



Discussion document

# Te mana whakahaere māketē o te mahere hokohoko tukunga

## Market governance of the New Zealand Emissions Trading Scheme



Ministry for the  
**Environment**  
*Manatū Mō Te Taiao*



**Te Kāwanatanga o Aotearoa**  
New Zealand Government

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While the term 'financial product' is a defined term in the Financial Markets Conduct Act 2013 and it is one option to treat NZUs as if it were a 'financial product', the shape and form of legislative design of any New Zealand Emissions Trading Scheme market governance reform package will be decided at a later stage.

These proposals should not be treated as consulting on the use of any particular regulatory framework or design.

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# Executive summary

A poorly governed New Zealand Emissions Trading Scheme (NZ ETS) could impact our ability to meet our domestic emissions budgets and undermine the robustness of the NZ ETS and its reputation internationally. Through this consultation, we want to better understand the impact of leveraging existing financial market frameworks to address the key risks in the NZ ETS market when trading New Zealand Units (NZUs) (referred to here as the 'NZU market').<sup>1</sup>

## Aotearoa New Zealand lacks a robust NZU market governance framework

Setting up a comprehensive NZU market governance framework and appointing a regulator is important to ensure integrity, efficiency and confidence in the market.

### Seven market governance risks

The Government has identified seven market governance risks, set out in three themes.

- **Theme A: Governance of advice**
  - **Risk 1:** Inadequate, false or misleading advice relating to NZUs
  - **Risk 2:** Conflicts of interest involving the New Zealand Emissions Trading Register (NZETR)
- **Theme B: Governance of trading**
  - **Risk 3:** Potential lack of transparency, oversight and monitoring of trades in the secondary NZU market
  - **Risk 4:** Credit and counterparty risks
- **Theme C: Governance of market conduct**
  - **Risk 5:** Insider trading and information asymmetry
  - **Risk 6:** Manipulation of NZU prices
  - **Risk 7:** Money laundering and financing of terrorism in the NZU market

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<sup>1</sup> There is a distinction between the use of the terms 'NZ ETS' and 'NZU market' in this document. The NZ ETS refers, more broadly, to the scheme, which has an underlying purpose to reduce emissions. The NZU market refers to governance – that is, the rules and oversight of different types of conduct in the NZ ETS market where NZUs are traded. This distinction is to differentiate the purpose of market governance reform from the wider purpose of the NZ ETS as an emissions reduction scheme. This includes conduct that overlaps within the primary and secondary market of the NZ ETS. The term NZU market is used intentionally in this document to refer to the parts of the NZ ETS where there are risks in trading NZUs, which the proposals in this document are intended to regulate. Refer to [Glossary](#) for full definitions of both terms.

## Prior consultations informed policy options

In the 2021 market governance consultation, stakeholders identified their preferred policy options to address the risk themes. With stakeholder feedback in mind, the tools chosen to progress the market governance package are listed below for each theme:

- **Governance of advice:** Code of conduct, licensing and registration of NZU financial advisers
- **Governance of trading:** Optional centralised exchange platform for NZU trades
- **Governance of conduct:** Improved transaction reporting

Stakeholders also favoured appointing a skilled regulator with market design and market compliance powers to oversee the NZU market.

## We want your feedback

We want your feedback on the impact of the market governance proposal.

This document presents four market governance topics, informed by the themes and tools we have previously consulted on. Table 1 outlines each topic below:

**Table 1: Market governance options**

### Topic 1: Regulating the market based on financial legislation

- **Option one:** Crimes Act 1961 (status quo). Continue to use the Crimes Act to manage insider-trading risks. No provisions against market manipulation in the NZU market. Market operators would not be licensed.
- **Option two:** Financial Markets Conduct Act 2013 (FMC Act) with suitable modifications. Apply market manipulation prohibitions and offences to the NZU market like those in the FMC Act. Licensing requirements would apply to any facility for the trading of NZUs that met the definition of a financial product market (a licensed NZU exchange).
- **Option three:** Crimes Act 1961 and market manipulation prohibitions. Use the Crimes Act to manage insider trading risks. Market manipulation would be addressed using prohibitions like those in the FMC Act. There would be no licensed market operators.

### Topic 2: Regulating NZU financial advice, transactional and/or custodial services

- **Option one:** Relying on existing legislation (status quo). Advice relating to NZUs is partially covered by four Acts, including the Fair Trading Act 1986 (FTA), Forests Act 1949, FMC Act and Financial Service Providers (Registration and Dispute Resolution) Act 2008, which together create a complex framework for regulation advice.
- **Option two:** Regulating NZU financial advice, transactional and/or custodial services. Require persons that provide a financial advice service to comply with FMC Act fair-dealing rules, certain statutory financial advice duties, and additional statutory duties if they provide a service to retail clients. Those who have retail clients would also be required to hold or operate under a licence and belong to a mandatory dispute-resolution scheme. Fees and levies would be payable.
- **Option three:** Applying FMC Act wholesale client settings. Implement a code of conduct that outlines the expectations of a person providing NZU financial advice. A person providing NZU financial advice would be required to be registered and comply with some statutory duties. No licensing would be required.

### Topic 3: Improved transaction reporting

- **Option one: Current reporting obligations (status quo).** Under the status quo, the NZETR collects the following information about transactions:
  - the parties involved in the trade
  - the number of units in the trade

- the time and date of transaction
- who set up the transaction
- who authorised it and how they got their transaction authorisation code.
- **Option two: Improved transaction reporting.** Implement new reporting requirements for parties to NZU trades, including:
  - the price at which the NZUs were bought or sold, or otherwise the total value of the unit block
  - whether the trade is with someone else or between the transactor’s own accounts in the NZETR
  - the transactor’s primary reason for holding an account.
- **Option three: Full transaction reporting.** Replicate the prescribed wire transaction reporting obligations in the [Anti-Money Laundering and Countering Financing of Terrorism \(Prescribed Transactions Reporting\) Regulations 2016](#) (AML/CFT Regulations). This would apply to transaction and customer details.

#### Topic 4: Applying the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) framework

- **Proposal: (status quo).** No further [AML/CFT Act](#) obligations would apply to the NZU market beyond what already applies today. This highlights how the AML/CFT Act already captures activities of interest within the NZU market to deter money laundering and financing of terrorism.

# About this engagement

This engagement is a follow-up to the 2018<sup>2</sup> and 2021<sup>3</sup> consultations on market risks, options and governance scenarios.

The intended audience is those who already interact with the NZU market or who have previously engaged or followed the market governance consultations. The information collected from this engagement will help inform the Cabinet decision-making process on the final market governance project.

We are considering addressing the identified risks of treating NZUs as a financial product<sup>4</sup> in the NZU market.<sup>5</sup> This means that the discussion document outlines the key aspects of, and regulatory concepts in, financial markets legislation that are intended to apply to NZUs in a manner broadly equivalent to financial products.

We seek your feedback on the impacts of treating NZUs as a financial product, as well as feedback on alternative options. Your feedback is a key part of improving the NZ ETS. We want to hear your views on how these options may affect you and the NZU market.

## Scope of this engagement

### Limitations and constraints

The scope of options in this discussion document has been limited by earlier market governance consultations, stakeholder feedback and Cabinet decisions.

Between 2015 and 2021, the Ministry for the Environment (the Ministry) conducted multiple consultations on the prevalence of risks in the NZU market, the appropriate policy tools to address these risks, and potential market governance scenarios. Between 2018 and 2022, Cabinet agreed to various improvements to the governance of the NZ ETS and NZU market.

A review of the NZ ETS in 2015 found room for improvement. The review identified that the current market governance framework in the NZ ETS is not fit for purpose.

In 2018, the Government consulted on improving the NZU market and identified seven key risks in relation to market governance.<sup>6</sup> Stakeholder feedback to the consultation indicated that the risks in the NZU market existed and would likely continue to exist.

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<sup>2</sup> Ministry for the Environment. 2018. *Improvements to the New Zealand Emissions Trading Scheme: Consultation document*. Wellington: Ministry for the Environment.

<sup>3</sup> Ministry for the Environment. 2021. *Designing a governance framework for the New Zealand Emissions Trading Scheme: Consultation document*. Wellington: Ministry for the Environment.

<sup>4</sup> While the term 'financial product' is a defined term in [section 7 of the FMC Act](#), and it is one option to treat NZUs as if they were a financial product, the shape and form of legislative design of any ETS market governance reform package will be decided at a later stage. These proposals should not be treated as consulting on the use of any particular regulatory framework or design.

<sup>5</sup> Note the distinction drawn between the NZ ETS and the NZU market, as outlined at n 1 above, and in the definitions of each term provided in the [Glossary](#).

<sup>6</sup> Above, n 2.

In 2018, Cabinet agreed in principle to:

- prohibit insider trading and market manipulation in the NZU market and, as much is practical and appropriate, approach these two risks in the same manner as they are treated in the FMC Act
- as much as is practical and appropriate, provide penalties and offences for insider trading and market manipulation in the NZ ETS that mirror the equivalent penalties and offences in the FMC Act.

In July 2019, Cabinet also decided to establish a market governance work programme to address all seven market governance risks.

In July 2021, the Ministry for the Environment consulted on the seven market governance risks.<sup>7</sup> The consultation included a range of proposed regulatory and non-regulatory options, and possible market governance regulatory scenarios. Stakeholder feedback:

- agreed that the NZU market needed market governance amendments to be implemented
- supported the use of existing frameworks to regulate the NZ ETS
- supported a code of conduct, licensing and registration of NZU market users
- supported an optional centralised exchange for greater transparency
- supported appointment of an appropriately skilled regulator to improve trust, efficiency and confidence in the NZ ETS.

This 2022 targeted engagement continues the consultation process. Some stakeholders suggested, in response to an earlier consultation, that we should consider leveraging the existing financial market framework and policy tools. For this reason, we are seeking your feedback on:

- treating NZUs as a financial product
- treating financial advice relating to NZUs as a financial advice service
- treating market risks in the NZU market as financial risks
- including the NZU market under existing financial frameworks legislation
- appointing the Financial Markets Authority (FMA) to oversee and regulate the NZU market.

We also seek your feedback on other matters, such as the financial and administrative impacts of leveraging policy tools from the FMC Act and the AML/CFT Act, and what alternative market governance proposals we should consider to mitigate the seven identified risks.

While we have in this document expressed a preference for particular options, we are open to feedback on what may and may not work in practice and how effective the options are likely to be.

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<sup>7</sup> Above, n 3.

# Context

The NZ ETS is critical to meeting emissions reduction targets in Aotearoa New Zealand. The Government is committed to responding to climate change by transitioning to a climate-resilient economy in a manner that is fair to all New Zealanders.

The [Climate Change Response Act 2002](#) (CCRA) established the NZ ETS in 2008 as an important tool for meeting our international and domestic emissions targets. The NZ ETS puts a price on greenhouse gas emissions by requiring people and businesses covered by the scheme (NZ ETS participants) to purchase and surrender NZUs to the Government for their emissions.

In the NZ ETS, the primary market includes the supply of NZUs from the Government to NZ ETS participants. The secondary market is where previously issued NZUs are bought and sold. The Government sets the number of units supplied into the scheme. This number reduces over time, limiting the total amount that people and businesses can emit, in line with Aotearoa New Zealand's emissions reduction targets.

A review of the NZ ETS in 2015/16<sup>8</sup> found that the framework is incomplete and could be improved. The review resulted in proposals to improve the NZ ETS so it supports the climate-resilient transition more effectively. The review acknowledged a need for good governance, to ensure consistency and alignment to improve operational efficiencies.

'Market governance' refers to the rules and oversight of different types of conduct in the NZ ETS market where NZUs are traded. This includes conduct that overlaps within the primary and secondary market of the NZ ETS. We refer to this as the NZU market, to differentiate the purpose of market governance reform within the wider purpose of the NZ ETS as an emissions reduction scheme.

The risks to the NZ ETS scheme due to insufficient market governance have been noted by the Ministry for the Environment,<sup>9</sup> the Climate Change Commission,<sup>10</sup> the Productivity Commission,<sup>11</sup> and the Government.<sup>12</sup>

At present, the NZU market lacks an integrated legislative framework to address misconduct. A comprehensive framework facilitates a well-functioning market and protects the integrity of the scheme. A robust framework could also facilitate links with international emissions trading schemes.

Improving the NZU market can contribute to Aotearoa New Zealand reaching international and domestic emissions reduction targets and make a just and inclusive transition to a low-emission economy.

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<sup>8</sup> Ministry for the Environment. 2016. *The New Zealand Emissions Trading Scheme Evaluation 2016*. Wellington: Ministry for the Environment.

<sup>9</sup> Above, n 2.

<sup>10</sup> Climate Change Commission. 2021. *2021 Draft advice for consultation*.

<sup>11</sup> New Zealand Productivity Commission. 2018. *Low-emissions economy: Final report*.

<sup>12</sup> Ministry for the Environment. 2019. *Transitioning to a low-emissions future – the Government response to the Productivity Commission's Low Emissions Economy report*. Wellington: Ministry for the Environment.

## **The NZ ETS is unique among international emissions trading schemes**

The NZ ETS is different to most international emissions trading schemes in that it has a forestry sector that generates NZUs, which can be made available to other NZU market users.

However, there is a higher level of regulation apparent in other international emissions trading schemes, when compared to the NZ ETS and the NZU market.

International emissions trading schemes use a range of approaches and tools to regulate and monitor trading and conduct in their schemes. In the NZU market, conduct between participants lacks this level of regulation.

Despite these differences, comparative review can provide important lessons for market governance in the NZU market. Many international emissions trading schemes include emissions allowances as a financial instrument under their own definitions, with regulation by their respective financial market authorities. Table 2 summarises the various approaches to market risks taken by international emissions trading schemes.

**Table 2: Treatment of market risks in international carbon markets**

	European Union	California	Quebec	United Kingdom	Australia	Switzerland	Aotearoa New Zealand
<b>Governance of advice</b>	Code of conduct	Unknown	Can suspend trades based on poor advice	Unknown	Australian Financial Services licences for carbon units	Swiss securities regulation does not apply to OTC emission allowances trading on secondary markets	Fair Trading Act 1986 Crimes Act 1961
<b>Governance of trading</b>	Licensed platforms, disclosure of 'know-your-consumer' (KYC) information	Centralised allowance-tracking system	Ministry-approved registration of market participants, disclosure of KYC information	Managed through the UK Emissions Trading Registry (records on allowances held, movement of allowances for UK). Also serves as the UK Kyoto Protocol Registry	Requires Australian market licence	Managed through the National Emissions Trading Registry	KYC obligations via AML/CFT Act 2009
<b>Governance of conduct</b>	Market abuse regulation	Market abuse regulation, purchase and holding limits	Market abuse regulation, purchase and holding limits	Market abuse regulation, position and purchase limits	Market integrity regulation for market operators and participants	Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading	Crimes Act 1961
<b>Appointing a regulator</b>	European Securities and Markets Authority	California Air Resources Board	Ministry of the Environment and the Fight Against Climate Change works with financial market regulatory agency	Financial Conduct Authority (with regulators ensuring compliance)	Australian Securities and Investments Commission	Swiss Financial Market Supervisory Authority	Department of Internal Affairs and FMA for parts of the NZU market
<b>Treatment of units and market risks</b>	Financial instrument	Non-financial <sup>13</sup>	Non-financial <sup>13</sup>	Financial instrument	Financial product	Non-financial	Non-financial

<sup>13</sup> The circumstances under which the Western Climate Initiative (WCI) was established differ to those which gave rise to the NZ ETS. The WCI represents a carbon market designed, developed and operated exclusively by subnational governments in different countries and under different legislation. A regional allowance market is created by the partner jurisdictions recognising one another's allowances for compliance, regardless of unit definition.

