Reference: 20180229

THE TREASURY
Kaitohutohu Kaupapa Rawa

28 June 2018

Thank you for your Official Information Act request, received on 30 May 2018. You requested the following (as part of an email chain):

> *So you have no documents, advice or other bits of information at this point?*
>
> AND
>
> *Carbon News has run a few stories on the potential to hedge against New Zealand's future carbon debt using European units.*
>
> *http://carbonnews.co.nz/story.asp?storyID=13639*
>
> *We'd like to know what work Treasury has done on this issue.*

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	27 Oct 2017	Email from Nigel Brunel, OMF, to the Treasury	Release in part
2.	31 Oct 2017	Email chain between MFAT and the Treasury	Release in part
3.	2 Nov 2017	Email from Nigel Brunel, OMF, to the Treasury	Release in part
4.	8 December 2017	Email from Nigel Brunel, OMF, to the Treasury	Release in part
5.	12 December 2017	Email chain between MfE, MFAT, and the Treasury	Release in part
6.	15 February 2018	Emails from Nigel Brunel and Phillip Lindberg, OMF, to the Treasury	Release in part

1 The Terrace
PO Box 3724
Wellington
New Zealand

tel. 64-4-472 2733
fax. 64-4-473 0982
www.treasury.govt.nz

I have decided to release the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- section 6(a) – *to protect the security or defence of New Zealand or the international relations of the Government of New Zealand*, and
- section 9(2)(a) – *to protect the privacy of natural persons, including that of deceased natural persons*, and
- section 9(2)(j) - *to enable the Crown to carry on, without prejudice or disadvantage, negotiations,* and
- section 9(2)(k) – *to prevent the disclosure of information for improper gain or improper advantage.*

Direct dial phone numbers of officials have been redacted under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including Treasury's website.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Natalie Labuschagne
Policy Manager, Natural Resources

OIA 20180229
Information being Released

From: Nigel Brunel <Nigel.Brunel@omf.co.nz>
Sent: Friday, 27 October 2017 3:16 p.m.
To: Murray Jones [TSY]; Andrew Hagan [TSY]; Kate Hodgkinson [TSY]
Cc: Phillip Lindberg
Subject: Hedging NZ Carbon risk

Follow Up Flag: Follow up
Flag Status: Flagged

Hi Murray, Andy & Kate

Thanks very much for your time yesterday and the opportunity to present our ideas. We hope you found it useful.

We are keen to continue the dialogue - please feel free to come back with any questions/comments. Following on from some of Kate's questions – I've detailed some initial feedback below.

Quick summary

New Zealand has an obligation under Paris. Most of that obligation will need to be met via international markets. The economy will face the price of carbon between 2021 and 2030 at the rate passed through by emitters. That is expected to be much higher than today. If you wanted to partially hedge the economy now against that future cost, we would recommend using European Phase 4 EUAs which will be the European unit applicable within the European ETS for that period. If you agree with our view that global carbon prices will be much higher in the 2020's than today whether markets link or not - then in our opinion, European Phase 4 EUAs represent the best hedging tool in regards to price, liquidity and the ability to secure on a forward (or futures) basis.

If global markets link - in particular – NZ & Europe link – you should be able to bring these units into the NZ ETS/Registry via the ITL

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Additional thinking – New Zealand would look to undertake bilateral "country-to-country" projects that deliver a NDC reduction for New Zealand once Article 6 is defined & agreed. This recommendation is a "paper" way of doing that.

Hedging Tool Questions

Regarding Phase 4 EUAs – are they the appropriate instrument and how do we know they will be the unit that links in future global markets.

Phase IV will commence on 1 January 2021 and finish on 31 December 2028.
Connie Hedegaard, the EU Commissioner for Climate Change until 2014, hoped "to link up the ETS with compatible systems around the world to form the backbone of a global carbon market
Source: https://en.wikipedia.org/wiki/European_Union_Emission_Trading_Scheme#Phase_IV

Can we be satisfied that the proceeds of these units sold by the EU ETS governments will be used for emission reduction purposes?

According to the EU ETS Directive, at least half of auction revenues should fund complementary GHG reduction measures in the EU and developing countries. Such measures can include renewable energy investment and energy efficiency, adaptation, minimising the economic impact on low to middle income households from higher electricity rates, reducing deforestation, and carbon capture and storage (CCS) projects. There is a divergence within member states on the extent to which auction revenues are used for climate protection – some will reinvest their full auction revenues in complementary GHG reduction measures, while others will return the auctioning revenues directly to their Treasury. Source: https://www.edf.org/sites/default/files/eu-case-study-may2015.pdf

Regards

Nigel Brunel
Director - Institutional Commodities

A: Level 2, Australis Nathan Building, 37 Galway Street, Britomart, Auckland
P: +64 9 521 7802 | **M:** s9(2)(a) | **W:** www.omf.co.nz

LinkedIn | **Twitter** | **YouTube** | **Facebook**

From: s9(2)(a) @mfat.govt.nz>
Sent: Tuesday, 31 October 2017 8:49 a.m.
To: Kate Hodgkinson [TSY]
Subject: RE: Hedging NZ Carbon risk

Follow Up Flag: Follow up
Flag Status: Flagged

[SEEMAIL] [IN CONFIDENCE]

Kate,

I won't be at COP, so let me know if you want to chat over the next couple of weeks.

