Regulatory Impact Statement: Proposal to remove NDC accordance requirement for NZ ETS settings

Decision sought	*Cabinet approval for removal of the requirement for New Zealand Emissions Trading Scheme settings to accord with New Zealand's nationally determined contributions.*
Agency responsible	*Ministry for the Environment*
Proposing Ministers	*Hon Simon Watts, Minister of Climate Change*
Date finalised	*01 August 2025*

The Minister of Climate Change proposes to progress an amendment to the CCRA to remove the requirement for the New Zealand Emissions Trading Scheme (NZ ETS) settings to accord with Nationally Determined Contributions (NDCs) under the Paris Agreement.

Summary: Problem definition and options

What is the policy problem?

- The current requirement for New Zealand Emissions Trading Scheme settings to 'accord' with New Zealand's NDCs risks undermining the proper functioning of the NZ ETS because of uncertainty around timelines for securing future offshore mitigation. Additionally, the requirement is misaligned with the NZ ETS as a domestically focused instrument .

What is the policy objective?

- To ensure legislative provisions for NZ ETS settings support the NZ ETS in providing credible and predictable markets to reduce domestic emissions.

What policy options have been considered, including any alternatives to regulation?

- We have considered three options:
  - Option One: Status quo
  - Option Two: Removing the requirement for the NZ ETS settings to accord with NDCs (preferred)
  - Option Three: Changing the NDC accordance requirement to specify that NZ ETS settings must accord with the expected domestic contribution to NDCs

What consultation has been undertaken?

- None

Is the preferred option in the Cabinet paper the same as preferred option in the RIS?

- Yes

Summary: Minister's preferred option in the Cabinet paper

Costs (Core information)

Outline the key monetised and non-monetised costs, where those costs fall (e.g. what people or organisations, or environments), and the nature of those impacts (e.g. direct or indirect)

- The proposal is an amendment to the CCRA and has no direct costs.

Benefits (Core information)

Outline the key monetised and non-monetised benefits, where those benefits fall (e.g. what people or organisations, or environments), and the nature of those impacts (e.g. direct or indirect)

- The proposal will improve the certainty of processes related to NZ ETS settings, with flow on benefits for credible and stable carbon markets. We have not quantified this benefit.
- Additionally, the proposal has significant benefits by avoiding risks or potential costs that could arise under the status quo legislation. Specifically, the proposal will reduce the risk of negative impacts that could occur if future NZ ETS settings decision could not accord with an NDC because of uncertainty in securing sufficient offshore mitigation. Some of the potential costs that are avoided by this proposal in this situation include:
    - Difficulty for some NZ ETS compliance participants to source units in the short term and meet compliance obligations, because of the unanticipated and sudden reduction in auction volumes. The exact impact will depend on the liquidity of the existing stockpile of units.
    - Higher NZU prices and price volatility with associated increased costs for firms and negative aggregate impacts on economic productivity and competitiveness.
    - Pass through of higher NZ ETS costs to consumers and households increasing inflation and cost of living.
    - Negative impact on confidence in NZ ETS markets by participants and the overall integrity of the NZ ETS.
    - A sharp reduction in future auction volumes, with direct financial costs to the Government. The central model projection for cash receipts from NZU auctions is $1.4 billion over the EB2 period. This would be offset somewhat by lower domestic emissions reducing the level of offshore purchasing needed to meet NDC1.

Balance of benefits and costs (Core information)

Does the RIS indicate that the benefits of the Ministers' preferred option are likely to outweigh the costs?

- The benefits exceed the costs, although these have largely not been quantified.

Implementation
How will the proposal be implemented, who will implement it, and what are the risks? • The proposed change will be progressed as part of legislation to amend the 2050 domestic emissions target in the CCRA (as discussed in the main regulatory impact statement).

Limitations and Constraints on Analysis

• The main limitation on the analysis in this paper is that there has been no public consultation on this proposal.
    ○ 9(2)(h) [redacted]
    ○ There are limited suitable legislative vehicles for making a change to NZ ETS accordance requirements, and the timing for the next did not allow time for consultation. Meaningful public consultation therefore could not take place.
• There are also limitations on the cost and benefit analysis because of the significant uncertainties involved in the likelihood of the inability for NZ ETS settings to accord with NDC1, and the possible market impacts that would stem from the resulting reduction in auction volumes, which would be relatively unprecedented and difficult to predict.