# What has happened so far

## 2018 consultation sought to better understand the impacts and prioritisation of the seven risks for stakeholders

In 2018, the Government identified and consulted on seven market governance risks<sup>14</sup> relating to bad advice, transparency issues with trading, and misconduct in the NZU market. Table 3 outlines the seven identified market governance risks and their corresponding themes.

**Table 3: Market governance risks and themes**

Theme	Risk
Theme A: Governance of advice	Risk 1: Inadequate, false or misleading advice relating to NZUs
	Risk 2: Conflicts of interest involving the NZETR
Theme B: Governance of trading	Risk 3: Potential lack of transparency, oversight and monitoring of trades in the secondary NZU market
	Risk 4: Credit and counterparty risks
Theme C: Governance of market conduct	Risk 5: Insider trading and information asymmetry
	Risk 6: Manipulation of NZU prices
	Risk 7: Money laundering and financing of terrorism in the NZU market

In general, submitters were more concerned about future misconduct than current behaviour.

One submitter noted, “As the market becomes more mature and the volume and value of trading increases, it will become important for units to take on some of the features that ordinary financial products have, as well as a more sophisticated compliance monitoring and enforcement regime”.

Some commented that initiatives to address risks and improve governance could have unintended consequences for engagement in the NZU market, or lead to higher compliance costs,<sup>15</sup> especially for smaller participants. They therefore recommended carefully considering any change, ensuring any proposed regulation is proportionate to the risks and not too onerous.

## 2018 Cabinet in-principle decisions

In 2018, alongside the decisions to introduce auctioning in 2020 and subject to the wider market governance decisions, Cabinet agreed in principle to address the risks of insider trading and market manipulation as a priority, because of the increased likelihood of misconduct.<sup>16</sup>

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<sup>14</sup> Above, n 2.

<sup>15</sup> Compliance cost refers to all the expenses that a firm incurs to adhere to industry regulations. Compliance costs are difficult to estimate as they depend on the extent to which a company complies or exceeds the current rules.

<sup>16</sup> [New Zealand Cabinet. 2018. Amendments to the Climate Change Response Act 2002: Tranche One. Cabinet Committee on Environment, Energy and Climate Minute of Decision CAB-18-MIN-0606.01. Wellington: Cabinet Office, Department of the Prime Minister and Cabinet.](#)

Cabinet agreed in principle that insider trading and market manipulation should, as much as practicable and appropriate, be treated in the same manner as in the FMC Act and have offences and penalties that mirror those in that Act.

Cabinet noted that Ministry for the Environment officials will do further work to determine the most appropriate regulator to enforce this conduct, including careful consideration of which regulator could be adequately resourced to deal with this conduct.<sup>17</sup>

## **2021 consultation informed policy options**

In July 2021, the Ministry for the Environment consulted on options to address the seven identified market governance risks.<sup>18</sup> The full range of options considered is provided in [Appendix A](#).

The consultation adopted a first-principles approach. The first-principles approach allowed the Ministry to establish the prevalence of market governance risks and consider the most appropriate regulatory and non-regulatory tools to address these risks, without being restricted to the types of tools that already existed in the market, the legislation or any prior policy assumptions.

In the consultation document, the Ministry:

- investigated the prevalence of the market governance risks and whether they still existed under the status quo
- presented a range of regulatory and non-regulatory options that would address the market governance risks (these options were not mutually exclusive)
- presented different combinations of options (market governance scenarios) which could apply in the NZU market (including low-regulatory, balanced, and high-risk-mitigation scenarios, to show a range of possible intervention levels)
- did not consult on the appropriate legislation to implement the changes, or on whether NZUs should be regulated as financial products (either under an existing or new framework).

The approach allowed stakeholders to express their opinion on their preferred direction and the types of tools that would be useful for addressing market governance risks, and it helped the Government gather a range of perspectives before making policy decisions.

Stakeholder feedback from the 2021 consultation confirmed the existence of the seven identified market governance risks to the NZU market, under the status quo, and informed our consideration of several options to address those risks. The market governance options below, for addressing misconduct, are modified versions of what was consulted on but are actively being considered based on stakeholder preference.

The following were identified as the appropriate types of tools to address the market governance risks, grouped by their risk themes (advice, trading, conduct):

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<sup>17</sup> Above, n 16, at [61].

<sup>18</sup> Above, n 3.

- **Governance of advice:** education campaign, code of conduct, licensing and registration of NZU advisers
- **Governance of trading:** optional centralised exchange platform for NZU trades (modified from the mandatory centralised exchange proposed in 2021)
- **Governance of conduct:** Improved transaction reporting (modified from full transaction reporting proposed in 2021).

The 2021 consultation also showed stakeholders favouring the appointment of a skilled regulator, with market design and market compliance powers, to oversee the NZU market.

# Market governance framework

## Objectives

### Overall market governance objectives

The Government has identified market governance risks relating to poor advice, transparency, and misconduct in the NZU market. Currently there is a lack of cohesive legislation to address these risks.

A poorly governed NZU market could have implications for meeting domestic emissions budgets. Through this consultation, we want to better understand the impact of leveraging existing financial market frameworks to address key risks in the NZU market.

As the NZU market matures, the value of NZUs continues to rise. Additional NZU market users are joining the scheme and there is potential to open the NZU market to international participants.

The overall policy objective of market governance is to address the seven identified market governance risks in order to:

- increase the integrity and efficiency of the NZU market
- promote confidence in NZU market trading, and
- reduce the risk of misconduct for NZU trades.

### Topic objectives and risks addressed

There are four topics included in this engagement that are derived from previous stakeholder feedback. Table 4 outlines those topics and their objectives. Table 5 sets out the risks covered by each topic chapter.

**Table 4: Summary of market governance topic objectives**

Theme	Risk
Topic 1: Regulating the NZU market based on financial legislation	To ensure the NZU market trades with integrity, functions efficiently, promotes confidence and addresses the risks of misconduct. To ensure all NZU market users have the same material information relating to NZUs.
Topic 2: Regulating NZU financial advice, transactional and/or custodial services	To ensure all persons who interacts with the markets where NZUs are traded has access to quality advice about buying and selling NZUs. To ensure services relating to NZUs are provided with appropriate levels of care, diligence and skill.
Topic 3: Improved transaction reporting	To increase transparency in the NZU market and address information asymmetry currently seen in the market.
Topic 4: AML/CFT Act framework	To better communicate how the AML/CFT Act captures activities of interest within the NZU market to deter money laundering and financing of terrorism.

**Table 5: How each topic addresses market governance risks**

	Topic 1: Regulating the market based on financial legislation	Topic 2: Regulating NZU financial advice, transactional and/or custodial services	Topic 3: Improved transaction reporting	Topic 4: AML/CFT Act framework
<b>Risk 1:</b> Inadequate, false or misleading advice relating to NZUs		✓		
<b>Risk 2:</b> Conflicts of interest involving the NZETR		✓		
<b>Risk 3:</b> Potential lack of transparency, oversight, and monitoring of trades in the secondary NZU market	✓		✓	
<b>Risk 4:</b> Credit and counterparty risks	✓			
<b>Risk 5:</b> Insider trading and information asymmetry	✓			
<b>Risk 6:</b> Manipulation of NZU prices	✓			
<b>Risk 7:</b> Money laundering and financing of terrorism in the NZU market				✓

## Topics are not mutually exclusive

Proposals given in topics 1–4 work together to achieve the overall policy objective. Some topics perform different functions – for example, regulating NZU financial advice performs a different function to the AML/CFT Act framework.

Other topics, however, reinforce each other. For example, the optional centralised exchange is reinforced by improved transaction reporting because, together, they provide a full picture of trading activity.

There are different options given under each topic (and a preferred option put forward) for stakeholders to consider.

## The status quo: no unified framework or regulator

Currently, there is no integrated legislative framework for market governance in the NZU market, creating risks to market function, integrity and confidence.

The status quo is that many different pieces of legislation and different regulatory systems provide overarching coverage for aspects of the risks identified in the NZU market, but none is tailored to provide full coverage.

Set out in topics 1–4 of this document is a series of proposals and alternative options for a range of statutory tools and obligations that can be used to build the market governance framework.

Table 6 below provides a detailed description of each topic’s status quo which, put together for the entire NZU market governance framework, provides a patchwork for coverage of the risks identified in 2018.

**Table 6: Status quo legislation under each proposal topic**

<p><b>Topic 1: Regulating the market based on financial legislation</b></p> <ul style="list-style-type: none"> <li>• <b>Crimes Act 1961:</b> Includes punishments and offences for crimes.</li> </ul> <p><b>The status quo: Crimes Act only.</b> The Crimes Act is used to manage insider trading risks. No provisions against market manipulation in the NZU market. Market operators would not be licensed.</p>
<p><b>Topic 2: Regulating NZU financial advice, transactional and/or custodial services</b></p> <ul style="list-style-type: none"> <li>• <b>Forests (Regulation of Log Traders and Forestry Advisers) Amendment Act 2020:</b> Establishes a registration system for log traders and forestry advisers.</li> <li>• <b>Fair Trading Act 1986 (FTA):</b> Generally prohibits false and misleading conduct by those in trade.</li> </ul> <p><b>The status quo: advice relating to NZUs is partially covered by four Acts.</b> The FTA, Forests Act 1949 and the FMC Act and Financial Service Providers (Registration and Dispute Resolution) Act 2008 together create a complex framework for regulating advice.</p>
<p><b>Topic 3: Improved transaction reporting</b></p> <ul style="list-style-type: none"> <li>• <b>Climate Change Response Act 2002:</b> Mandates annual emissions reporting to the NZETR.</li> </ul> <p><b>The status quo: the NZETR collects the same information for transactions.</b> Under the status quo, the NZETR collects the following information about transactions:</p> <ul style="list-style-type: none"> <li>– the parties involved in the trade</li> <li>– the number of units in the trade</li> <li>– the time and date of transaction</li> <li>– who set up the transaction</li> <li>– who authorised it and how they got their transaction authorisation code.</li> </ul>
<p><b>Topic 4: Applying the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) framework</b></p> <ul style="list-style-type: none"> <li>• <b>Anti-Money Laundering and Countering Financing of Terrorism Act 2009:</b> Generally requires businesses to take measures to guard against money laundering and terrorism financing.</li> </ul> <p><b>The status quo:</b> No further AML/CFT framework obligations would apply to the NZU market beyond what already applies today. This highlights how the AML/CFT Act already captures activities of interest within the NZU market to deter money laundering and financing of terrorism.</p>

## **Leverage existing financial market frameworks**

The Ministry for the Environment considers that there are common risks between the NZU market and financial product markets, regulated by the FMC Act. These risks include poor advice from professional advisers, insider trading and market manipulation.

It could be beneficial to include the NZU market under existing financial market frameworks to minimise market governance risks in the NZU market. This is because the approach could leverage well-established legislative tools and trusted financial market regulators. Using a financial market framework approach to govern the NZU market could align the NZ ETS to international emissions trading scheme standards and to our own domestic financial markets. This alignment could ensure NZU market integrity, efficiency and confidence.

The Government seeks to better understand the impact of leveraging existing financial market frameworks to address the seven identified risks. The Government acknowledges that there are key differences between NZUs and other more traditional financial products. For example, many parties are required to trade in NZUs because of their surrender obligations – a feature that does not exist in other financial markets, where trading is voluntary. All NZUs represent the same units (volume) of emissions, whereas there are a large range of different financial products.

An important aspect of this engagement will be understanding impacts on NZU market users and other affected parties that could eventuate because of these kinds of differences, the modifications that would be required to financial markets frameworks due to those differences, and how the application of these proposals would affect participants in the NZU market.

## **Appoint the FMA as a regulator**

Aligning the NZU market to financial market frameworks would require a regulator to oversee the market. A fit-for-purpose policy framework that treats NZUs as a financial product would leverage the financial market tools and institutional structures of the FMA as the regulator of financial markets to oversee the identified market governance risks, where appropriate, in the NZU market.

# Purpose of engagement

## Understand the impacts of treating NZUs as a financial product

The purpose of this engagement is to understand the impacts of leveraging existing financial markets frameworks to address the seven identified risks. The feedback from this engagement will help with considering any modifications that may be required to tailor financial markets frameworks to NZUs and whether alternative options may better achieve overall policy objectives.

## Criteria used to compare options to the status quo

The criteria used to evaluate the options are the same operational criteria used in the broader NZ ETS improvements package in 2018 and 2019, from which the market governance project was initiated.

Table 7 outlines the five impact criteria. We consider the criteria to remain applicable, given that the overarching intention of the NZ ETS reform is to ensure that the scheme operates to achieve Aotearoa New Zealand's broader emissions reduction targets.

**Table 7: Five impact criteria**

Criteria	Description
Integrity	Ensuring that the NZU market operates with integrity at all times, and through all trading markets (primary auctioning market and the secondary trading market).
Minimal complexity and administrative cost	Wherever practicable, the costs to administer the market and for NZU market users to participate in the market are minimised. All rules, regulations and legislation are as simple and clear as possible. In particular, how the NZU market is governed has clear regard for the impacts on market participation and engagement of key intermediaries, NZU traders and other parties.
Consistency and proportionality	Wherever possible, the same solutions are used to apply to both the primary auctioning market and secondary trading market. In addition, the solutions are consistent with similar solutions used in other similar contexts, and they are proportional to the risk.
Clarity and transparency	Ensuring that all relevant market information is clearly presented, at the right time and in a clear format. The risk of collusion due to excessive transparency is also considered. All rules, regulations and legislation are clearly explained so that NZU market users understand their obligations and what type of conduct is expected of them.
Market efficiency	The NZU market is efficient when it achieves allocative efficiency and delivers efficient price discovery. Allocative efficiency is the market's capacity to channel resources, in this case, NZUs – to their highest value uses. That is, emissions are reduced by those best placed to abate, at the best time. Efficient price discovery means that for NZUs to flow to their highest value uses, the carbon price needs to reflect all available information. Providing relevant market information and predictable policy will help NZU market users to identify and understand the overall supply and demand conditions for NZUs, facilitating efficient price discovery. This will produce a reliable price signal that informs investment decisions, while minimising the cost impact of the carbon price. To ensure this price is maintained, there need to be adequate rules and oversight in place to guard against the risks of manipulation of the price, insider trading and anti-competitive conduct.

Options are assessed for how well they perform for each criterion, against the status quo. Table 8 provides a key of symbols representing the results of the assessment.

**Table 8: Key to criteria analysis assessment**

Symbol	Meaning
++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
--	much worse than doing nothing/the status quo/counterfactual

Initially, all criteria are equally ranked. If two or more options received the same score, the following rankings were applied, in order of importance.