In response to your question below about whether "a ton equals a ton", s6(a) and s9(2)(j) s6(a) and s9(2)(j) All you /we would be looking for is financial products that we think are correlated with our future carbon costs.

Also you might want to liaise with DPMC about this as well as it was s9(2)(a) idea to put the decision about not buying units before 2019 into the mandate Cabinet paper.

s9(2)(a)

From: Kate Hodgkinson [TSY] [mailto:Kate.Hodgkinson@treasury.govt.nz]
Sent: Tuesday, 31 October 2017 8:22 a.m.
To: s9(2)(a)
Subject: FW: Hedging NZ Carbon risk

[IN-CONFIDENCE]

Hi s9(2)(a)

Thanks for the email. Are you off to COP at the end of this week? Things are all good here thanks, certainly lots going on – interesting times. Here's the email Nigel sent through after our meeting last week. I still have a couple of questions around areas such as what's already stopping NZ businesses from doing this, whether buying is the Crown or individuals' responsibility and how to make sure a ton = a ton (the below says at least half the revenue reinvested for emissions reduction – so do you need to buy 2 to get a ton?) etc. Some of the bigger questions will need to be worked through as part of the work programme to meet the 2030 target and the ETS review work, but it's an interesting concept.

I'll have a chat to Lindy and come back to you – if you're off to the COP too it might be a good opportunity for you and Lindy to have more of a chat there.

Have a great day
Kate

Kate Hodgkinson | Senior Analyst | Natural Resources | **The Treasury**
Tel: s9(2)(k) | kate.hodgkinson@treasury.govt.nz

From: Nigel Brunel [mailto:Nigel.Brunel@omf.co.nz]
Sent: Friday, 27 October 2017 3:16 p.m.
To: Murray Jones [TSY] <Murray.Jones@treasury.govt.nz>; Andrew Hagan [TSY] <Andrew.Hagan@treasury.govt.nz>; Kate Hodgkinson [TSY] <Kate.Hodgkinson@treasury.govt.nz>
Cc: Phillip Lindberg <Phillip.Lindberg@omf.co.nz>
Subject: Hedging NZ Carbon risk

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Additional thinking – New Zealand would look to undertake bilateral "country-to-country" projects that deliver a NDC reduction for New Zealand once Article 6 is defined & agreed. This recommendation is a "paper" way of doing that.

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Regarding Phase 4 EUAs – are they the appropriate instrument and how do we know they will be the unit that links in future global markets.

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revenues in complementary GHG reduction measures, while others will return the auctioning revenues directly to their Treasury. Source: https://www.edf.org/sites/default/files/eu-case-study-may2015.pdf

Regards

Nigel Brunel
Director - Institutional Commodities

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From: Nigel Brunel <Nigel.Brunel@omf.co.nz>
Sent: Thursday, 2 November 2017 10:49 a.m.
To: Murray Jones [TSY]; Andrew Hagan [TSY]; Kate Hodgkinson [TSY]
Cc: Phillip Lindberg
Subject: Our carbon price too low, says World Bank report

Hi Murray, Andy & Kate

Thought you might find this interesting/timely

An article this morning on Carbon News website (http://www.carbonnews.co.nz/story.asp?storyID=13521&src=newsletter) talks to this matter we discussed.

NEW ZEALAND'S carbon price is at the low end of global prices – and well below the level that will trigger the emissions cuts needed to meet the Paris Agreement, a new report shows.

A new report by the World Bank says that carbon pricing is growing, but it's not happening fast enough.

"A well-designed carbon price is an indispensable part of a strategy for efficiently reducing greenhouse gas emissions while also fostering growth," said the bank's senior director for climate change, John Roome.

"While we've seen progress over the past year, action to expand carbon pricing coverage and to increase prices to deepen its impact has to accelerate."

WITHOUT PRICE

There are now 42 national and 25 sub-national carbon-pricing regimes, worth $52 billion.

But they cover just 15 per cent of global emissions, leaving 85 per cent without a price.

What's more, carbon prices in most schemes are well below what's needed to incentivise decarbonisation – identified by economists Joseph Stiglitz and Lord Stern at between $US40-$80 per tonne ($NZ58-$116) by 2020 and $US50-$100 ($NZ72.50-$145) by 2030.

