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**RABOBANK NEW ZEALAND SUBMISSION TO THE EMISSIONS TRADING SCHEME REVIEW**

**Introduction:**

Rabobank is New Zealand's only specialist food and agribusiness bank. We are part of an international co-operative group based in the Netherlands, with over 500 staff working from 27 offices across New Zealand.

Bringing together our deep connections to the New Zealand rural sector, our specialist research expertise and our extensive international reach, we work closely with our rural and institutional clients under our global mission of 'Growing a Better World Together'.

With our co-operative roots and longstanding relationships with food and agribusinesses, Rabobank takes a long-term view of supporting farmers and food producers, who are critical to New Zealand's wider economic and social success.

As part of our active strategy as a food and agriculture thought leader, we provide constructive feedback and input for policymakers and government agencies, with a view to improving outcomes for our clients and their rural communities.

It is within this context that we welcome the opportunity to make a short form submission on the Emissions Trading Scheme (ETS) review.

**Key issues:**

Our fundamental concern with the proposed changes outlined in the ETS review is that they have, in our opinion, needlessly increased regulatory risk and significantly decreased overall confidence in the ETS, and the secondary market. In our opinion, the proposals have also had a significant adverse impact on sentiment and confidence within farm-forestry, forestry, charitable environmental trusts participating in the ETS, Iwi and investors (both onshore and offshore). We believe it will take considerable time for the market to regain confidence in the ETS.

It is disappointing to see such potentially significant and wide-ranging changes being proposed so close to an election, and based on modelling driven by a number of assumptions which are not likely plausible, and historical data which is limited, incomplete and therefore unreliable.

**In our opinion:**

1. The ETS, while not perfect for everyone, was after a long period of time starting to have an impact on decisions relating to emission reductions. Importantly, the ETS was relatively stable, which gave participants confidence to make long-term investment decisions. It is not only the current NZU price which influences long term decisions, but also participants' expectations of where the NZU will trend over the medium to long term. Our larger corporate clients had been reacting positively to those signals. What will negatively impact New Zealand's ability to decarbonise sectors in a timely manner is the current (and any further) regulatory risk and uncertainty. The Government significantly heightened regulatory risk and uncertainty by ignoring the advice of the Climate Change Commission, by not following due legal process (noting the Government has subsequently reversed its decision following the court ruling), and through the unnecessary ETS review.

2. Options 3 and 4 of the ETS review represent significant structural changes, which we do not support. They are based on a long-term theoretical issue which is driven by a number of key supply and demand assumptions that are subject to considerable change. The modelling provided in support is long term, and therefore the findings are inherently uncertain. Specifically, whether NZU supply will exceed demand is subject to significant uncertainty. The model appears to forecast afforestation at levels which are materially higher than historic levels, and in doing so, fails to reflect real world constraints, such as regulatory uncertainty, labour and material shortages. For example, afforestation levels this year, and for the foreseeable future, are likely to be impacted by the current regulatory uncertainty.

3. We believe options 1 and 2 are more targeted and can be used incrementally until a result is achieved. In contrast to options 3 and 4 of the ETS review, option 1 and 2 reduce the risk of unintended consequences and maintain market confidence and stability. Levers available under these options include directly reducing the NZU supply available to industrial allocations (generally and particularly when Energy Intensive Trade Exposed Industries (EITEs) receive direct subsidies to reduce emissions on a bilateral basis with the Government), auction volumes and the Cost-Containment Reserve (CCR). Forgoing short term auction revenue, including from the CCR, in exchange for maintaining long-term stability and confidence in the ETS seems an easy decision. Lastly, but importantly, land use can and should be regulated, which could also help achieve the "right tree in the right place," ensuring that land, which is

highly productive remains in food production, and avoids production levels being reduced. Additional demand can also be met through the sale of NZUs (NZ Units) offshore and to voluntary markets. The Ministry appears to have discounted a number of these levers without an appropriate due diligence. For example, the Ministry states that *"demand from overseas [for NZUs] is likely to be limited."* It would be good to understand what market evidence the Ministry holds in making that assumption as it's inconsistent with what we see in the market, including through the Rabobank Carbon Bank, which buys and sells units in the global voluntary markets.