- (1) **Integrity.** The most important of the five criteria, the integrity of the NZU market helps achieve the purposes of the market governance framework.
- (2) **Minimal complexity and administrative cost.** This enables regulations to operate sustainably and without burdensome requirements for NZU market users and regulators.
- (3) **Consistency and proportionality.** We want to ensure that the NZU market is regulated in a manner consistent with financial markets and international carbon markets. We also want to ensure that the regulation is proportional to the seven identified market governance risks.
- (4) **Clarity and transparency.** Clarity helps to ensure that stakeholders have access to the information they need to understand their obligations. Transparency helps the status of the market. We note that not all complexity can be eradicated from legislation.
- (5) **Market efficiency.** The market operates in a way that supports channelling resources to their highest value uses. NZU prices reflect all available information, and the market produces a reliable price signal that informs investment decisions, while minimising the cost impact of the carbon price.

## Your views

The Government seeks feedback on incorporating the NZU market into existing financial frameworks legislation, including:

- treating NZUs as a financial product to bring the NZU market into the financial legislation framework, similar to that observed in financial markets
- treating advice relating to NZUs as financial advice, similar to that observed in financial markets
- treating market risks as financial risks, to bring the NZU market into the financial market legislation framework, similar to how risks of misconduct are treated in financial markets
- appointing the FMA to oversee and regulate the NZU market.

This engagement presents options and analysis and includes questions for you to consider. Your views will help us fill information gaps and measure support for the options.

# Topic 1: Regulating the NZU market based on financial legislation

## Summary of options

- **Option one: Crimes Act 1961 (*status quo*).** There are key protections under the Crimes Act and penalties apply for crimes, but the Act has limited insider trading provisions and no laws against market manipulation in the NZU market.
- **Option two: Financial Markets Conduct Act with suitable modifications.** This would prohibit insider trading and market manipulation in relation to trading of NZUs. An optional centralised exchange has been agreed to, in principle, and the Government is considering options to procure and fund an NZU exchange. Market operators would be required to hold a licence and comply with obligations.
- **Option three: Crimes Act and market manipulation prohibitions.** This would use key protections in the Crimes Act while prohibiting market manipulation with similar FMC Act provisions. This option would not require a licensed market operator, meaning the operator would not be required to monitor for insider trading or market manipulation.
- **We recommend progressing with option two: FMC Act with suitable modifications.**

## Summary of impact

- Option two has a new regulatory burden for any person providing a facility that meets the definition of financial product market, including ongoing financial and resource impacts of applying for and complying with licence terms and obligations. This may affect existing facilities that allow or facilitate NZUs to be bought or sold if it meets the definition of financial product market.
- Option two may have flow-on costs for users trading on those facilities, in the form of fees to use the market along with the burden of complying with market rules.
- Both options two and three could promote confidence and integrity in NZU trading, as market manipulation and insider trading are prohibited, using similar frameworks as other financial product markets. However, the degree of surveillance and regulation varies between the options.
- Option two increases oversight of facilities where NZUs are traded.
- Option one falls short of preventing insider trading and market manipulation in a growing market.

## Objective

We aim to ensure that the NZU market trades with integrity, functions efficiently, promotes confidence and addresses the risks of misconduct.

A fair, efficient, transparent NZU market requires all NZU market users to have the same material information relating to NZUs. If some people have material information before others and are allowed to take advantage of this through trading, it undermines the fairness of the NZU market.

Additional objectives of this topic include:

- greater activity oversight by a regulator on NZU trading facilities or exchanges
- that market access, including the cost of trading on the NZU market, is proportionate and not a barrier to using those markets, and that those markets operate efficiently
- that proposed rules do not unnecessarily limit trading – recognising that some people are *required* to trade NZUs to meet surrender obligations.

## What we have heard so far

Stakeholders recommended that the Government should consider treating NZUs as a ‘financial product’, because the FMC Act is well placed to protect users from the market risks.

Stakeholders supported appointing an appropriately skilled regulator to improve the NZU market. Submitters stated a market regulator would improve the integrity of the NZU market and promote confidence that NZU market users are behaving ethically.

## Options considered

### Option one: Crimes Act 1961 (status quo)

This option would maintain current provisions and laws. Under the status quo, there are limited insider trading provisions and no specific laws against market manipulation in NZU markets.

The current key protections are outlined below.

Officials:

- are bound by employment contracts, employers’ policies and the [Public Service Commission Standards of Integrity and Conduct](#), which are all governed by the [Employment Relations Act 2000](#)
- commit an offence if they corruptly use or disclose any information, acquired in their official capacity, to obtain an advantage or pecuniary gain for themselves or any other person under [section 105A](#) of the Crimes Act. This is subject to a maximum term of seven years’ imprisonment but no civil penalties.

All other persons, otherwise:

- are bound by the terms of service of particular trading platforms (eg, terms of use) which can include contractual provisions about conduct expectations (limited to that platform)
- commit an offence under [section 105B](#) of the Crimes Act if they use or disclose personal information (ie, about a natural person only) that comes into their possession as a result of an offence under [section 105A](#), knowing that the information is in contravention of that provision, and use/disclose the information to obtain an advantage or pecuniary gain. This is subject to a maximum term of seven years’ imprisonment but no civil penalties
- are not subject to any statutory restrictions on the use of non-public material information about NZUs.

Under this option:

- insider trading and market manipulation would continue to be addressed under the existing law
- there is no proposal to license market operators, and persons that facilitate (directly or indirectly) acquisitions and disposals of NZUs are not required to monitor for suspected insider trading or market manipulation
- any misconduct complaints relating to the corrupt use of official information remain a matter for the police. Any complaints about conduct on market platforms remain the responsibility of the market operator as a matter of contract.

## Option two: FMC Act with suitable modifications

Option two proposes regulating the NZU market based on how financial markets prohibit insider trading and market manipulation, and require persons who operate an NZU exchange to hold a licence to operate. We discuss modifications that could account for the differences between NZU markets and financial markets.

The duties and proposed requirements are further discussed in the 'What this proposal means in practice' section below. At a high level, the obligations would apply in the following ways:

- **Insider trading:** A person could not trade NZUs if they have material non-public information about government policy.
  - The FMC Act insider trading provision prohibits a person from buying or selling financial products that are 'quoted' (ie, listed for trading) on a licensed market if they hold material non-public information.
  - We propose a much narrower and more tailored definition of material information to non-public information on government policy.
- **Market manipulation:** To promote integrity in NZU markets, we propose that market manipulation prohibitions and offences similar to those in the FMC Act could apply to NZUs.
- **An optional centralised exchange:** This would increase market visibility and assist in the regulation of insider trading and market manipulation.
  - In the event misconduct is detected, it will be forwarded to the FMA.
- **Regulatory responsibility for investigation and enforcement proposed to sit with the FMA:**
  - In the NZU secondary market there is a frontline monitor for insider trading and market manipulation. Trades that could occur on the proposed optional centralised exchange would be forwarded to the FMA for investigation and enforcement.

## Option three: Crimes Act 1961 and market manipulation prohibitions

Option three aligns with the objective for topic 1,<sup>19</sup> in that it satisfies the criteria of integrity and market efficiency better than the status quo.

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<sup>19</sup> Table 4 provides details on the objectives under each topic.

Under the alternative option, we propose the following:

- **Use the key protections outlined above in the Crimes Act.**
- **Prohibit market manipulation with provisions similar to those in the FMC Act.** Under this option, acts or omissions would be prohibited which have, or are likely to have, the effect of creating, or causing the creation of, a false or misleading appearance with respect to:
  - the extent of active trading in NZUs
  - the supply of, demand for, price for trading in, or value of NZUs.
- **No licensed markets.** Under this option, there are no licensed market operators. This means market operators would not be required to proactively monitor for potential insider trading or market manipulation. Any such misconduct would likely only be picked up in response to a complaint to the responsible market regulator by another NZU market user.
- There would be no direct costs or obligations imposed on NZU market users.

This alternative option is a light regulatory approach, which prohibits some forms of insider trading and market manipulation but is less likely to detect such misconduct. This option has been put forward as a lighter-touch regime, to reflect that the scope of insider trading in the NZU market is narrower given it relates only to government policy that is not generally available to the market. The scope for market manipulation remains comparable to financial markets.

## Options analysis

[Appendix B](#) of this discussion document provides the option and risk analysis tables for topic 1.

Option one (the status quo) provides limited protection from insider trading and market manipulation and does not meet the objectives set out. Maintaining this option when the NZU market is increasing in value could create opportunities for bad actors to take advantage of a poorly regulated market.

Option two (FMC Act with suitable modifications) provides the highest integrity of all the options by applying trusted and tested financial market tools. Those that operate and use markets for trading NZUs will likely be subject to additional costs, however the costs associated with implementing this option are mitigated by removing some unnecessary obligations, while still providing the greatest amount of protection to market users. The established rules in the FMC Act are consistent and proportionate to other financial markets and carve-outs have been proposed to allow for the unique nature of the NZU market. Feedback on this document will also be considered to assess whether other modifications are necessary.

This option increases market efficiency by creating clear rules against insider trading and market manipulation and establishing a regulator to investigate any potential misconduct. When compared to the status quo, option two meets the objectives of integrity, efficiency, fairness and promoting confidence in the NZU market.

In terms of risk mitigation, option two also provides the best overall coverage. In particular, the FMC Act has specific provisions to address insider trading and market manipulation in financial markets. Option two will also minimise a lack of transparency, and credit and counterparty risks, through market rules for licensed market operators. The market operators

are required to operate their platforms in a fair, orderly and transparent manner. The market rules often contain provisions to resolve events of transaction defaults among platform users.

Option three (Crimes Act and market manipulation prohibitions) is an improvement when compared to the status quo but falls short on catching misconduct. This option does not require licensed markets and therefore lacks a market operator to conduct frontline monitoring surveillance.

Option three relies on formal complaints being lodged to the regulator about possible misconduct instead of maintaining active surveillance on the market. The lack of information collected from a frontline market operator could also be difficult when investigating a complaint. Further, this option does not align with domestic financial markets or international carbon market standards.

While option three is better than the status quo, it provides a lower level of protection against poor transparency in secondary markets and market manipulation. Our analysis also suggests it performs no better than the status quo in addressing credit and counterparty risk and insider trading.

## **Option two is preferred at this stage: FMC Act with suitable modifications**

Considering the analyses above, our current view is that option two (FMC Act with suitable modifications) is best suited to address the risks of insider trading and market manipulation while meeting the criteria set out for market governance.

The proposed option aligns with the objective for topic 1, in that it satisfies the criteria much better than option one (status quo) and option three (Crimes Act and market manipulation prohibitions), in terms of integrity, consistency and proportionality, and clarity and transparency.

The proposals outlined in option two increases market confidence by requiring a licensed market operator to survey for misconduct and a regulator to investigate irregular trades. This option meets the criteria and objectives that increase market efficiency.

## **What this proposal means in practice**

### **A person could not trade NZUs if they have material non-public information about government policy**

The FMC Act insider trading provision prohibits a person from buying or selling financial products that are 'quoted' (ie, listed for trading) on a licensed market if they hold material non-public information, being information that:

- is not generally available to the market
- a reasonable person would expect to have a material effect on the price of the financial product on the licensed market if the information was generally available.

This includes provisions for an information insider (Person A) of a listed issuer to not directly or indirectly disclose inside information to another person (Person B) if Person A knows or ought reasonably to know or believes that Person B will, or is likely to:

- trade quoted financial products (ie, NZUs) of the listed issuer
- advise or encourage another person (Person C) to trade or hold those products.

Table 9 provides a summary of this proposed prohibition.

**Table 9: Proposal to prohibit insider trading for quoted financial products and NZUs**

	Quoted financial products	NZUs (proposed)
Information insider / Person A	Prohibited	Prohibited (modified meaning of 'material information')
Person B	Prohibited	Prohibited (as above)
Person C	Prohibited	Prohibited (as above)

However, there could be scenarios where, for example, a person who receives inside information may need to trade to meet a legal obligation that may require forms of exclusions or exemptions.

In these circumstances, we consider a likely source of a person becoming an NZU information insider is through targeted consultation. In this instance, it may be appropriate for the Government to first consider its approach to consultation, and whether it may have a negative impact on one or more persons with legal surrender obligations.

Second, matters may also be manageable by clearly stating that the terms of the targeted consultation may involve the recipients becoming NZU information insiders and are thereby prohibited from trading for a defined period. We may also consider whether future exclusions and/or modifications may be appropriate if this approach is insufficient.

## Government information as material information

In relation to NZUs, we propose a much narrower and more tailored definition of material information for prohibitions on insider trading, which would apply where a person holds material non-public information about *government policy only*.<sup>20</sup> As part of this discussion document, we are seeking your feedback on:

- what information should be considered government policy – for example, decisions approved by Cabinet or policy under active consideration
- what stakeholders expect from the Government in terms of disclosures and publishing of information.

Our objective is to provide sufficient transparency and to not impede the Government's ability to consult on and test proposals with the marketplace.

However, the definition of 'information insider' is broad enough to capture third parties if they hold material information relating to the government that they ought to reasonably know is material information and generally not available to the market.

<sup>20</sup> See [below](#) in relation to proposals to apply the prohibition to both licensed markets and beyond.

### Example

If a government employee or other person (Person A) became aware that the Government was planning to announce a policy that would materially reduce demand for NZUs, and Person A encouraged another person (Person B) to trade NZUs, Person B would be prohibited from trading if a reasonable person would expect that information to have a material effect on the price of NZUs on the licensed exchange(s).

The proposed approach reflects that information about government policy is the source of information most likely to have a material impact on NZU price. It provides greater clarity for NZU market users about what is and is not insider trading.

### Example

A person is not prohibited from trading if they have knowledge that a large emitter that is an NZU market user is planning to stop operations and reduce future demand for NZUs, because that emitter is neither an issuer of quoted financial products nor subject to any disclosure (or continuous disclosure) obligations in the NZU market.

Also, knowledge of a person's own intentions or activities is not considered insider trading. This generally allows for an NZU market user to buy and sell NZUs in the course of normal business, and for an adviser to advise a NZU market user to buy or sell NZUs in the course of normal business.

We propose that the same offences and penalties could apply as in financial markets where, in serious cases, insider trading may amount to a criminal offence and can be punishable with up to five years' imprisonment and a maximum fine of \$500,000 for individuals or \$2.5 million for companies.

### Question 1

What are your views on the proposed insider-trading prohibition?

### Question 2

In what way could these insider trading obligations impact any other forms of legitimate conduct?

### Question 3

What other types of insider trading should be prohibited?

### Question 4

What information should be defined as 'government policy' in the context of insider trading?

### Question 5

What other type of information should be considered 'material non-public information' in the context of insider trading and the NZU market?

## Market manipulation would be prohibited

Market manipulation is where someone misleads (or attempts to mislead) the market through false or misleading information or statements, or by giving a false appearance of trading activity, supply, demand, or the value of financial products.

The FMC Act includes provisions for two types of market manipulation in relation to financial products traded on licensed markets:

- Information-based manipulation ([section 262](#)): This is where someone says something – or otherwise shares information – that they know (or should know) contains information that is false or materially misleading, and which is likely to:
  - induce a person to trade in financial products
  - impact the price for trading those products
  - impact the way a person exercises any voting rights associated with a financial product.
- Transaction-based manipulation ([section 265](#)): This is where someone does something, or chooses not to do something, that the person knows or ought to reasonably know will (or could) give a false or misleading impression about the extent of trading activity of a financial product or about its popularity, availability, price or value.

