

New Zealand Emissions Trading Scheme Review 2015/6:

Discussion document and call for written submissions

Westpac Submission

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Summary

This submission is from Westpac Banking Corporation New Zealand and Westpac Institutional Bank (referred to collectively as 'Westpac' or the 'Bank') on the discussion paper 'New Zealand Emissions Trading Scheme 2016/16: Discussion document and call for written submissions (the 'Discussion Document').

Westpac is an active participant in ongoing public policy dialogue on an appropriate national response to climate change. We welcome the opportunity to provide a submission on the proposed changes to the New Zealand Emissions Trading Scheme (NZ ETS).

Over the past decade Westpac has played a fundamental role in supporting the emergence of carbon trading and carbon finance market frameworks in the Asia-Pacific region, and has developed an integrated strategic response for our clients across New Zealand and Australia.

Westpac was the first financial institution making a market in the NZ ETS. Westpac sees our role in the carbon market as:

- Promoting an economy-wide perspective;
- Supporting positive environmental outcomes;
- Applying our financial market expertise; and
- Acting as an important intermediary in the community through our employees, customers, suppliers and shareholders.

Westpac's longstanding commitment to working with clients to transition to a low carbon operating environment is built upon our broader commitment to sustainability as a key differentiator of our business (see Appendix for Westpac's climate change actions).

Broadly speaking, Westpac supports the proposals outlined in the Discussion Document.

In developing the legislation and subsequent regulation that will underpin the proposed amendments, Westpac would strongly support measures which ensure market participants have a clear understanding of how and when future changes to the scheme will be made. This should include the following detail:

- Timeframes for future amendments;
- A mechanism for making future amendments;
- A defined period during which no changes to the scheme will be made;
- A set of goals, targets or principles that will guide future changes to the scheme; and
- The mechanism for the release of information to the market, recognising the price-sensitivity of such releases in a market created by regulation.

It should be noted that Westpac New Zealand recently issued a report on the economic impact of COP21 on New Zealand industries. The report discusses the economic efficiency of the scheme and details how New Zealand is likely to meet its obligations, the impact across particular industries and the likely impact on carbon markets. This report was prepared by Westpac's economic and market research specialists, who provide independent and comprehensive analysis, forecasts and opinion of the New Zealand and international economies and their financial markets.

Submission

Feedback on the priority issues

Westpac's feedback draws upon the Bank's considerable experience in factoring environmental considerations into business policies and investment decisions and our practical participation in carbon and environmental markets across a number of jurisdictions.

Westpac strongly believes that any amendments to the NZ ETS should aim to achieve the following objectives:

- Environmental integrity;
- Economically efficient greenhouse gas abatement across the broad economy;
- Investment certainty; and
- Market confidence;

Drivers for the review

1. Do you agree with the drivers for the review? (Yes/No/Unsure)

Yes - Westpac broadly agrees with the drivers of the review. Consideration of these factors is also timely given the recent COP21 Paris Agreement which provided fresh impetus and early parameters for international participation and the development of future global market mechanisms.

2. What other factors should the Government be considering in this NZ ETS Review?

While notionally covered under the noted driver "increasing certainty about future policy settings" in the discussion paper, consideration should also be given to what future changes to post-2020 scheme architecture could be ear-marked now in order to avoid unscheduled changes to the scheme in the future.

In a market created by regulation and particularly in one designed to incentivise behavioural change and technological advancement, there will always be "known unknowns". These will substantially impact supply and demand in the future and risk the need for rapid changes. Indeed, the NZETS already has in its history several changes made at short notice to respond to unforeseen international outcomes. This can undermine confidence in the scheme. Therefore, consideration could be given to design elements which would limit this such as 1) more robust/automatic linking of unit eligibility criteria to larger international schemes post-2020, and 2) employment of annual rolling emissions targets (such as in Australia's CPM) to increase granularity across a commitment period - helping to guide price forecasts and smooth the path to intended emissions outcomes.

While not immediately relevant, heralding any such longer term design intentions now will serve to shape the pre-2020 strategies of market participants and influence their response to any shorter term changes.