The only countries with prices currently in those ranges are Sweden ($US140), Switzerland and Liechenstein (both $87), Finland ($73 for liquid fossil fuels and $69 for other fossil fuels) and Norway ($56).

LOWEST PRICES

At the lowest end are Poland, Mexico and Chongqing province, with prices less than $1.

New Zealand's carbon price (given in the report at $US13) is shown as the 16th highest in the world, comparable with those of Tokyo, California and Quebec.

The State and Trends of Carbon Pricing 2017 report estimates that an additional US$700 billion a year will be needed annually by 2030 to finance the transition to low-carbon economies.

It calls for an integrated approach that links climate-focused domestic policies and carbon pricing, complemented by effective international cooperation through climate finance from donors and new climate markets, to mobilise resources at the speed and scale required to deliver low-carbon growth, jobs and innovation.

It says effective carbon pricing will to catalyse increased private-sector investment in low-carbon technologies and industries.

International climate finance will remain important, and could be targeted where it is most effective at supporting the low-carbon transition and to promote the development of climate markets.

Nigel Brunel
Director - Institutional Commodities

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From: Nigel Brunel
Sent: Friday, 27 October 2017 3:16 p.m.
To: 'murray.jones@treasury.govt.nz' <murray.jones@treasury.govt.nz>; 'andrew.hagan@treasury.govt.nz' <andrew.hagan@treasury.govt.nz>; 'kate.hodgkinson@treasury.govt.nz' <kate.hodgkinson@treasury.govt.nz>
Cc: Phillip Lindberg <Phillip.Lindberg@omf.co.nz>
Subject: Hedging NZ Carbon risk

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Regards

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From: Nigel Brunel <Nigel.Brunel@omf.co.nz>
Sent: Friday, 8 December 2017 3:31 p.m.
To: Matthew Collin [TSY]; Murray Jones [TSY]; Andrew Hagan [TSY]; Kate Hodgkinson [TSY]
Cc: Phillip Lindberg
Subject: Hedging NZ Carbon risk

Follow Up Flag: Follow up
Flag Status: Flagged

Hi All

Just as an update and further reply to a question your analyst (Kate) asked.

Kate asked "if we buy phase 4 EUAs – how can we be sure the proceeds received by the EU will be used by them to meet the EU Paris commitment?"

We are positive we could guarantee any hedge you undertook could meet that requirement.

Our view is New Zealand should look to proxy hedge the present risk. Carbon prices are on the rise – NZ Carbon prices have moved from mid $18's to mid $20's since we met. EU prices have moved from €4.50 in May to €7.35 today

Kind regards

Nigel Brunel
Director - Institutional Commodities

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From: s9(2)(a) @mfat.govt.nz>
Sent: Tuesday, 12 December 2017 9:49 a.m.
To: Kate Hodgkinson [TSY]; Lindy Fursman [TSY]; Ben Temple [TSY]
Subject: FW: NZ has 'reckless' plan for global carbon-trading

Follow Up Flag: Follow up
Flag Status: Flagged

[SEEMAIL] [IN CONFIDENCE]

Kate/Lindy/Ben,

I gather that a group from TSY spoke to Nigel Brunel about hedging NZ's future international carbon market exposure earlier this year. He has also mentioned it to us several times and this article below is not the first time that he has brought it up in public. I haven't heard anything from the office about this article and so I don't know if they are concerned about it (I assume not). However, it would be great if you had time to have a chat in person about this topic soon to try and see whether you have the same opinions about this as we do. Is there any time in your diaries later this week that could work? I could do anytime today, Wed morning or Fri morning.

Thanks,
s9(2)(a)

From: s9(2)(a) @mfe.govt.nz]
Sent: Monday, 11 December 2017 5:09 p.m.
To: s9(2)(a)
Subject: NZ has 'reckless' plan for global carbon-trading

Nigel's latest Carbon News comments….

NZ has 'reckless' plan for global carbon-trading

New Zealand's approach to negotiating carbon-trading relationships with other countries is drawing fire.

On Friday, Carbon News reported that officials are working on securing access to developing carbon markets to help to offset the country's carbon debt, but fear that making details public could cause volatility in the domestic carbon market.

That's drawn the ire of OMFinancial's head of financial markets, Nigel Brunel.


Nigel Brunel

"If this article is correct, it borders on tragic, reckless and possibly financially irresponsible that officials who have hardly worked or never worked in financial markets can (a) give such ridiculous ill-informed advice and (b) are about to embark on attempting to manage one of the biggest financial risks New Zealand will face in the next 10 years, on their own without seeking experienced financial carbon market advice," he said in a newsletter to customers on Friday.

Today, he said "pretending" that officials could negotiate government-to-government for carbon deals to meet New Zealand's Paris commitment was "somewhere between laughable and utopian".