Market manipulation could include a person placing, or giving the impression that they will place, orders on a licensed financial product market to buy a product when they do not actually want or intend to buy it. This would give a false impression of demand for the product.

As with insider trading, in the most serious cases, market manipulation may amount to a criminal offence and be punishable with up to five years' imprisonment, and a maximum fine of \$500,000 for individuals or \$2.5 million for companies.

To promote integrity in NZU markets, we propose that similar market manipulation prohibitions and offences that apply in financial markets could apply to NZUs.

#### Question 6

What are your views on the proposed market manipulation prohibition?

#### Question 7

In what way could these market manipulation obligations impact any other forms of legitimate conduct?

## Responsibility for insider trading and market manipulation in the NZU market

There are two functions in detecting insider trading and market manipulation.

- **Monitoring and surveillance**, which take place on the market frontline. If misconduct is detected by the licensed market operator, it would be forwarded for investigation.
- **Investigation and enforcement**, by which misconduct would be sent for investigation and, if considered to have a good basis, there is potential for enforcement via regulatory action or formal proceedings.

### *Frontline monitoring and surveillance*

In other financial product markets, a licensed market operator receives both on- and off-market trading information about products quoted on its market and is responsible for the frontline monitoring of insider trading and market manipulation.

We propose that in the NZU secondary market there is a frontline monitor for insider trading and market manipulation who can gather information, from both over-the-counter trades and trades that could occur on the proposed optional centralised exchange discussed [below](#).

#### *Regulatory responsibility for investigation and enforcement could sit with the FMA*

We propose that, in the event misconduct is detected, it will be forwarded to the FMA as the potential regulator of the NZU market, for investigation and possibly enforcement.

##### **Question 8**

The FMA, as the regulator of financial markets, could oversee and regulate the NZU market where we propose similar regulations would apply. What are your views on the FMA having regulatory responsibility over insider trading and market manipulation?

##### **Question 9**

Do you consider it appropriate to expand the FMA's remit to include investigation and enforcement responsibilities to the matters set out in topic 1?

## **The NZU market structure and its interaction with FMC Act insider trading and market manipulation rules**

In financial product markets, insider trading and market manipulation are prohibited in relation to products 'quoted' on licensed market (ie, products listed on the NZX).

##### **Example**

If Company X's shares are listed for trading on the NZX, insider trading and market manipulation are prohibited in relation to trading of Company X's shares – both trading through the NZX exchange or off the exchange (noting that off-exchange transactions are reported to the exchange operator).

Insider trading and market manipulation are not prohibited in the trading of financial products that are not listed on licensed markets. The limitation to quoted financial products aligns with the responsibility of licensed market operators to monitor for insider trading and market manipulation in relation to trading in products quoted on their market.

Given there is only one product being discussed (NZUs), if NZUs are traded (quoted) on one licensed market, applying the FMC Act rules would mean insider trading and market manipulation would be prohibited for all forms of secondary trading of NZUs, whether over the counter or through other platforms that may not meet the definition of being a financial product market.

We will further consider the impact of the possible shape of the secondary market for the insider trading and market manipulation provisions and monitoring of those provisions.

## **An optional centralised exchange has been agreed to in principle**

We are considering addressing governance of trading risks with an optional centralised exchange, given that the optional centralised exchange would be designed to preserve the option of treating NZUs as a financial product.

As part of this engagement, we seek your feedback on applying particular FMC Act definitions and obligations for licensed markets to the potential NZU market centralised exchange.

## **The Government is considering options to procure and fund a licensed market operator to run an NZU market platform**

The Government intends to run a procurement process for the supply of market services for a trading platform to buy and sell NZUs, alongside the development of the NZ ETS market governance reform package. This would be subject to the terms and conditions of any RFI and RFP, the nature and extent of interest, and any offers received.

The objectives of progressing this non-legislative tool now are to improve the liquidity and functioning of the NZU market, and to increase transparency, monitoring and oversight of the NZU market.

It is currently intended that the market operator(s) on this platform would be subject to the same regulatory requirements that are proposed in this engagement document, including being required to hold a market operator licence to operate that licensed market.

## **Facilities for trading NZUs would be required to be licensed**

Under the FMC Act, a financial product market is a facility where financial products are bought or sold, or where offers or invitations to buy or sell financial products are made. Financial product market operators are required to hold a licence issued by the Minister of Commerce and Consumer Affairs for each market that they operate.

[Section 314](#) and [section 316](#) set out the considerations for the Minister and the FMA before a licence may be granted. These include meeting general obligations that a market operator must ensure that licensed markets operate in a fair, orderly and transparent way, and must have arrangements in place for:

- handling conflicts between the operator's commercial interests and fair, orderly and transparent licensed markets
- making market disclosures available
- monitoring conduct on licensed markets
- enforcing market rules.

Those requirements also include having adequate arrangements to monitor for potential insider trading and market manipulation for trading on that licensed market. Market operators are also required to notify the FMA of certain events, such as when disciplinary action is taken for breaches of market rules (eg, by market participants).

We propose that similar licensing requirements could apply to any facility for trading of NZUs that meets the definition of a financial product market (a licensed NZU exchange).

## **Existing exclusions would be maintained**

This proposal would maintain the existing exclusions from the definition of financial product market under [section 309\(2\)](#) of the FMC Act. For example, a person making or accepting offers

to acquire or dispose of NZUs on the sole behalf of one party to the transaction would be excluded from the definition of a licensed NZU exchange.

Licensing of NZU trading facilities that meet the definition of a financial product market would provide greater oversight of some trading activity on secondary markets generally, as well as maintaining mechanisms for detecting insider trading and market manipulation on licensed NZU exchanges.

Some adjustments to the existing obligations of licensed market operators would be required, to reflect that there are no 'issuers' of financial products for the operator to oversee, as the Government would be the issuer in this market (and potentially in others).

## **Application fees and levies**

This proposal would have a large impact on market operators because:

- market operators may incur material compliance costs to put in place processes, systems and rules (to the extent those are not in place or below the required standard)
- those who trade on a licensed NZU exchange incur costs complying with those rules (eg, becoming an authorised broker – to the extent that is applicable).

The licensing process can take an extended period – potentially upwards of six months – which businesses would need to factor in as part of any transitional period if this proposal is implemented.

A licensed market operator would need to pay licensing fees (based on the FMA's hourly rate) and annual FMA levies. Any brokers authorised to trade on the market would also need to pay annual FMA levies.<sup>21</sup> Levy amounts would need to be determined at a later stage. There may be a need to introduce a separate FMA levy for any NZU exchange market operator if the nature of the obligations and regulation differ sufficiently from general market operators (this is currently uncertain).

The licence fee and levy structure are still being considered, as levies for existing markets may differ from a new market. However, these costs (or a portion of them) are likely to be passed on to participants – for example, in the form of transaction fees.

## **The primary auction market**

The following proposals are made in relation to the primary NZU auction market:

- It is expected that the auction market operator would not need to be licensed as a financial product market operator. A person accepting offers to acquire NZUs on behalf of one party to the transaction only (the Crown) would be excluded from the definition of a licensed financial product market operator.
- We propose that the insider trading prohibition does not apply to transactions on the primary auction market. This is consistent with the treatment of most financial products

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<sup>21</sup> As an example, the NZX is currently required to pay annual FMA levies of \$74,750, and brokers authorised to trade on NZX are required to pay annual FMA levies of \$9,545 each annually.

under the FMC Act,<sup>22</sup> as the Government aims to make all material information available before the auction.

## **Impact on existing operators and platforms**

We are aware that there are several operators who provide different types of facilities or services that enable parties to make direct or indirect offers to buy or sell NZUs.

Under this proposal, these facilities or services (to the extent they would meet the definition of financial product market and do not fall under the existing exclusions) would be required to either change the way those services are provided or to seek a market operator licence.

We note that, because the Government is the issuer of NZUs, those operators would need to have an agreement to quote NZUs on any market, as well as needing to obtain a licence.

### **Question 10**

Do you agree that operators of facilities for trading NZUs that would meet the definition of a 'financial product market' should be required to be licensed, and to incur and comply with associated costs and obligations?

### **Question 11**

As a market operator who currently does, or would, provide a platform for the trade of NZUs, what is the impact of a licensing requirement on your business (eg, costs and obligations)?

### **Question 12**

If you plan to buy and sell NZUs, how would access to a licensed market platform affect your willingness to participate in the NZU market?

### **Question 13**

For stakeholders, what would be the costs and benefits to your business associated with buying and selling NZUs on a licensed market platform with market rules (eg, new administrative costs, trustworthy market operators)?

### **Question 14**

If you plan to buy and sell NZUs, would a fee to trade on a licensed market platform affect your willingness to participate in the NZU market?

### **Question 15**

Do you have any comments on the impact of the proposals in this topic, given differences in structure between NZU markets and financial markets?

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<sup>22</sup> See [reg 114A of the Financial Markets Conduct Regulations 2014](#).

## Disclosure obligations

### Information disclosure requirements would not apply, but the Government would observe best practice in relation to release of material information

When financial products are issued for the first time, the issuer is required to provide a Product Disclosure Statement that sets out material information about the product, in accordance with detailed requirements in legislation.<sup>23</sup> If the product is listed for trading on a market platform, then 'continuous disclosure' provisions apply, which require the issuer to release material information to the public, as and when such information comes to light.

These disclosure requirements promote transparency and reduce the risk of insider trading, as they limit the ability of a person to trade on non-public information.

We do not propose to introduce legislated disclosure requirements in relation to NZU markets, as the Government is the only 'issuer' of NZUs. The Government is, however, committed to best practice in releasing material information before auctions as and when information arises, including observing the principles of the relevant Cabinet circular (eg, around releasing information outside of trading hours).<sup>24</sup>

#### Question 16

What do you expect from the Government in terms of disclosure obligations, including the content of the disclosure and the process of disclosing information?

### Default features that apply to financial products will not necessarily apply to NZUs

While we propose regulating some aspects of NZU markets by applying the same obligations as in financial markets, we do not propose applying other obligations that apply in financial markets in relation to:

- requiring Product Disclosure Statements ([Part 3](#) of FMC Act)
- governance relating to debt securities and managed investment schemes ([Part 4](#) of FMC Act)
- obligations of FMC reporting entities ([Part 7](#) of FMC Act) for NZU financial advice providers (although we expect any licensed market operator would be an FMC reporting entity and need to comply with the additional associated financial reporting requirements)
- regulation of discretionary investment management services ([subpart 6 of Part 6](#) of FMC Act).

#### Question 17

Do you prefer the alternative options (status quo: Crimes Act 1961 or option three: Crimes Act and market manipulation prohibitions) to the preferred option? If so, why? And if so, please describe the aspects that you see as particularly advantageous to achieve the stated policy objectives.

<sup>23</sup> Unless the offer is not a 'regulated offer'. See [section 48](#) of the FMC Act.

<sup>24</sup> Cabinet Office. 2012. *CO(12) 7: Guidelines for Dealing with Inside Information About Public Issuers*.

### Question 18

Do you have any views on whether market conduct (insider trading and market manipulation) should proceed as a priority to, or instead of, creating a licensing framework for NZU market operators?

### Question 19

Can you suggest alternative options that would achieve the stated policy objectives?

## Clearing and settlement systems

Market operators are required to have systems and processes to allow the market to operate in a fair, orderly and transparent manner, including arrangements to clear and settle transactions.

### Previous feedback

Submitters on the July 2021 consultation provided feedback that, under the current NZ ETS settings, credit and counterparty risks were seen as negligible. Although some participants had been required to adapt their procedures to manage those risks, it had not limited their ability to participate in the NZ ETS. Submitters also suggested that an in-built escrow arrangement within the NZETR may help to mitigate counterparty risk.<sup>25</sup>

Most submitters also favoured voluntary exchange-based trading while leaving space for over-the-counter (OTC) markets to continue to operate.

### Current proposal

The current market governance proposal is to introduce licensing for NZU market operators. It has been considered desirable to develop a centralised clearing and settlement arrangement to handle the transfer of payments and NZUs in a similar manner as financial markets.

The objectives for doing so would be to mitigate credit and counterparty risks, and to improve oversight of price, volumes and trading activity on the secondary market.

The form and structure of any clearing and settlement system will depend on the future state of the secondary market structure. For example, it may look like in-house clearing and settlement systems and processes operated separately by one or more small NZU markets for persons that participate in trading on each particular market (eg, auction houses or small exchanges, where the secondary market has low levels of trading activity and/or liquidity).

In its most sophisticated form, the clearing and settlement system may involve:

- a general centralised clearing (with or without a central counterparty).
- a 'NZU securities' depository function (among other things).

Collectively, these functions:

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<sup>25</sup> An escrow is a contractual arrangement in which a third party receives and disburses money or property for the primary transacting parties, with the disbursement dependent on conditions agreed to by the transacting parties.

- support the management of counterparty risks
- allow multilateral netting of trades
- provide custodial holdings, recording of beneficial and security interests, and transaction settling.

This system may be accessible for all NZU transactions (whether they take place on-market or over the counter).

We seek your feedback on the extent to which you consider it necessary or desirable to facilitate particular forms of clearing and settlement systems and arrangements. This will help us to determine what (if any) changes should be made to the systems-level regulatory settings in the context of the NZU market, and consideration of the costs and benefits of requiring NZU financial product markets to be licensed.

**Question 20**

Do you consider a centralised clearing and settlement system necessary or desirable to manage counterparty, credit and other settlement risks for NZU markets if there are one or more licensed market operators? Why or why not?

**Question 21**

What are your views on whether it should be limited to on-market transactions or should be available for over-the-counter transactions?

**Question 22**

How would the availability of a centralised clearing party benefit and/or impact your business in terms of managing credit and counterparty risk?

# Topic 2: Regulating NZU financial advice, transactional and/or custodial services

## Summary of options

- **Option one: Existing legislation (*status quo*).** The NZU market is partially covered by four Acts that protect market users from poor or misleading advice. The status quo also captures private remedies that exist independently of legislation, such as a claim for breach of contract. This option may not provide adequate coverage from the potential of increasingly poor advice.
- **Option two: Regulating NZU financial advice, transactional and/or custodial services.** Regulating NZU financial advice means that persons who make recommendations or give opinions about buying, selling or holding NZUs would be regulated in a similar manner as under the FMC Act. Obligations for advice providers to retail clients include complying with a code of conduct, meeting standards of competence, operating under a licence from the FMA and belonging to a dispute-resolution scheme. This proposal also tests whether client money and property services as part of the FMC Act should now be considered, as it was not a part of the 2021 consultation.
- **Option three: FMC Act wholesale client settings.** This option assumes that a larger proportion of those receiving NZU financial advice would have a higher degree of experience, compared to clients who receive advice about other financial products. This option proposes that wholesale client settings apply for all NZU market users.
- **Subject to feedback, we recommend progressing with option two: Regulating NZU financial advice, transactional and/or custodial services.**

## Summary of impacts

- Option two provides greater oversight for government agencies, the regulator and the public as to who provides financial advice relating to NZUs, as well as greater ability to monitor compliance with existing laws.
- Option two provides greater oversight of financial advice and additional protections for smaller NZU market users – in particular, increased access to redress for clients of NZU advisers if something goes wrong.
- Option two increases confidence for those receiving advice from NZU advisers, as the advisers would be required to act ethically and have competence in relation to NZUs and would be subject to oversight by the FMA.
- Option two subjects NZU advisers to compliance costs – both internal compliance costs and external direct fees (such as licensing fees, Financial Service Providers Register (FSPR) registration fees, FMA levies, dispute-resolution scheme fees) – which may be passed onto clients.
- While option three would not amount to a big difference for existing wholesale clients, it could impact the advice received from retail clients.