Priority Issues

Moving to full surrender obligations

3. Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors? (Yes/No/Unsure)

Yes. Westpac would support the move to full surrender obligations. The current measures within the NZ ETS were always meant to be transitional but have now been in place for 7 years. Following the re-affirmation of international intent evident at the Paris COP, it is timely to remove these. This will provide a clear next step in terms of business transitioning to a carbon constrained economy and provide more certainty to the market around the rules going forward. From Westpac's interaction with a broad range of liable entities across the NZ economy, this move has been widely expected with many businesses already factoring such a change into their forecasts and planning, reducing any significant shock.

4. What impact will moving to full surrender obligations have on you or your business? Please include specific examples or evidence of the impacts on you or your business of:
 - a. increased carbon prices, including actions to reduce emissions and future investment decisions. Please comment on effects that may occur at carbon prices ranging from \$5 to \$50, including any evidence of actions taken previously when carbon prices were higher.
 - b. any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.

As a financial institution Westpac has a relatively small corporate emission profile which is not subject to ETS obligations. However, as a leading sustainable organisation Westpac NZ has committed to maintaining carbon neutrality until at least 2017. For the last three years this has been achieved through the voluntary purchase and full surrender of NZU and accordingly, it would be expected that this ongoing cost would be subject to any NZU price increase that resulted from the move to full surrender obligations.

A move to full surrender obligations would also theoretically result in increased levels of activity in the wholesale NZU market. As a key price-maker and liquidity provider in the NZETS, Westpac would potentially see a small increase in volumes, but tight margins and a business model aimed at servicing our customers means this would produce a minimal benefit.

However, for clarity, these impacts, positive and negative, are immaterial in the bigger picture for Westpac. Westpac NZ's growth is strongly linked to the growth of the New Zealand economy. Westpac has long accepted the scientific consensus that climate change is occurring and believes a smooth transition to a carbon-constrained business environment will produce the best long-term outcomes for the economies we operate in. Westpac's focus is therefore firmly on helping our customers transition and adapt to this new environment. Westpac believes that, following the fresh impetus delivered via the Paris Agreement, the removal of transitional measures in the NZETS is consistent with this. A steady and consistent shift

delivered through an effective carbon price will ensure business is best positioned to adapt to this global trend.

5. If full surrender obligations are applied, when should this be implemented?
- a. 2016
 - b. 2017
 - c. 2018
 - d. other – please specify.

Outline the reasons for your answer, and include any comments on the pros and cons of applying an increased surrender obligation to a partial or a full NZ ETS reporting year.

The timing of any implementation requires a balance between two competing ideals – 1) the need to re-establish momentum in the economic transition of the NZ economy as soon as practicable following the Paris Agreement and 2) the principle of telegraphing changes well in advance to build confidence and minimise the market impacts of short term regulatory uncertainty.

Factors to be considered include:

- As noted in the Discussion Document, the NZ ETS transitional measures have been in place since 2009, when the global economy was in recovery post-GFC and international regulation around climate change took a back seat.
- With a new international climate agreement in place following COP21, there is a need to support international linking. Ensuring the NZ ETS continues to develop and stabilise to allow future linking with other schemes will be important in reducing compliance costs for liable entities and arbitrage between markets.
- Applying full surrender obligations sooner rather than later will minimise regulatory uncertainty - improving market confidence underpinning the NZ ETS by clearly and consistently setting out proposed changes to the scheme and the timeline for implementation, thereby allowing liable entities and other market participants to pursue longer term carbon price risk hedging opportunities.
- Many liable entities have been operating for several years under the assumption that a move to full surrender obligations was imminent. Accordingly, many are well prepared allowing them to adapt to such a change in the near term without significant financial impost.
- However, acting over partial reporting years and/or with little notice does increase the complexity of passing on costs to the customers and of contractual obligations.

Managing the costs of moving to full surrender obligations

6. If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?
Yes/No/Unsure

Westpac would support only a single mechanism to manage price shocks – that being the existing fixed price option at \$25, for one final year, which has been legislated since 2009.

7. If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?
 - a. maintain the fixed price option at \$25
 - b. lower the fixed price option
 - c. gradually move to full surrender obligation
 - d. other methods.

Westpac has consistently supported the need for Government to deliver transparent and consistent information on proposed amendments to the NZ ETS, telegraphed well in advance, to build confidence and minimise the market impacts of short term regulatory uncertainty.

Accordingly, use of this sole pre-existing mechanism for the one final year in which the transition to full surrender obligations occurs would serve to minimise changes to the market while still ensuring the existence of a relief value in the event of unforeseen market events.

