not?

Yes

Releasing cost containment reserve volumes is an appropriate way to manage an unexpectedly high NZU price.

Process for release of NZ ETS settings information

Q12. Do you agree with the proposed approach for release of NZ ETS settings information? If not, why not?

Yes

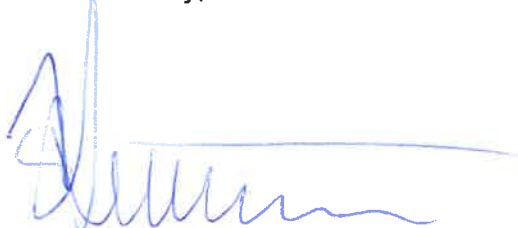
We support a 5-year rolling period for the ETS settings, as this should promote regulatory certainty and transparency, both of which are essential to participants' confidence in the ETS.

Closing comments

In closing, we support the Government in seeking to develop the policy settings for the NZ ETS given its important status in reducing emissions and getting New Zealand on the path to net zero emissions by 2050.

We thank the Ministry for this opportunity to submit on these proposals and our organisations are happy to provide further information or clarification of any matters contained within. We would welcome the opportunity to meet with officials to discuss any aspect of this submission.

Yours faithfully,



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