## Objective

We want all persons who interacts with the NZU market to have access to quality advice about buying and selling NZUs. We also want to ensure services relating to NZUs are provided with appropriate levels of care, diligence and skill. To achieve this, the following are required:

- NZU advisers are to be competent and to act ethically. This will enable those who receive financial advice relating to NZUs to have confidence that the advice they receive will help them meet their financial goals.
- Regulatory obligations are to be proportionate, so that financial advice relating to NZUs is accessible at affordable prices.

## What we have heard so far

Stakeholders stated they had not received poor or misleading advice from advisers but acknowledged they were aware of poor advice in the market. However, in 2014 the Ministry for the Environment received complaints of poor advice, which initiated the NZU market governance work programme.

Some stakeholders mentioned that any registration framework and code of conduct for NZU advisers should consider linkages to similar frameworks. In particular, that consideration should be given to the FMC Act and its [Code of Professional Conduct for Financial Advice Services](#).

Submitters also wanted to ensure double regulation was avoided for complementary frameworks such as the Forests Act 1949.<sup>26</sup>

## Options considered

### Option one: Existing legislation (status quo)

Under the status quo, advice relating to NZUs is partially covered by four Acts: the Fair Trading Act 1986, the Forests Act 1949, the FMC Act and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

The status quo also captures private remedies that exist independently of statute, such as a claim for breach of contract.

### Coverage under the FTA

For trade in general goods and services, the FTA seeks to protect consumer interests and to allow businesses and consumers to participate confidently in trade. The FTA does this by prohibiting certain unfair conduct and practices, and providing for proportionate offences, penalties and avenues for consumer redress.

NZU advice remains within the general remit of the FTA as a service (unless parties lawfully contract out).

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<sup>26</sup> See the definition of forestry adviser service in [section 63M](#) of the Forests Act 1949.

Consumer protections are limited, and the key avenue for remedy is to take a claim to the Disputes Tribunal, the District Court or the High Court. The jurisdiction of the Disputes Tribunal is limited to making orders for values and amounts that do not exceed \$30,000; the District Court's jurisdictional limit for such orders is \$350,000; the High Court has unlimited jurisdiction.

As for all services governed by the FTA, the Commerce Commission can:

- receive and investigate complaints
- provide advice and/or warnings
- take enforcement action.

As above, the penalties and offences are designed for general services and are lower than the approaches and maximums set out in the FMC Act for financial products and financial services.

## **Coverage under the Forests Act 1949**

In the case where two parties in the forestry sector contract out of the FTA, there may remain protections under the Forests Act 1949.

In that case, under [section 63V\(2\)](#) of the Forests Act 1949, any person may complain to the Forestry Authority (or the Forestry Authority may itself initiate a complaint) that a person has engaged in unsatisfactory conduct or misconduct in their capacity as a registered person.

If the Forestry Authority is satisfied that a person has, in their capacity as a registered person, engaged in misconduct (as defined in [section 63ZI](#)), the Forestry Authority may consider whether there are grounds to prosecute the person for an offence under [section 63ZK](#). A person who commits an offence under section 63ZK is liable on conviction for a fine (not exceeding \$40,000 in the case of an individual, and \$100,000 in any other case).

## **Coverage under the FMC Act and Financial Service Providers (Registration and Dispute Resolution) Act 2008**

Ancillary services (such as the managing or administering of money) provided in connection with NZ ETS-related transactions by persons that are in the business of providing a 'financial service'<sup>27</sup> are governed by the FMC Act fair-dealing provisions.

There are stronger consumer protections for this component of services, including:

- fair dealing rules that are tailored to dealings in financial products and financial services
- providers are required to register on the Financial Service Providers Register (FSPR)
- providing services to retail clients requires mandatory membership of an approved dispute-resolution scheme.

The FMA has regulatory remit over financial service providers and has access to a broader range of regulatory tools when considering intervening. As well as providing guidance and undertaking investigations, the FMA may issue stop orders to pause or end conduct. These orders can be used to stop or prevent advertising or disclosure that confuses, or is likely to

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<sup>27</sup> As defined in [section 5](#) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

confuse, consumers or investors on matters that influence their investment decisions. For example, the FMA could issue a stop order to restrict the supply, or possible supply, of services that are likely to mislead or confuse in a serious manner.

The FMA may also take prosecutions for breaches of the fair-dealing provisions. As noted above, the offences and penalties are tailored to financial products and financial services, where there is a much greater prospect of financial harm or loss than other types of services.

## **Option two: Regulating NZU financial advice, transactional and/or custodial services**

Under option two, we would extend the regulation of financial advice to persons who, as part of their ordinary course of business, make recommendations or give an opinion about acquiring, disposing of, or holding NZUs.

### **Duties and licensing requirements for NZU advisers**

All duties and licensing requirements are discussed further in the ‘What this proposal means in practice’ section below. At a high level, obligations include the following:

- **Licensing:** Under the financial advice regime, anyone who gives regulated financial advice to retail clients must hold or operate under a licence granted by the FMA.
- **Registration:** All financial service providers are required to register on the FSPR (under the Financial Service Providers (Registration and Dispute Resolution) Act 2008).
- **Fair dealing:** As is applied under the FMC Act, fair dealing includes:
  - not engaging in misleading or deceptive conduct
  - not making false or misleading representations
  - not making unsubstantiated representations.

Fair-dealing requirements for NZU advisers would ensure that ‘NZU financial advice’ is treated on a like-for-like basis with ‘financial advice’, in order to enhance the integrity and confidence of the NZU market.

- **Statutory duties:** In providing financial advice, all financial advice providers must:
  - exercise care, diligence and skill
  - give priority to client’s interests where the provider knows, or ought to reasonably know, there is a conflict between the provider’s and the client’s interests
  - comply with a code of conduct and other statutory duties if they give regulated financial advice to retail clients.

Table 10 below indicates, at a high level, what changes this proposal is intended to make to the current regulatory environment.

**Table 10: Effect of proposed changes on financial advice relating to NZUs**

Service	Activity	Change proposed	Effect
NZU financial advice	Recommendation/opinion to buy/sell/hold NZUs	Yes	Regulate as financial advice relating to NZUs
	Design investment plan that includes NZUs	No	Status quo – already regulated as financial advice
Transactional and/or custodial services	Buying or selling NZUs on behalf of a client (where that involves dealing with client money or NZUs)	For consultation	Regulate as client money and property service
	Holding/administering NZUs on behalf of a client	For consultation	Regulate as client money and property service
NZ ETS advice	Advice about ETS obligations, entitlements, or options	No	Status quo – partly regulated as ‘forestry adviser service’
Direct transactions	Buying/selling NZUs on own behalf	No	Status quo – no limits

We set out below some detailed examples to illustrate how this proposal would affect (or not affect) different persons interacting with the NZU market.

The Crown is broadly exempt from financial advice obligations. For example, the FMC Act is not intended to include communications from or between representatives of the Crown (such as Environmental Protection Authority (EPA) staff) to help NZ ETS participants meet their obligations.

### **Option three: Applying FMC Act wholesale client settings**

We considered the option of regulating NZU financial advice by broadening the application of the settings for wholesale-only clients in relation to other financial products. This alternative option assumes the likelihood that a larger proportion of those receiving NZU financial advice would have a higher degree of experience, compared to clients receiving advice about other financial products.<sup>28</sup> Given uncertain evidence of a problem, regulators can better monitor the level of problems in the market and, if justified, the Government can look to increase the level of regulation at a later stage.

Under this option, persons who provide NZU financial advice could be required to:

- register on the FSPR to provide that type of service
- comply with FMC Act fair-dealing standards
- meet advice duties to put their client’s interests first and to exercise care, skill and diligence.

The objectives in proposing this option are intended to recognise that:

<sup>28</sup> This assumption does not align with preliminary data available on the wholesale vs. retail market split.

- persons who engage with the NZU market, as opposed to other types of financial products, are much more likely to be as sophisticated and experienced as a wholesale investor under the FMC Act (eg, because they own a forestry block)
- the regulatory burden of complying with the obligations for services provided to clients that include retail clients (including mandatory dispute resolution and additional advice duties as outlined [below](#)) is likely to be disproportionate to the benefits intended to be achieved, including reducing the availability of providers willing to provide this type of service
- regulators can better monitor the level of problems in the market and, if justified, the Government can look to increase the level of regulation at a later stage.

In more detail, these components involve the following key features:

- **FSPR registration:** Persons who provide NZU advice must register on the FSPR and pay levies. This would allow regulatory oversight of those registered and minimum character requirements of persons providing this type of advice.
- **FMC Act fair dealing:** This aligns the NZU advice service with other types of financial advice (and with their penalties and offences) but does not materially change the standards currently expected under the FTA. It does allow the FMA to intervene in behaviour that appears to contravene the FMC Act standards.
- **FMC Act advice duties:** Persons who give NZU financial advice are required to:
  - give priority to their client’s interests where they know, or ought reasonably to know, there is a conflict between the client’s interests and the advice-giver’s interests, by taking all reasonable steps to ensure that the advice is not materially influenced by the adviser’s or firm’s own interests
  - exercise the care, diligence and skill that a prudent person engaged in the occupation of giving regulated financial advice would exercise in the same circumstances.

For completeness, this option would not require:

- mandatory membership of an approved dispute-resolution scheme
- licensing by the FMA
- complying with the FMC Act advice duties for retail clients, including:
  - meeting standards of competence, knowledge and skill
  - complying with the [Code of Professional Conduct for Financial Advice Services](#) (including, where the service includes retail clients, having capabilities equivalent to the NZ Certificate of Financial Services (Level 5), version 2
  - ensuring the client understands the nature and scope of advice being provided.

### Question 23

Can you suggest alternative options that would achieve the stated policy objectives?

## Options analysis

Appendix C of this discussion document provides the option and risk analysis tables for topic 2.

Option one, the existing legislation, relies on a patchwork of existing regulation, which provides limited protection to market users. The status quo does not improve on the risks of poor advice and credit and counterparty risks in the NZU market, or provide any positive effect to the impact analysis criteria.

Option two, regulating NZU financial advice, provides a comprehensive protection framework for misleading and deceptive conduct in relation to NZU financial advice. Retail clients receive a high level of protection, while wholesale clients are covered by statutory obligations. This option is more proportional, considering the risk of poor advice compared to the status quo. However, there is a risk that some providers will choose not to provide NZU financial advice to avoid the costs of regulation (or provide advice to wholesale clients only to avoid having to be licensed).

Option two addresses the market risks much better than the status quo and minimises the risks of poor advice and conflict of interest in the NZU market.

Option three, applying FMC Act wholesale client settings, would apply only wholesale protections to both wholesale and retail clients. Retail clients are considered to need additional protections as they generally make up smaller businesses. A disadvantage of option three is that it provides retail and wholesale clients (larger businesses who are better equipped to deal with the risk of poor or misleading advice) with the same level of protection.

This option provides some level of protection for large businesses but is insufficient for small businesses. The obligations are clear for both parties but are not proportional to retail clients. To some degree this is better than the status quo, as it provides some limited protections to clients, but it is not suitable or fair to retail clients.

Option three provides much lower complexity than the status quo through clearer and lighter obligations on parties and lower cost through no licensing. This option also addresses the market risks better than the status quo, as it provides minimum statutory obligations for wholesale and retail clients.

## **Option two is preferred at this stage: Regulating NZU financial advice, transaction and/or custodial services**

We currently consider that the proposed option aligns with the objective for topic 2, in that it satisfies the criteria much better than the status quo for integrity, consistency and proportionality, and market efficiency.

# What this proposal means in practice

## What advice about NZUs is already regulated as ‘financial advice’?

Under [section 431C\(1\)\(c\)](#) of the FMC Act, financial advice includes where a person designs an investment plan for a person that:

- purports to be based on an analysis of the person’s current and future overall financial situation (including investment needs) and the identification of the person’s investment goals
- includes one or more recommendations or opinions on how to realise one or more of those goals.

This part of the definition already applies to NZUs in some situations – for example, where a person, as part of designing an investment plan, includes recommendations to acquire and hold NZUs as an asset within a diversified portfolio in order to achieve future income aspirations.

This proposal is not intended to change how this part of the definition currently applies to the design of an investment plan that includes NZUs.

In the examples set out below, we illustrate the narrow scope of investment-planning services in the context of those buying, selling or holding NZUs. We expect this to only apply to a small range of persons.

## What is intended to be ‘NZU financial advice’?

The activities we are intending to regulate are where, in the ordinary course of business and as a financial advice product, a person is providing opinions or recommendations about acquiring or disposing of (or not acquiring or disposing of) NZUs. In practice, the main type of advice regulated would be advice about whether to buy, sell, or hold NZUs, given the price that is being or may be offered.

This is envisaged to include advice provided to others based on the adviser’s own research and analysis of matters like:

- NZU market activity (eg, buying and selling activity)
- NZU price forecasts and modelling (ie, based on the adviser’s own assumptions and inputs about expected changes in supply and demand for NZUs)

This would also include advice relating to:

- how to trade NZUs (eg, trading on a licensed market or over the counter to achieve a better purchase or sale price, or trading in blocks or a series of smaller trades over time)
- whether the client should trade on a licensed market or over the counter to achieve a better purchase or sale price.

The proposal is also intended to maintain the same or similar exclusions to the definition of financial advice and regulated financial advice as those provided under the FMC Act.

For example, [clause 7 of Schedule 5](#) of the FMC Act provides exclusions from what is ‘financial advice’ for matters that include:

- providing factual information (eg, information about the cost or terms and conditions of a financial advice product, or about the procedure for acquiring or disposing of a financial advice product)
- carrying out an instruction from a person to acquire or dispose of, or not to acquire or dispose of, a financial advice product for that person.

Schedule 5 also provides 11 exclusions from regulated financial advice that include, for example, Crown entities and public sector departments giving financial advice in the ordinary course of business.

In the financial advice regime, a recommendation relating to a kind of financial advice product in general, rather than a particular financial advice product (eg, an opinion about shares generally rather than shares of a particular company), would not be financial advice.

#### Question 24

What are your views on whether these exclusions should, in principle, apply to NZU financial advice? If not appropriate, what modifications or changes do you think are necessary?