I have read the Regulatory Impact Statement and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the preferred option.

Responsible Manager(s) signature:

Simon Mandal-Johnson
Manager, Emissions Trading Scheme Policy
7 August 2025

Quality Assurance Statement ***[Note this isn't included in the four-page limit]***	
Reviewing Agency: Ministry for the Environment	**QA rating:** Partially meets
Panel Comment: *An independent quality assurance panel with members from the Ministry for the Environment has reviewed the Regulatory Impact Statement (RIS): "Proposal to remove NDC accordance requirement for NZ ETS settings". The Panel considers the proposal 'Partially meets' the standard.* *There is a clear problem relating to current ETS settings posing significant risk of destabilising the domestic ETS market in relation to offshore mitigation opportunities. The paper presents*	

suitable options for the Minister to address this risk. Qualitative costs and benefits and hypothetical financial implications of the preferred options versus the status quo are discussed.

However, there has been no consultation on the proposals and minimal quantified financial costs and benefits, which would be appropriate given the potential scale of impacts. This is because of shorter timeframes for the chosen legislative vehicle. Given more time, the RIS should identify these figures and views where possible, to show a better understanding of the scale, likelihood and impacts of the risk on stakeholders, including for New Zealand's overall climate change response.

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 NZ ETS is the key tool to help New Zealand meet its emissions budgets, NDCs and the 2050 target. The NZ ETS supports net emissions reductions by:

   - requiring businesses to measure and report on their greenhouse gas emissions
   - pricing emissions and removals
   - requiring businesses to surrender one 'emissions unit' – a New Zealand Unit (NZU or unit) – to the Government for each tonne of emissions they are responsible for under the NZ ETS
   - limiting the number of units supplied into the NZ ETS through auctioning and industrial allocation.

2. The NZ ETS cap outlines the total emissions for NZ ETS-covered sectors, and is determined based on the projected emissions necessary to meet our emissions budgets. In line with the NZ ETS cap, the Government sets the number of units supplied into the NZ ETS over time through auctions and industrial allocation and reduces the number over time. This incentivises reduction of net emissions from participants in the NZ ETS, in line with New Zealand's emissions reduction targets.
3. Every year the Government is required to review settings for the NZ ETS for the next five years. It must decide on the appropriate supply of New Zealand Units (NZUs or units) and price control settings that accord with emissions reduction targets, including NDCs.
4. The ETS contributes to domestic action towards NDCs. However, NDCs can also be met through the use of offshore mitigation as provided by the Paris Agreement. We have set two NDCs under the Paris Agreement:

   - NDC1 - our first NDC for the period 2021 to 2030, was set on the basis that it would require offshore mitigation (i.e. purchasing emission reductions from other countries).
   - NDC2 – for 2031 to 2035 was set to align with emissions budget 3, meaning that it may be met without offshore mitigation.

What is the policy problem or opportunity?

5. Under the s30GC of the CCRA, the Minister of Climate Change must be satisfied that the limits and price control settings are in accordance with:

a. the emissions budget, and the nationally determined contribution for New Zealand under the Paris Agreement, that applies to:
    i. the period for which the limits or price control settings are being prescribed; or
    ii. any period after that, if a budget or contribution exists for that period; and
b. the 2050 target.