"New Zealand doesn't possess the commercial experience or know-how within government to actually negotiate these types of financial carbon deals," he said.

BEST SOURCE

"International markets are where the cleanest and best-sized deals will exist. Emissions trading schemes will form the backbone of international markets, and China will most likely be the best source of carbon."

Brunel has been active in the international carbon market for a decade, and brokered the first domestic trade in New Zealand.

Last month, he told Carbon News that anyone with a future carbon liability - including the New Zealand Government, which is likely to need 200 million tonnes to meet its 2030 Paris Agreement carbon reduction target - should think about hedging using European units.

"If New Zealand were a business, this is how it would hedge that liability; it would buy units now that could be used in the Paris period," he said.

"If the New Zealand market links to other markets, then it will be able to use them. If it doesn't, it can sell them."

PRICE CHANGES

He is repeating the call today.

"Right now, carbon prices continue to rise and officials either seem oblivious or ignorant of the risk and how to mitigate it," he said in an email to customers.

"By the time New Zealand looks to lock in its economic risk, if it ever does, carbon prices could be double what they are now."

The price of phase 4 European units (2021-2018 units) has increase 50 per cent over the past six months, but are still good buying, he says.

"Our point is even now, even today, New Zealand could and should hedge some of its risk and take a position in the market, not chase utopian government-to-government deals in the never-never or wait for international markets to form in three years' time," he said.

"The Government needs to get advice from those with financial commercial experience who understand markets and risk - not bureaucrats who have zero real-world experience."

NO SECRETS

The suggestion that information about work on gaining access to international markets should be kept secret has also drawn criticism from New Zealand's first climate ambassador.

Dr Adrian Macey, now with Victoria University's Institute for Governance and Policy Studies, says the Government cannot engage in a major economic negotiation, with billions of dollars potentially at stake, in secret.

The secrecy is at odds with MFAT's own website, he says, which says "interested countries will work together to develop standards and guidelines for using market mechanisms that ensure environmental integrity and avoid any double-counting or double-claiming of emissions reduction units. This gives countries, and investors, more confidence that carbon markets will be underpinned by robust standards in future years."

Macey told Carbon News that New Zealanders – including investors – should not be denied information about which countries their government is talking to.

s9(2)(a) **Senior Policy Analyst, Climate Policy**
Ministry for the Environment – Manatū Mō Te Taiao
s9(2)(a) Website: www.mfe.govt.nz
23 Kate Sheppard Place, Thorndon, Wellington 6143

Ministry for the Environment
Manatū Mō Te Taiao

Click below for the latest findings on the state of our atmosphere and climate

Watch a short video

Download the infographic

Flick through the summary

Read the full report

****

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From: Nigel Brunel <Nigel.Brunel@omf.co.nz>
Sent: Thursday, 15 February 2018 3:15 p.m.
To: Murray Jones [TSY]; Andrew Hagan [TSY]; kate.hodgkinson@treasury.govt.nz; Matthew Collin [TSY]
Cc: Phillip Lindberg
Subject: Hedging NZ Carbon risk - Update

Hi , Matthew, Murray, Andy & Kate

Just an update for you – European carbon prices hit €10 yesterday – that's over a doubling since we saw you in July. (chart below)

Our view and recommendation isn't changing on this market in spite of its rise. New Zealand's economic risk to higher carbon prices remains unhedged

Whilst issues around eligibility between now and the start of Paris are yet to be resolved - our view is that this won't change the trend we are seeing in prices and we do believe these eligibility issues (or risks) can be extinguished in our favour in any event.

Did you have any further thoughts on this recommendation? Is it worth revisiting the matter?

Kind regards

Nigel Brunel
Director - Institutional Commodities

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P: +64 9 521 7802 | **M:** s9(2)(a) | **W:** www.omf.co.nz

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From: Phillip Lindberg
Sent: Friday, 3 November 2017 9:17 a.m.
To: matthew.collin@treasury.govt.nz
Cc: Nigel Brunel <Nigel.Brunel@omf.co.nz>
Subject: FW: Hedging NZ Carbon risk

Hello Matt,

Well we missed you the other day, but it was a really good meeting and appreciate you organising. I will keep you included on all further correspondence going forward as I suspect "when", not "if" MFE pull the trigger you will be in the hot seat. The bottom line is we have an unhedged and unfunded liability that can be hedged, via European markets, which we expect is going to get more expensive by the day, week, year !!

So I will keep you on all email traffic and have included Nige the guru but I will give you a shout and run you through the big picture next week.

Looking forward to a catch up one day when you are up or I am down in the village !!

Have a great weekend….

Phillip Lindberg
Manager, Foreign Exchange

A: Level 2, Australis Nathan Building, 37 Galway Street, Britomart, Auckland
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