## What is proposed to be excluded from being ‘NZU financial advice’?

This proposal is not intended to regulate advice about current or prospective NZ ETS participants’ obligations or entitlements under the Climate Change Response Act 2002 (NZ ETS advice). This general NZ ETS advice includes advice that relates to:

- current or prospective allocations, entitlements and/or surrender obligations in respect of NZUs
- whether or not a participant should register under the NZ ETS in respect to an activity (eg, registering a post-1989 forest for a removal activity)
- complying with obligations in the NZ ETS as a participant or recipient (as defined in the CCRA)
- activities required to calculate NZU surrender obligations
- activities that indirectly result in NZUs being acquired (such as the purchase of a forestry business)
- land encumbrances relating to the NZ ETS
- exiting the NZ ETS.

### *NZ ETS advice generally*

While we are aware that there is presently no targeted occupational regulation of NZ ETS advice for persons who undertake eligible industrial activities or persons that have surrender or repayment obligations for NZUs, we are not intending to include these areas in this proposal.

### *Forestry adviser services*

Forestry adviser services have, in part, been addressed by the occupational regulation of forestry adviser services under the Forests Act 1949.

### *Ancillary services or financial advice provided via other occupations*

Financial advice is not regulated financial advice if it is an ancillary service or provided via other occupations (eg, advice provided by an incorporated law firm or if the person giving advice carries on one of the defined occupations in the FMC Act).<sup>29</sup>

## **Examples of NZU financial advice and NZ ETS advice**

Table 11 and the scenarios below are intended to indicate how this proposal would apply in practice for persons who may deal in NZUs on the supply side and demand side in the NZU market.

**Table 11: Examples of advice included (or partly included) in the proposed definition of NZU financial advice**

Sector	Activity	Outcome
Any	Advising a client to buy, sell, or hold NZUs based on desktop studies into emitters' emissions profiles and devising custom forward NZU price modelling	Regulated as NZU financial advice
Any	Providing advice about NZU market activity to inform when a client should decide to buy NZUs on-market, and that acquiring units on-market is likely to yield the best price	Regulated as NZU financial advice
Any	Preparing recommendations for a client about how to manage and sequence acquisition of NZUs to meet their upcoming NZU surrender obligations	Regulated as NZU financial advice to the extent that the advice relates to buying, selling or holding NZUs <ul style="list-style-type: none"><li>Any advice about how many units the client is required to surrender is out of scope of this proposal</li><li>As part of preparing NZU financial advice, the adviser would consider information (which might be communicated by the client) about how many units the client is required to surrender</li><li>How the adviser considers that information to reach recommendations about when to buy NZUs would be regulated as NZU financial advice</li></ul>
Any	Preparing an investment plan for a client that includes holding NZUs as part of a diversified investment portfolio, or providing advice about a managed investment product that includes holding NZUs	Already regulated as 'financial advice'
Any	Analysis of a company's emissions profile, developing estimates for future NZU surrender obligations, and the design of a strategy to buy and sell NZUs to mitigate financial risk	Partly regulated as NZU financial advice <ul style="list-style-type: none"><li>The advice that applies CCRA obligations to calculate surrender obligations is out of scope of this proposal, but the strategy to buy and sell NZUs is regulated as NZU financial advice</li></ul>

<sup>29</sup> See [Part 2, Schedule 5](#) of the FMC Act for broad exclusions from regulated financial advice and, in particular, see [clause 8, Part 2, Schedule 5](#) for a list of ancillary services and other occupations excluded from regulated financial advice.

### Question 25

Do you agree that the 'NZU financial advice' described in the section 'What is intended to be 'NZU financial advice'?' is the type of advice that should be regulated? (Table 11 provides examples.)

Table 12 and its scenarios are examples of advice we do not intend to regulate as NZU financial advice.

**Table 12: Examples of advice excluded from the proposed definition of NZU financial advice**

Sector	Activity	Outcome
Forestry	Providing advice about NZU entitlement and surrender obligations for a post-1989 forestry block	Regulated as a forestry adviser service under the Forests Act 1949 and not intended to be regulated as NZU financial advice
	Calculating and modelling the economic potential of different tree species, or future revenue from timber and NZUs	Regulated as a forestry adviser service under the Forests Act 1949 and not intended to be regulated as NZU financial advice
Forestry/emitter	Giving advice that a person does not hold a sufficient number of NZUs to meet their surrender obligation	Not intended to be NZU financial advice <ul style="list-style-type: none"><li>• However, any advice regarding a strategy to buy and sell NZUs is intended to be regulated as NZU financial advice</li></ul>
Emitter	Carrying out an assessment of a future emissions profile and devising an estimate of the required number of NZUs to meet surrender obligations over a period of time	Not intended to be NZU financial advice <ul style="list-style-type: none"><li>• This activity does not relate to making an 'investment' in NZUs</li></ul>
Investor/trader	Providing information about how to access the primary or secondary market to trade NZUs	Not intended to be NZU financial advice <ul style="list-style-type: none"><li>• It is factual information and is therefore excluded from the FMC Act scope of financial advice</li></ul>
Any	Summarising price forecasts and information about NZUs from Climate Change Commission reports	Not intended to be NZU financial advice <ul style="list-style-type: none"><li>• This is publicly available information and is therefore excluded from the FMC Act scope of financial advice</li></ul>

### Question 26

Do you agree that the advice excluded from the proposed definition of NZU financial advice is the type of advice that should not be regulated? (Table 12 provides examples.)

## A 'forestry adviser service' and 'NZU financial advice' do not overlap

The proposal to make financial advice relating to NZUs a form of financial advice would mean that only financial advisers could give financial advice relating to NZUs, and only forestry advisers could continue to provide a forestry advice service.<sup>30</sup>

<sup>30</sup> See the definition of forestry adviser service in [section 63M](#) of the Forests Act 1949.

The intention is that there is no overlap between the types of advice regulated by the Forests Act and this proposal. Table 12 above provides examples of advice included (or partly included) and excluded, in the proposed definition of NZU financial advice.

Forestry advisers and NZU advisers would be obliged to:

- make the boundaries of their regulated advice clear
- understand where each type of regulated advice begins, and when they should recommend a differently qualified adviser, if a client seeks it.

If any adviser (forestry advisers or NZU adviser wants to be able to provide both advice services, the adviser may seek to acquire the relevant forestry adviser and NZU financial adviser qualification and be registered and licensed (if applicable) under both schemes.

What regulatory settings would apply to persons providing NZU financial advice?

In general terms, persons who provide a financial advice service must:

- comply with fair-dealing rules
- comply with certain statutory financial advice duties
- if they provide a service to retail clients:
  - comply with additional statutory duties about the provision of financial advice
  - hold or operate under a licence
  - belong to a mandatory dispute-resolution scheme
- register on the FSPR
- pay fees and levies to the FMA.

## **Fair dealing**

This proposal adopts the same requirements as the fair-dealing standards under the FMC Act in relation to financial services, including:

- not engaging in misleading or deceptive conduct
- not making false or misleading representations
- not making unsubstantiated representations.

These obligations are broadly the same as the FTA fair-dealing provisions. However, applying the same concepts as the FMC Act means that the FMA can take enforcement action, and higher maximum penalties would apply. It ensures that 'NZU financial advice' is treated on a like-for-like basis with 'financial advice', to enhance the integrity and confidence of the NZU market in a fair and transparent manner.

## **Licensing**

Under the financial advice regime, anyone who gives regulated financial advice to retail clients must hold or operate under a licence granted by the FMA.

However, providers are exempt from the licensing requirement in respect of a service that is not provided to any retail clients (ie, provided to wholesale clients only), although they may opt for voluntary licensing.

The distinction between retail and wholesale clients also affects the duties that financial advice providers must comply with to give financial advice, and whether or not belonging to a dispute-resolution scheme is mandatory. These definitions are expanded further [below](#).

Licensing can be at the firm level – that is, if a firm employs individuals to give advice on its behalf, then it is the firm that needs to be licensed by the FMA. The firm must take all reasonable steps to ensure its advisers comply with obligations.

Before granting a licence, the FMA must be satisfied about various matters, including that:

- directors and senior managers are fit and proper persons
- the applicant is capable of effectively performing the service
- there is no reason to believe that the applicant is likely to breach its obligations.

Similar requirements for licensing NZU advice businesses would:

- give clients confidence that licensed firms have been through checks conducted by the FMA
- give the FMA further information to assist its monitoring of NZU advisers
- add financial and non-financial compliance costs due to FMA levies, as licence application fees vary based on the class of licence.<sup>31</sup> Applicants also need to spend time and resources to put in place the policies and processes necessary to meet the licensing standard.

The FMA sets out its expectations around licensing requirements in its [Guide to Financial Advice Provider licence requirements and application kit](#).

Financial advice licences also have standard conditions relating to: record-keeping, internal complaints processes, regulatory returns, outsourcing, business continuity and technology systems, ongoing requirements and notification of material changes.<sup>32</sup>

## Duties in providing financial advice

### *All advice providers*

All providers of financial advice must comply with minimum statutory duties that include:

- exercising care, diligence and skill that a prudent person engaged in the occupation of giving regulated financial advice would exercise in the same circumstances
- giving priority to a client's interests where the provider knows, or ought to reasonably know, there is a conflict between the provider's and the client's interests.

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<sup>31</sup> For example, for a business that engages two or more financial advisers, a licence application fee would be \$882.05 (inc. GST). Additional fees may apply if the application assessment time exceeds three hours. The licensing of financial advice providers occurs in two stages – transitional and full licensing – to facilitate a smooth transition from the previous [Financial Advisers Act 2008](#). This proposal assumes only one stage of licensing for NZU advice providers.

<sup>32</sup> [Financial Markets Authority. 2020. Standard Conditions for full financial advice provider licences.](#)

## *Advice to retail clients*

Providers who give regulated financial advice to a retail client must comply with additional statutory duties, including:

- complying with the standards of ethical behaviour, conduct and client care required by the [Code of Professional Conduct for Financial Advice Services](#)
- meeting the standards provided in the code of competence, knowledge and skill in giving advice, and meeting any prescribed eligibility criteria to give advice
- taking reasonable steps to ensure the client understands the nature and scope of the advice being given, including any limitations on the nature and scope of the advice
- making prescribed disclosure information available, including
  - making certain information publicly available (to help the public with choosing an adviser)
  - disclosing certain information to the client (to help potential clients decide whether to obtain advice from that adviser, and to help clients decide whether to follow the advice given)
  - providing, at prescribed times (such as when the provider knows the nature and scope of the advice service the client is seeking), information about the firm's licence, the scope of advice, fees, commissions, conflicts, disciplinary history, and conduct obligations and complaints process.

The Code of Professional Conduct for Financial Advice Services contains nine standards and, among other matters, sets out the following:

- The standard of general competence, knowledge and skill means that the person has capabilities *equivalent* to the New Zealand Certificate in Financial Services (Level 5), version 2.<sup>33</sup>
- Individuals are required, at least annually, to plan for and progressively complete learning activities designed to ensure they maintain the competence, knowledge and skill for the financial advice they give, as well as an up-to-date understanding of the regulatory framework for financial advice in Aotearoa New Zealand.

It is proposed that these obligations also apply to persons that provide NZU financial advice.

## **Registration and dispute resolution**

All financial service providers are required to register on the FSPR<sup>34</sup> under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

In practice, the following would apply under the NZU financial advice proposal:

- For advice to retail clients, both the financial advice provider and individual advisers<sup>35</sup> would be required to register on the FSPR. Registration and annual confirmation fees

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<sup>33</sup> Approved by the New Zealand Qualifications Authority in January 2019 (NZQA reference 2315).

<sup>34</sup> A publicly searchable register of all financial service providers in Aotearoa New Zealand.

<sup>35</sup> Under the financial advice regime, an individual 'nominated representative' can give advice of limited scope under the control of the licensed provider, and that individual is not required to be registered. We assume that nominated representative arrangements are unlikely to be common in relation to NZU advice.

would be payable.<sup>36</sup>

- Where a provider gives advice only to wholesale clients, only the provider/firm needs to register.

Registration enables government agencies and the public to know who is providing financial advice services and includes criminal history checks on the applicant and its directors/senior managers/controlling owners.

Where financial services are provided to a retail client, the provider must belong to an approved dispute-resolution scheme. This requirement does not apply to financial services provided to a wholesale client.

If a provider gives poor or misleading advice, the retail client can bring a complaint to the provider's internal complaints-handling process. If the internal complaints-handling process does not resolve the complaint, it can be forwarded to the provider's dispute-resolution scheme at no cost to the client.

The scheme can consider breach of contract, industry codes and legal obligations. Depending on the severity of the complaint, the findings of the scheme can result in a range of orders, including compensation.<sup>37</sup> Providers are required to pay an annual fee to belong to a scheme and an investigation fee per complaint (the fee varies by scheme).

## Meaning of wholesale and retail clients

The regulation that applies to services provided to retail clients is significantly higher than for wholesale clients. This is because wholesale clients are generally considered to have greater experience in investing, financial expertise and wealth. Typically they are also better placed than retail investors to assess risks and seek additional information (including financial advice) where required, and therefore need less protection.

The meaning of 'wholesale client' is set out under clauses 37–41 of [Schedule 1 of the FMC Act](#) as a person (including entities controlled by the person and, as relevant, on a consolidated basis) who meets any one of the following summarised criteria:

- **Investment business:** A person who is, for example, a principal business investing in financial products, a registered bank, a financial adviser or issuer of derivatives.
- **Investment activity criteria:** A person who has, within the previous two years, owned a portfolio of (or carried out one or more transactions to acquire) specified financial products<sup>38</sup> of a value of (or where the amount payable under those transactions was) at least \$1 million (in aggregate).
- **A large person:** A person who (including entities controlled by the person and, as relevant, on a consolidated basis) had net assets in excess of \$5 million as at the last day of each of the two most recently completed financial years.

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<sup>36</sup> Fees apply for the firm and each adviser. The registration fee is \$345 plus a \$40.25 criminal check fee per person (eg, per director) and an annual confirmation fee of \$86.25.

<sup>37</sup> Up to \$200,000 or \$350,000, depending on the scheme.

<sup>38</sup> This currently includes equity securities (eg, shares), debt securities (eg, bonds), managed investment products and derivatives, but excludes interests in retirement schemes and some other simpler financial products, such as bank term deposits. See full list of exclusions at [clause 46A, Schedule 8 of the Financial Markets Conduct Regulations 2014](#).

It may be simpler for our proposal to adopt the same wholesale/retail distinction above for NZU financial advice. Using different wholesale/retail thresholds could introduce complexity, particularly if it leads to the same person being a retail client for one purpose (getting NZU financial advice) but a wholesale client for another purpose (getting financial advice about NZU derivatives or about any other financial product).

If adopting the same definitions (eg, if NZUs were a specified financial product for the purpose of the investment activity criteria described above, and thresholds were otherwise unchanged), that means a person who held more than \$1 million of NZUs at any point in the past two years would be treated as a wholesale client.

We are conscious this could mean a number of small forestry participants would not benefit from the full protections of this proposal. We also note that the FMC Act thresholds were developed in the context of parties who buy or hold investment financial products generally by choice, whereas in NZU markets some parties need to hold NZUs to meet surrender obligations.

We seek feedback on whether the existing FMC Act distinction is appropriate in the context of NZUs.

#### **Question 27**

Do you consider that applying the wholesale client definition to NZU financial advice is appropriate? Why or why not?