Westpac believes a lowering of the fixed price option would be unnecessary given the current supply and demand balance, as noted in the discussion paper.

8. If the \$25 fixed price surrender option value should change, what should it change to and why?

n/a

Concluding comments

Westpac is well known in the market for adopting strong risk management practices and a forward looking progressive approach to identifying emerging material risks and opportunities for our business. We recognised a number of years ago that climate change is ultimately a business issue requiring the same approach.

As markets and policy frameworks develop as a means of taking greenhouse gas emissions out of everyday lives, financial institutions have a key role to play in partnering with customers across all areas of our business to help transition to a low-carbon operating environment.

Westpac has played a critical role in the establishment and commencement of the NZ ETS. Westpac was the first bank to trade the NZ ETS and make a market for our clients, for forestry companies and for liable entities covered by the scheme.

Westpac would strongly advocate that any adjustments or amendments to the NZETS support the smooth operation of the functioning of the market and deliver environmental outcomes for the New Zealand economy at least cost for business.

Westpac would welcome the opportunity to continue to engage constructively with the Ministry for Environment to ensure the ongoing success of the development of the NZ ETS.

Appendix

Westpac's climate change credentials

Westpac's longstanding commitment to working with clients to transition to a low carbon operating environment is built upon our broader commitment to sustainability as a key differentiator of our business.

Westpac is determined to play a constructive and positive role in promoting effective and practical solutions for our customers and across our business.

Recent significant achievements include:

- In 2015, Westpac Ranked as the global bank industry leader in the 2015 Dow Jones Sustainability Indices (DJSI) Review, with our strongest ever score of 94. Westpac has been recognised as a global leader for banks in the DJSI since 2002.
- Westpac was recognised as one of the Global 100 Most Sustainable Corporations at the 2015 Davos World Economic Forum in Switzerland.
- The Westpac Group was listed in the CDP ASX 200 and NZX 50 Climate Disclosure Leadership Index in 2014 & 2015 and has been included in the global Carbon Disclosure Project Climate Leadership Index since 2003.
- Westpac was named as one of the World's Most Ethical Companies from 2008 - 2014 by the Ethisphere Institute.
- Westpac Institutional Bank has been voted as Best Trading Company in Australasia in the global Environmental Finance Awards, every year awarded, beginning 2010.
- In 2003, Westpac was the first Australasian bank, and one of only ten founding signatories globally to sign the Equator Principles, a voluntary global set of guidelines developed for managing social and environmental issues related to the financing of projects. Today there are over 50 signatories worldwide.
- In 1991 Westpac was one of six founding members of the United Nations Environment Programme Finance Initiative (UNEP FI). Today there are over 250 signatory institutions, in more than 45 countries.

Westpac first launched an Environment Policy in 1991 and began measuring and reporting on operational greenhouse gas emissions and broader environmental impacts in 1996.

The Westpac Climate Change Position Statement was first published in 2008 and is endorsed by the Westpac Group Executive and the full Westpac Board. Progress is reported to the Board on a quarterly basis and performance against Key Performance Indicators is built into the remuneration scorecard of the full Group Executive. In 2014, Westpac revitalised its Climate Change and Environment Position Statement and developed a 2017 Action Plan, which reaffirms our commitment to finding economic solutions to environmental challenges. Westpac lends over NZ\$6 billion to CleanTech sector businesses across Australia and New Zealand. Today, 61% of our global infrastructure and utilities financing is directed towards hydro and renewables.

In 2007, Westpac Institutional Bank (WIB) brought together financial markets teams trading commodities markets and the National Energy Market (NEM) in Australia, along with Group Sustainability and emerging carbon market expertise in New Zealand and Europe to form an integrated global trading team Commodities, Carbon and Energy (CCE). Now embedded as business-

as-usual under the banner Commodities, this group recognizes overlapping market dynamics and resource conditions influencing pricing as well as how our clients look to manage their own price risk exposure.

Westpac Commodities continues to build a strong track record of market firsts:

- Westpac has been trading the EU ETS since 2006.
- Westpac undertook the very first trade of Australian compliance credits in May 2008.
- Westpac was the first financial institution making a market in the New Zealand Emissions Trading Scheme (NZ ETS), which has been operating since January 2010.

Westpac believes that managing the risks and opportunities posed by climate change will be a defining factor in achieving long term profitability for our clients and for business. Westpac is committed to developing practical and effective solutions for our customers at every level of the economy.