4. It is essential that the Government provides a minimum level of certainty to existing participants in the ETS, who have made investment decisions based on current regulations. Any regulatory changes must not apply to existing investments. Retrospective changes made by any government negatively impact investor appetite across all sectors.

5. With further consideration to New Zealand meeting its Nationally Determined Contribution (NDC), outside of the ETS, we believe, the Government needs to better develop an environment where New Zealand's climate targets can be met through domestic action over and beyond relying on international carbon markets. Relying on imported credits is high risk. Within the context of a world that at each commitment date is likely to be short on credits and long on emissions, we are not aware of a counterparty or firm price (Treasury has suggested a range of $3.3 billion to $23.7 billion), and we do not appear to have committed volumes on offer. To minimise New Zealand paying offshore providers for credits, the Government should first consider New Zealand projects to the maximum extent possible. For example, from Rabobank's perspective, New Zealand needs indigenous afforestation at scale on degraded country exceeding 1.4 million hectares. Although, the ETS is unlikely to achieve this outcome alone, transitional forestry could potentially make a significant contribution which is currently under consideration in the review of the permanent forest category. However, the Government should otherwise not make the ETS overly complicated trying to achieve indigenous afforestation at scale.

6. Outside of the ETS, and with the support of Government, numerous structures across debt, equity or grants (or a combination) could be used to fund projects that contribute towards New Zealand's NDC and its domestic targets. Revenue from ETS auctions, as an example, would be an appropriate source of funding for high quality indigenous afforestation projects on farmland. Over an appropriate timeframe, this could underwrite the success of indigenous afforestation at scale. This should cover sequestration of post-1989 species already planted but outside of the ETS, as well as new projects. This will acknowledge and reward the historical planting efforts that farmers and landowners have already undertaken. The lack of acknowledgement and consideration to this has evoked negative sentiment to date. The terms of the structures could ensure other essential co-benefits are also achieved and monitored, with the possibility of some remuneration being linked to targets being achieved. In addition, the Government should as a priority support the development of a voluntary carbon market. This would provide farmers and landowners with an additional and reliable channel to market to sell their high-quality credits at an acceptable price. In the context of on farm emissions being priced, and climate risk more broadly, both physical and transitional, we do not believe it is acceptable for farmers and other landowners to meet the significant effort and cost of

indigenous afforestation on their own. Farmers need tools to manage those challenges, and having access to affordable afforestation, high quality indigenous credits generated by those forests, and acceptable market prices, are important aspects. Not only is it a risk management tool (insetting), but it is another revenue source which will enable farmers to adapt to a changing climate by making on farm investments, which will also support food production.

**Response to questions:**

1. **What is the current NZ ETS going to do to emissions reductions and removals?** Incentivise both.

   **Is this a problem? Please write your answer here.** No that is the original design of the ETS. Other than forestry, NZU supply is synthetic, and the Government has enough levers to ensure removal volumes do not materially impact price to a degree which decreases reductions. The Government has options on the demand side as well (see 3 above).

2. **Does the NZ ETS need to be able to drive emissions reductions in transport, energy and waste?** Yes.

3. **Does the NZ ETS need to be able to drive emissions removals from activities like forestry?** Yes, the Paris Agreement relies on a level of removals. Paragraph 3 above contains the levers available to the Government to ensure NZU demand / supply is balanced to the point where price is high enough to incentivise emissions reductions.

4. **If emissions reductions are to be prioritised in the NZ ETS, how could the scheme be changed to achieve this?** Let the ETS function as it was. There are numerous options available to the Government to change settings if and when there's credible evidence showing forestry volumes are likely to impact price (see paragraph 3 above). The key to reductions in numerous sectors is a stable market and expectations of a long-term increase (no shocks) in the carbon price. Continuing and unnecessary regulatory uncertainty will make it difficult for New Zealand to achieve its domestic targets and its NDC. In turn, this will impact New Zealand's global reputation, and therefore the ability of our farmers and other exporters to access export markets.

Thank you for the opportunity to make a submission to the ETS review.

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