6. However, ETS settings need not strictly accord with the budgets or NDCs as long as the Minister is satisfied that the discrepancy is justified, after considering a range of other matters, including the international climate change obligations and instruments or contracts that New Zealand has with other jurisdictions to access emissions reductions through carbon markets.
7. These accordance requirements play an important role in ensuring NZ ETS settings are aligned with our climate targets and the NZ ETS will play a role in helping achieve NDCs by driving domestic emissions reduction.
8. The Paris Agreement provides for countries to meet their NDCs through international cooperation including the use of offshore mitigation. The Government remains committed to achieving NDC1 and officials are currently exploring international cooperation and carbon market mechanisms under Article 6 of the Paris Agreement, including bilateral agreements, plurilateral collaborations and participation in global forums to enhance New Zealand climate action. However, timelines for securing offshore mitigation remain uncertain.
9. The NDC accordance requirement inadvertently creates uncertainty for NZ ETS settings by making them subject to review based on progress in advancing offshore mitigation. For NDC1 this means accordance is dependent on the extent to which access to offshore mitigation is successful. This risks the proper functioning of the market.
10. 9(2)(h) [redacted]
11. This is likely to result in higher ETS prices and volatility and negative impacts on businesses and households.
12. More generally, the possibility of needing to reduce NZ ETS auction volumes based on NDC accordance could undermine confidence in the ongoing stability of the NZ ETS, hampering business planning and investment decisions. This risk becomes more likely as the end of the NDC1 period draws closer, by which the extent to which arrangements for offshore mitigation are in place will be clearer.
13. In its advice on NZ ETS unit limits and price control settings for 2026–2030, the Commission highlighted that meeting the first NDC with domestic action only would require a scale and pace of economic, social and technological change over the next five years that would be highly disruptive. The accordance test could therefore result in ETS settings that go well beyond what the Commission thought reasonable or desirable to do domestically.
14. Additionally, the ETS as currently designed is purely a domestic instrument, meaning that it only places a cost and surrender obligation on domestic emissions. It has no ability to account for or contribute to the offshore mitigation component of an NDC. The accordance requirement is therefore disconnected from the design and capabilities of the ETS and the nature of NDCs under the Paris Agreement.

15. The accordance requirement for NZ ETS settings is unique amongst domestically focused Government decisions. For example, there is no similar requirement for emissions reduction plans (ERPs), reflecting the domestic focus of decisions for ERPs (though, as with the NZ ETS, they are also a key contributor to meeting New Zealand's NDCs).

What objectives are sought in relation to the policy problem?

16. Our objective for this proposal is to ensure legislative provisions for NZ ETS settings support the NZ ETS in providing credible and predictable markets to reduce domestic emissions.

What consultation has been undertaken?

17. There has been no consultation on this proposal.

9(2)(h)

[redacted]

20. There are limited suitable legislative vehicles for making a change to NZ ETS accordance requirements, and the timing for the next did not allow time for consultation. Meaningful public consultation therefore could not take place.

Section 2: Assessing options to address the policy problem

What criteria will be used to compare options to the status quo?

The options have been assessed based on the extent to which they support the proper functioning of the NZ ETS by addressing the identified problem and reducing the risk to the stability of NZ ETS settings. None of the options would impact on the options or decisions for 2025 NZ ETS settings, which are already designed assuming the use of offshore mitigation.

What scope will options be considered within?

21. Options have been considered that will address the identified problem in an enduring manner. An option to remove the accordance requirement only for NDC1 was considered but discounted because it would not address the underlying problem of the disconnect between the accordance requirement and the design and capabilities of the NZ ETS. It also does not address the risk of accordance if future NDCs do not align with emissions budgets or if EB3 was changed, resulting in a gap between EB3 and NDC2.

What options are being considered?

22. We have considered three options:
    a. Option One: Status quo
    b. Option Two: Removing the requirement for the NZ ETS settings to accord with NDCs
    c. Option Three: Changing the NDC accordance requirement to specify that NZ ETS settings must accord with the expected domestic contribution to NDCs

Option One – Status quo

23. This option maintains the current requirement for NZ ETS settings to accord with NDCs. It would not clarify the expected domestic role of the NZ ETS in line with the Government's direction or address the identified problem that legislative provisions for the NZ ETS create a risk that auction volumes may need to be reduced because of uncertainty in securing sufficient offshore mitigation.

Option Two – Removing the requirement for the NZ ETS settings to accord with NDCs – Preferred option

24. This option removes the requirement for NZ ETS settings to accord with NDCs. It would remove the risk that auction volumes may need to be reduced because of uncertainty in securing sufficient offshore mitigation, improving confidence for participants in the stability of the NZ ETS. It would also clarify that the NZ ETS is a domestic instrument that should be required only to align with domestic targets, specifically emissions budgets and the 2050 target.