#### **Question 28**

What changes (if any) would you have to make to your business to accommodate the difference in the obligations between these two classes of clients?

#### **Question 29**

What are the expected costs and benefits to your business of the proposed new obligations in relation to regulating NZU financial advice, transactional and/or custodial services?

## **Professional training and qualifications about the NZ ETS**

There is a current gap between those who provide NZU advice and their qualification credentials. For example:

- forestry advisers do not explicitly have NZ ETS, NZU market or financial training in their qualifications
- financial adviser qualifications do not entail NZ ETS or NZU market training
- there is a general lack of formal NZ ETS or NZU market training across NZ ETS information providers.

A standardised qualification providing targeted professional modules would bridge the gap between the advice currently given to clients on how to manage NZUs and its financial implications.

#### **Question 30**

What are your views about whether requiring a minimum qualification would help improve the quality of NZU financial advice, given the types of activities involved in that advice?

## Fees and levies

The FMA is funded through a combination of levies charged to financial markets participants, Crown funding, and licensing fees.

The FMA has a cost-recovery model for the licensing and regulatory oversight of the financial advice sector. Under this proposal, no change is intended to the way FMA currently collects fees and levies for this sector.

The size of any levies for NZU financial advice providers would be considered later. If NZU advisers and financial advisers are subject to similar levels of regulation by the FMA, it may be appropriate that NZU advisers pay similar FMA levies.<sup>39</sup>

For these financial advice providers that require a licence, the minimum application fees are:

- **Class 1 licence (sole-advisers):** \$703.80 (includes up to two hours' assessment time)
- **Class 2 licence (businesses that engage more than one adviser):** \$882.05 (includes up to three hours' assessment time)
- **Class 3 licence (large organisations with nominated representatives):** \$1,060.30 (includes up to four hours' assessment time).

Additional fees may apply, at a rate of \$178.35 per hour, if the application assessment exceeds the allocated hours.

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<sup>39</sup> The annual levies that are payable for financial advice providers are currently \$449.65 for each licensed provider and \$460 for each adviser engaged by the licensed provider. Levies for wholesale advice providers are \$759 each (with no levies for individual advisers giving advice on behalf of wholesale advice firms).

### Question 31

Are the costs of licensing and other obligations under the FMC Act appropriate for NZU financial advice?

### Question 32

Are there likely to be impacts on availability of advice? For example, if you are an NZU adviser, would you consider choosing not to provide NZU advice to avoid the burden of licensing?

## **Should client money or property services apply to the NZU market?**

We have received complaints of NZETR account operators withholding access to NZUs from account holders. We want to understand the gravity of this risk in the NZU market and possible solutions to mitigate this risk.

Persons who receive client money, or client money in connection with a financial advice product, are subject to the client money or property service regime under the FMC Act. This regime is not part of financial advice regulation. It imposes key duties and obligations to help ensure providers meet minimum conduct, disclosure and record-keeping standards (among other things).

However, there are material differences between the holding of client money and client NZUs, compared with other financial products under the FMA regime, which require further thought. These differences are:

- how ownership of NZUs is recorded, managed and administered compared to other financial product markets
- the role of account operators in the NZETR.

While client money or property services for NZUs were not proposed in the previous 2021 market governance consultation, the purpose of looking at it in this topic is to consider consistent treatment between persons providing client money or property services in relation to financial advice products (eg, shares) and persons providing equivalent services in the NZU market.

As part of this discussion document, we seek views on what role (if any) a client money and property regime should play in the NZU market.

## **What is a client money or property service?**

At a high level, a person provides a client money or property service by:

- receiving money from a client (or from a person on the client's behalf) in connection with the acquiring, holding or disposing of a financial advice product
- receiving property from a client (or from a person on the client's behalf) that is a financial advice product, a beneficial interest in a financial advice product, or in connection with a financial advice product
- holding, paying, or transferring that client money or client property.

It includes a custodial service, whereby a person holds the client money or client property on trust for, or on behalf of, a client (or another person nominated by the client).

Broadly speaking, under financial markets legislation, a custodian is a provider who holds money or property for clients, rather than someone who merely executes orders to pay or transfer money or property to another person. Providing a custodial service is when a person:

- holds client money or client property on trust for a client (Person A) or another person nominated by Person A (Person B) under an arrangement between Person A and Person B
- holds client money or client property on trust for another person with whom Person A has an arrangement.

In practical terms, if NZUs were to be included within the definition of a financial advice product, then client money or property services could include:

- receiving money or property in connection with the acquisition or disposition of a client's NZUs (eg, the purchase, sale or transfer of NZUs), and holding, paying or transferring that money or property
- receiving payment from a client to acquire NZUs on their behalf
- holding and/or administering a portfolio of a client's NZUs (where, for example, a firm holds legal title to the NZUs on trust for the client who owns the beneficial interest).

A service is a regulated client money or property service if it is not excluded under [Part 3 of Schedule 5](#) of the FMC Act (which relate to, for example, the Crown or ancillary services such as conveyancing).

## **What regulatory obligations would apply to a client money or property service?**

Client money or property service providers do not require a licence to operate. They must, however, comply with a set of statutory obligations and register on the FSPR.

### *Conduct obligations*

All providers of regulated client money or property services must:

- exercise the care, diligence, and skill that a prudent person engaged in the business of providing the service would exercise in the same circumstances
- not receive client money or client property for the acquisition of a financial product if the provider knows, or ought to reasonably know, the product was made under an offer that contravenes the FMC Act.

Providers of regulated client money or property services to retail clients (as defined [above](#)) have additional duties to:

- make prescribed disclosures to the retail client before receiving client money or property (or, if not practicable, as soon as practicable after receiving the same)
- not make false or misleading statements or omissions in the prescribed disclosures.

There are currently no prescribed disclosures.

## Handling obligations

Some providers (such as those who provide these services to a retail client) must also comply with obligations for handling client money and client property, including:

- paying client money into a separate trust account in Aotearoa New Zealand and ensuring the money or property is held on trust for the client
- account properly (or ensure the account is properly made) to the client for that client money
- keeping, or ensuring there are kept, trust account records that clearly disclose the position of the client money in the trust account (and/or the equivalent records for client property)
- must not use client money or client property for any other purpose than as expressly directed by the client.

## Custodians

Custodians also have obligations to:

- report to clients about their money and property held
- reconcile records
- obtain and submit to the FMA an annual assurance report from an auditor qualified to carry out audits under the FMC Act in relation to the custodian's processes, procedures and controls.<sup>40</sup>

## Registration costs

All registered financial service providers must pay registration and annual fees and levies. Table 13 summarises the fees and levies for financial service providers. Table 14 details the fees and levies for custodians and client money or property services. Additional administrative costs can be incurred in the form of time spent to meet obligations.

**Table 13: Registration fees and levies for financial service providers**

Service	Total incl. GST
Application fee	\$345.00
Criminal history fee (per person)	\$40.25
FMA levy	\$690.00

**Table 14: Annual FMA levies for custodians and client money or property services**

Financial service	Definition	FMA levy incl. GST
Custodians	Persons who act as a custodian or provide custodial services	\$13,685
Client money or property services	Providers of regulated client money or property services (other than custodians)	\$4,140

<sup>40</sup> [Regulations 229P to 229V of the Financial Market Conduct Regulations 2014.](#)

## **What types of services might be impacted by a proposal to regulate client money or property services in the NZU market?**

If this proposal is included for financial advice providers of NZUs, it is expected to relate to persons who are in the business of receiving client money or NZUs, and of the holding, payment or transfer of that client money or NZUs.

However, we are conscious the NZU market has material differences, compared to other financial product markets, in how the ownership of NZUs is recorded, managed and administered.

### *NZETR accounts and NZU transactions*

Persons are required to have an account in the NZETR to be able to own or trade NZUs. Different types of persons may hold an account, such as individuals, companies, incorporated trusts or unincorporated organisations of people and entities (eg, joint ventures).

Account holders may also appoint one or more people as account operators who may, independently and without supervision:

- manage the account holder's emissions units (transactions, surrenders or repayments of emission units)
- complete applications for industrial allocations for emissions units
- have an option for account operators to participate in NZ ETS auctions.

These features, which have similarities to share registry services, separate the management of property from money (used, for example, to complete a transaction).

### *Potential effect of client money or property services regulation*

It is currently unclear how the client money or property service provisions will be structured if they are applied to adviser framework for NZUs.

Further, given the role of account operators, it is possible that these obligations may not be appropriate if NZUs were treated as financial products, because those operators have authority to manage NZU holdings without holding legal title. However, the operators may be captured, to the extent they receive client money and carry out payment in order to execute the transaction(s).

We therefore seek your feedback on:

- what role (if any) a client money and property regime should play in the NZU market
- whether and to what extent similar risks to persons handling client money and/or property exist in NZU markets, as compared with financial products
- whether and to what extent client money or property services should be tailored to apply to NZU markets, particularly in light of the proposal to introduce licensed market operators.

**Question 33**

We have received complaints of NZETR account operators withholding access to NZUs from account holders. As an account holder, do you think there is a risk of NZETR account operators withholding such access? Regulating NZETR account operators may not resolve this type of issue; however, is it reasonable for NZETR operators to be regulated under a client money and property services framework to ensure transparency and integrity when managing NZUs?

**Question 34**

Is it appropriate to consider applying client money and property service regulation to persons other than account operators in the NZ ETS? If so, what client money and property service obligations are appropriate in relation to NZUs?

**Question 35**

Are the existing protections (to the extent applicable) under the FTA and Trusts Act 2019 (including obligations for those holding money or property on trust to act honestly and in good faith, and use powers for a proper purpose) sufficient to address the risks in the NZU market?

**Question 36**

If applied, would your business be covered by the definition of custodial service or otherwise by the meaning of client money or property service?

**Question 37**

If you are currently an account operator in the NZETR, how would you be impacted (if at all) by the proposal to regulate client money or property services?

# Topic 3: Improved transaction reporting

## Summary of options

- **Option one: Current reporting obligations (*status quo*).** This includes the collection and recording of activities that are reported to the EPA. The status quo currently provides no visibility on price and value information, which would be useful for market efficiency and investigating market misconduct.
- **Option two: Improved transaction reporting.** This would involve adding additional reporting fields on:
  - price of NZUs or total value of the transaction
  - whether the trade is with someone else or between the transactor's own accounts
  - the transactor's primary reason for holding an account.

Collecting this additional transaction information would provide greater access to useful data.

- **Option three: Full transaction reporting.** This would involve adding additional reporting fields that replicate many prescribed wire transaction reporting obligations in the AML/CFT Act.
- Subject to feedback, we recommend progressing with option two: Improved transaction reporting.

## Summary of impact

- Option two would require all NZU secondary market users to report additional transaction details.
- Option two would assist the regulator to detect fraudulent activity or price manipulation.
- Both options two and three would provide price and value of NZU transactions, which would be visible to the Government. Price or value details can improve price discovery for the wider NZU market.
- Options two and three would require OTC trades to be submitted manually to the NZETR.
- For all options, the individual and commercially sensitive information collected would remain non-public and subject to the NZ ETS confidentiality obligations on regulators.
- Option one does not provide sufficient information to detect misconduct.

## Objective

The objective of improved transaction reporting is to increase transparency in the market and address information asymmetry currently seen in the NZU market.

## Reducing information asymmetry in the NZU market

Information asymmetry occurs when some parties have access to useful market information which, if public, would affect NZU buying and selling decisions.

Information asymmetry is a problem because it can reduce confidence in the NZU market and lead to adverse selection.

Adverse selection occurs when a buyer or seller (Person A) perceives that the other party (Person B) has more useful market information. To compensate:

- an NZU seller may increase the price of their NZUs to offset the risk of uncertainty
- an NZU buyer may reduce the price they are willing to pay for NZUs, to offset the risk of uncertainty
- the incentive to engage in the NZU market is reduced overall, reducing the pool of buyers and sellers.

Ultimately, the price of NZUs is suboptimal because market risk is implicitly incorporated into the price due to market uncertainty. We are seeking ways to improve transparency and confidence in the NZU market.

There are two viable solutions to combat information asymmetry and adverse selection, including:

- bridging the information gap
- increasing monitoring and oversight to protect market users.

## What we have heard so far

In the 2021 consultation,<sup>41</sup> the Government consulted stakeholders on 'full transaction reporting'.<sup>42</sup>

There was a mixed response from stakeholders and many did not support full transaction reporting. Other stakeholders stated they were comfortable with transaction reporting on a confidential basis. These stakeholders generally agreed this information could assist a regulator in preventing market manipulation and fraud.

## Options considered

### Option one: Current reporting obligations (status quo)

NZU market users in the NZ ETS already collect and record information on their activities (either on emissions or on the carbon dioxide equivalent removals their activities negate) and provide it to the EPA (or the Ministry for Primary Industries, in the case of forestry activities).

Currently, participants in the NZ ETS are required to:

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<sup>41</sup> Above, n 3.

<sup>42</sup> This option would replicate many prescribed transaction reporting obligations in [Part 1 of the Anti-Money Laundering and Countering Financing of Terrorism \(Prescribed Transactions Reporting\) Regulations 2016](#).

- apply to open a holding account in the NZETR
- register as a participant
- file an emissions return
- if necessary, surrender, repay, or receive units.

The NZETR records and tracks all emission units used in the NZ ETS. As such, it holds a great deal of data that is useful for the NZU market. At present, the NZETR collects the following information for transactions:

- the parties involved in the trade
- the number of units in the trade
- the time and date of transaction
- who set up the transaction, who authorised it, and how they got their transaction authorisation code.

## **Option two: Improved transaction reporting**

Improved transaction reporting would require the following additional fields to be recorded and tracked in the NZETR for all NZU trades:

- the price of NZUs or total value of the transaction
- whether the trade is with someone else or between the transactor's own accounts
- the transactor's primary reason for holding an account.

We propose that improved transaction reporting would apply to all NZU trades, to increase transparency. Collecting this additional transaction information would provide greater access to useful data.

## **Option three: Full transaction reporting**

In 2021, the Government consulted on a proposal to introduce full transaction reporting for NZU transactions, as mentioned [above](#).

This option proposed replicating many prescribed wire transaction reporting obligations in the AML/CFT Regulations,<sup>43</sup> including:

- transaction details
- transaction details in relation to the originator or beneficiary
- customer details.

The proposed option aligns with the objective for topic 3, in that it satisfies the criteria much better than the status quo for integrity and market efficiency, and better for clarity and transparency.

However, stakeholder feedback did not favour full transaction detail reports.

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<sup>43</sup> See [Part 1 of Schedule 2 of the Anti-Money Laundering and Countering Financing of Terrorism \(Prescribed Transactions Reporting\) Regulations 2016](#).

## Options analysis

Appendix D of this discussion document provides the option and risk analysis tables for topic 3.

Option one, the status quo, does not meet the criteria, nor does it improve the risk of potential lack of transparency in the NZU market. Option one is insufficient to mitigate market risks, as the current transaction reporting does not supply the Government with sufficient information to have oversight and transparency of the market.

Option two, improved transaction reporting, provides the Government with additional information to detect misconduct, which increases the integrity of the NZU market. The collection of this information fills gaps, which is a proportional response to the risks when compared to the proposals in option three. The market information can support the regulator to detect misconduct, and improve price discovery, both of which increase market efficiency.