Option Three – Changing the NDC accordance requirement to specify that NZ ETS settings must accord with the expected domestic contribution to NDCs

25. This option would change the requirement for NZ ETS settings to accord with NDCs, clarifying that NZ ETS is only responsible for addressing the domestic component of NDCs. This option would require the government to state expected domestic and offshore contributions to NDCs. The Government could choose to use emissions budgets as the expected domestic contribution or develop a separate process for determining the expected domestic contribution.
26. It would remove the risk that auction volumes may need to be reduced because of uncertainty in securing sufficient offshore mitigation, improving confidence for participants in the stability of the NZ ETS. It would also clarify that the NZ ETS is a domestic instrument that should be required only to align with domestic targets, specifically emissions budgets and the 2050 target.

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

27. While both Options 2 and 3 better support the proper functioning of the NZ ETS, Option 2 provides certainty to market participants more quickly and clearly than Option 3. The Government has already set out our level of domestic ambition through emissions budgets. It is therefore likely that the expected domestic contribution under Option 3 would likely be set at the same level as emissions budgets. This would unnecessarily duplicate the emissions budget accordance requirements, which could be confusing for participants. Alternatively, it would require a separate process for determining the expected domestic contribution, delaying certainty for market participants and adding an administrative burden.

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

28. Option 2, for the reasons set out above.

Is the Minister's preferred option in the Cabinet paper the same as the agency's preferred option in the RIS?

29. Yes.

What are the marginal costs and benefits of the preferred option in the Cabinet paper?

30. The proposal will improve the certainty of processes related to NZ ETS settings, with flow on benefits for credible and stable carbon markets. We have not quantified this benefit.
31. Additionally, the proposal has significant benefits by avoiding risks or potential costs that could arise under the status quo legislation. Specifically, the proposal will reduce the risk of negative impacts that could occur if future NZ ETS settings decision could not accord with an NDC because of uncertainty in securing sufficient offshore mitigation. This benefit is difficult to quantify. We have listed below some of the potential costs that are avoided by this proposal in this situation:
    a. Difficulty for some NZ ETS compliance participants to source units in the short term and meet compliance obligations, because of the unanticipated and sudden reduction in auction volumes. The exact impact will depend on the liquidity of the existing stockpile of units.
    b. Higher NZU prices and price volatility with associated increased costs for firms and negative aggregate impacts on economic productivity and competitiveness. This is difficult to quantify given the nature of the market shock has little precedent.
    c. Pass through of higher NZ ETS costs to consumers and households increasing inflation and cost of living. A $10 increase in NZU prices is estimated to increase annual household expenditure on emissions costs by approximately $90 per year to the average household's expenditure, mostly through its impacts on fuel and electricity prices. This impact is proportionally higher on lower-income households. The exact impact will depend on the level of increase in NZU price as a result of the change in auction volumes.
    d. Negative impact on confidence in NZ ETS markets by participants and the overall integrity of the NZ ETS.
    e. A sharp reduction in future auction volumes, with direct financial costs to the Government. The central model projection for cash receipts from NZU auctions is $1.4 billion over the EB2 period. This would be offset somewhat by lower domestic emissions reducing the level of offshore purchasing needed to meet NDC1.
32. Costs are relatively limited. In the situation outlined above, maintaining the status quo accordance requirements is expected to result in lower emissions, though not enough to meet NDC1.

Section 3: Delivering an option

How will the proposal be implemented?

33. The proposed change will be progressed as part of legislation to amend the 2050 domestic emissions target in the CCRA (as discussed in the main regulatory impact statement).

How will the proposal be monitored, evaluated, and reviewed?

34. ETS settings will continue to be monitored through the annual review of settings. Consideration of accordance with the NDC specifically will no longer be included, but the settings process will still require accordance with the 2050 target and emissions budget

and will continue to drive domestic emissions reductions that will support meeting NDCs.