Improved transaction reporting provides key information relating to OTC trades that contribute to the risk of potential lack of transparency in the market.

Option three, full transaction reporting, is administratively complex compared to the status quo and is not aligned with other financial market reporting. However, it does provide high integrity and market efficiency, albeit at an administrative cost to market users.

Full transaction reporting provides a complete, detailed oversight of OTC trades occurring in the NZU market, which greatly improves the risk of potential lack of transparency in the market.

## Option two is preferred at this stage: Improved transaction reporting

We currently consider the proposed option aligns with objective for topic 3, in that it satisfies the criteria much better than the status quo for integrity and market efficiency. It also satisfies the criteria better than the status quo for consistency and proportionality and clarity and transparency.

## What this proposal means in practice

Improved transaction reporting would require manually reporting the additional three fields when completing an NZU transaction over the counter. This will involve completing three additional fields when completing a transaction report via the NZETR.

Alternatively, trading NZUs through the optional centralised exchange would automatically report the NZUs or value of the transaction, volume and unit type on behalf of the buyers and sellers.

The rationale for collecting more transaction information is as follows:

- Recording and tracking the price of NZUs via the NZETR helps create a reliable price signal, if published. This price signal helps inform buying and selling decisions, while minimising the cost impact of the carbon price. Given all transactions are recorded and tracked via the NZETR anyway, including an additional field to collect price and/or value information is among the most cost-effective and low-burden methods to improve transaction reporting.

- With the collection of price information, it is also important to be able to distinguish what is a market transaction with a market price, or a transfer of units between own accounts. In the former case, the price and volume information continue to be a reflection of trading activity in the market.
- Some stakeholder submissions to the 2021 market governance consultation suggested it would be useful to record transaction by stakeholder type (ie, whether the buyer or seller was a forester, financial intermediary, or a participant with surrender obligations under the CCRA). The rationale for this was that there are now more different types of people trading NZUs in the NZU market than at its inception, and some of those traders do not have surrender obligations under the CCRA.

## Bridging the information gap by publishing more information

To support efficient markets, relevant and useful market information must be available to help NZU market users understand overall supply and demand conditions in the market.

We consider a method to improve market efficiency further is to support the EPA in publishing (anonymised and in aggregate) some of the useful market information collected.

Markets are efficient when they achieve allocative efficiency and efficient price discovery.

- **Allocative efficiency** means that the market channels resources, such as NZUs, to their highest value uses, and where emissions are reduced by those best placed to abate, at the best time.
- **Efficient price discovery**, whether explicit or inferred, means the price of NZUs needs to reflect all available information – including the price at which other buyers and sellers are selling NZUs.

The EPA already publishes a range of NZU market data, such as transaction trends, transactions by volume, emissions units transferred and privately held units.<sup>44</sup> We propose that the EPA could also be empowered to publish additional reports, including:

- an end-of-day price for all NZU transactions in the NZETR
- the number of transactions, and the volume bought and sold, between accounts (identified using the 'with someone else' field), as distinguishing between the two types of trades helps inform reliable price and volume signals
- the types of NZU market users – which would help identify market sentiment and provide supply and demand indicators relevant to sale and purchase decisions.

In doing so, we would be mindful of privacy and confidentiality obligations, so as to not expose the buying and selling activities of NZU traders. Publishing this data would help reduce information asymmetry in the NZU market.

The EPA would continue to oversee NZ ETS reporting, including new information on price, who the trade is between, and the type of stakeholders involved in the transaction. Collecting this additional information supports the EPA in their role of monitoring and providing oversight of

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<sup>44</sup> See <https://www.epa.govt.nz/industry-areas/emissions-trading-scheme/market-information/>

trades. This provides additional oversight to guard against the risks of manipulation of the price, insider trading and anti-competitive conduct.

**Question 38**

How would the additional transaction-reporting requirements impact your business?

**Question 39**

How would publishing more market information about NZU prices help you understand overall supply and demand conditions in the NZU market?

# Topic 4: Applying the AML/CFT Act framework

## Summary option

- No further AML/CFT obligations will apply to the NZU market beyond what already applies.
- This section describes how the AML/CFT Act currently operates and captures particular financial activity in the NZU market, and who might be regulated.
- Alternative options to the status quo have not been considered. This topic serves as a reminder of AML/CFT obligations.

## Summary of impact

- The purpose is to detect and deter money laundering and terrorism financing within the NZU market.
- Employing the status quo means highlighting how the AML/CFT already applies to the NZU market. There may be parties who did not know they are currently regulated.
- Those who are regulated entities under the AML/CFT Act are regulated based on captured activities.

## Objective

Our objective is to better communicate how the AML/CFT Act captures activities of interest within the NZU market to deter money laundering and financing of terrorism.

We propose to introduce no further AML/CFT obligations to the NZU market beyond what already applies at present.

## What we have heard so far

Stakeholder feedback from the 2021 consultation<sup>45</sup> noted that adequate frameworks already exist in the FMC Act and AML/CFT, which are better suited to address misconduct.

## Describing the AML/CFT Act

### Supervisors

The AML/CFT Act and its associated regulations have a role in the activities surrounding any financial product market, by placing obligations on Aotearoa New Zealand's financial institutions to detect and deter money laundering and terrorism financing.

The purpose of the AML/CFT Act is to:

- detect and deter money laundering and the financing of terrorism

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<sup>45</sup> Above, n 3.

- maintain and enhance Aotearoa New Zealand’s international reputation
- contribute to public confidence in the financial system.

There are three supervisors responsible for monitoring and enforcing the Act: the FMA, the Reserve Bank and the Department of Internal Affairs.

These supervisors actively cooperate with each other, with the New Zealand Police’s Financial Intelligence Unit, and with the Ministry of Justice (which administers the AML/CFT Act). The Financial Intelligence Unit also publishes guidance information for reporting entities on their obligations to report suspicious activities and prescribed transactions, and how to meet those obligations.

## Reporting entities under the AML/CFT Act

The AML/CFT Act applies to reporting entities as defined in the Act. These reporting entities include financial institutions that engage in one or more of a defined list of financial activities (described [below](#)), which will include some activities related to the NZU market.

An example of financial activity that may occur in the NZU market, which **is** captured in by the AML/CFT Act today:

- when a client receives a service that is investing, administering or managing money on that client’s behalf.

An example of a financial activity that may occur in the NZU market, which is **not** captured by the AML/CFT Act today:

- simply providing regulated financial advice (eg, a recommendation to acquire shares in Company X), where the adviser does not handle client money or cash (because the client will carry out the transaction through a third party).

Even though NZUs are not a listed financial product under the FMC Act, nor are they expressly mentioned in the AML/CFT Act, certain NZU market activities in the marketplace can be captured.

## Scope

The AML/CFT Act already applies to activities related to the NZU market – in particular where persons handle or invest money on behalf of others, or carry out other types of financial activities. This is the current scope of the AML/CFT legislation as it applies to financial product markets generally.

At this time, it is not necessary to extend the scope beyond the way the AML/CFT Act already applies in the NZU market.

## Form of regulation and oversight

AML/CFT legislation is a risk-based regime. It allows businesses to determine the level of risk they are exposed to, in the particular circumstances of their business, and tailor their compliance practices accordingly.

User guides and regular guidance is published to ensure that regulation is effective, and that entities understand their obligations.

## Obligations under the AML/CFT Act

Below are some basic obligations for a reporting entity identified under the AML/CFT Act:<sup>46</sup>

- Written risk assessment
- Compliance programme
- Customer due diligence (CDD) (customer identification and verification and ongoing CDD)
- Annual reporting obligations
- Independent audit obligations
- Prescribed transaction reporting obligations

## What this means in practice

### Financial advice providers (and financial advice relating to NZUs)

In this discussion document, we have proposed that those who give financial advice relating to NZUs are regulated in the same manner as a financial advice provider. It is important to note that not all who give financial advice (and financial advice relating to NZUs) are captured by the AML/CFT Act.

### Not all financial advice providers are captured by the AML/CFT Act

This is because the AML/CFT Act is primarily applicable to those who handle money, cash or valuable assets on behalf of other persons. Only some financial advice providers (eg, those who handle client money or purchase securities on behalf of clients) are subject to the AML/CFT Act in this context.

#### Example

If a person today in the ordinary course of business invests, administers or manages funds or money on behalf of another person (eg, in the process of buying or selling NZUs), they are identified as a financial institution and are subject to AML/CFT Act obligations.

Alternatively, a financial advice provider who only gives advice about acquiring or disposing of NZUs (and does not deal with a client's money) is not captured under the AML/CFT Act.

**It is important to note** that individuals registered as financial advisers are not reporting entities under the AML/CFT Act, simply by being a financial adviser.

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<sup>46</sup> A detailed guideline is available: [Financial Markets Authority, Reserve Bank of New Zealand, Internal Affairs. 2022. AML/CFT Programme Guideline](#). Further information is also available on the [FMA website](#).

## Licensed market operators

The status quo proposal will apply existing AML/CFT obligations to new actors – for example, persons who become licensed NZU market operators and who fall under the definition of a ‘financial institution’, which is detailed in the capture points [below](#).

## Capture points for AML/CFT framework within the NZU market

The AML/CFT Act specifies a list of financial activities that can help an NZU market user to determine what type of actions would mean they are captured.

The Act provides a list of activities which, if carried on in the ordinary course of business,<sup>47</sup> will mean a person is a ‘financial institution’ and therefore a reporting entity under the AML/CFT Act. Table 15 sets out the description of the activities, contained in [section 5\(1\) of the AML/CFT Act](#). The Act also specifies the inclusion of a person or class of persons declared by regulations to be a financial institution for the purposes of the AML/CFT Act (and the exclusion of the inverse).

**Table 15: Activities undertaken by an AML/CFT reporting entity**

Activities of a financial institution (described by AML/CFT Act)
• accepting deposits or other repayable funds from the public
• lending to or for a customer, including consumer credit, mortgage credit, factoring (with or without recourse), and financing of commercial transactions (including forfeiting)
• financial leasing (excluding financial leasing arrangements in relation to consumer products)
• transferring money or value for, or on behalf of, a customer
• issuing or managing the means of payment (eg, credit or debit cards, cheques, traveller’s cheques, money orders, bankers’ drafts, or electronic money)
• undertaking financial guarantees and commitments
• trading for, or on behalf of, a customer in any of the following, using the person’s account or the customer’s account: <ul style="list-style-type: none"><li>– money market instruments (eg, cheques, bills, or derivatives)</li><li>– foreign exchange</li><li>– exchange, interest rate or index instruments</li><li>– transferable securities</li><li>– commodity futures trading</li></ul>
• participating in securities issues and the provision of financial services related to those issues
• managing individual or collective portfolios
• safe keeping or administering of cash or liquid securities on behalf of other persons
• investing, administering, or managing funds or money on behalf of other persons
• issuing, or undertaking liability under, life insurance policies as an insurer
• money or currency changing

A designated non-financial business or profession may also be captured as a reporting entity. This would include:

- a law firm
- a conveyancing practitioner or an incorporated conveyancing firm

<sup>47</sup> Financial Markets Authority, Reserve Bank of New Zealand, Internal Affairs. 2017. Interpreting “ordinary course of business” Guideline.

- a real estate agent
- a trust and company service provider/

Certain obligations will apply to anyone who identifies that their organisation undertakes these activities. More information about how to fulfil these obligations can be found in the section on ‘Guidance – understanding AML/CFT obligations’.

### *OTC trades in the NZU market*

OTC or bilateral trades in the NZU market would not be captured under the AML/CFT Act. Although the underlying transfer of funds with value (eg, through a bank) are captured, it is the bank which holds AML/CFT reporting obligations.

#### Examples of NZ ETS forestry interactions with the AML/CFT Act

- (a) *Family member A manages Family member B’s accounts on their behalf, and NZUs are traded in the NZU market. Are they captured under the AML/CFT framework?*

The AML is only interested in people who do activities **in the ordinary course of business**. Family member A managing accounts on behalf of Family member B would therefore not be captured as a reporting entity.

- (b) *A land sale has NZUs included as part of the sale at a \$0 value. While this is a zero-dollar trade, NZUs still have a price in the market – are they captured under the AML/CFT framework?*

The sale and purchase of land (and any associated property, such as NZUs) is captured by the AML/CFT Act if there is a law firm or conveyancing practitioner processing the sale. While units are forming part of the sale price in some regard, there is no specific financial activity captured.

However, if two persons bought and sold NZUs between themselves, those persons would not be reporting entities under the AML/CFT Act, but the bank through which payment is processed would be subject to AML/CFT obligations as a reporting entity.

## **Obligations when captured**

If captured, basic obligations imposed on reporting entities in the AML/CFT framework include:

- assessing the money laundering and financing of terrorism risk that they may reasonably expect to face in the course of their business
- establishing, implementing and maintaining an AML/CFT programme (procedures, policies and controls) to detect, manage and mitigate the risk of money laundering and the financing of terrorism
- CDD (identification and verification of identity)
- ongoing CDD
- suspicious activity reporting
- record-keeping.

Note that reporting entities have considerable flexibility, within the limits prescribed by the AML/CFT Act, in how they meet their obligations.

## **Guidance – understanding AML/CFT obligations**

Guidelines are available and are designed to help develop and implement AML/CFT programmes.

The AML/CFT programme is based around the fact that no one understands a business better than its operator and, to that end, the supervisors of the programme have provided guidance.<sup>48</sup>

## **How other countries apply AML/CFT provisions to their carbon markets**

Since 1990, the EU has modernised its regulatory framework to deter money laundering and financing of terrorism. The latest developments from 2019 to 2022 include the publication of multiple reports, an action plan, ambitious legislative packages, and user manuals. The European Commission has published information on how it is fighting against money laundering and the financing of terrorism.<sup>49</sup>

## **No alternative options are proposed, because they could not feasibly be included in the wider NZ ETS market governance proposal at this time**

Under this topic, detailing the status quo is only intended to serve as a reminder of how the AML/CFT Act framework currently works in the NZU market. Additional obligations in this space have not been suggested, as they would likely have implications throughout the AML/CFT Act, which has recently undergone review.

### **Question 40**

How can we support you to better understand your AML/CFT obligations?

### **Question 41**

Are the current AML/CFT settings that apply to the NZU market appropriate to safeguard against risks of money laundering and the financing of terrorism? If not, how could they be improved?

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<sup>48</sup> A detailed guideline is available: [Financial Markets Authority, Reserve Bank of New Zealand, Internal Affairs. 2022. AML/CFT Programme Guideline](#). Further information is also available on the [FMA website](#).

<sup>49</sup> European Commission. *EU context of anti-money laundering and countering the financing of terrorism*. Retrieved from [https://finance.ec.europa.eu/financial-crime/eu-context-anti-money-laundering-and-countering-financing-terrorism\\_en](https://finance.ec.europa.eu/financial-crime/eu-context-anti-money-laundering-and-countering-financing-terrorism_en) (6 November 2022).

# Summary of engagement questions

## Topic 1: Regulating the NZU market based on financial legislation

1. What are your views on the proposed insider-trading prohibition?
2. In what way could these insider trading obligations impact any other forms of legitimate conduct?
3. What other types of insider trading should be prohibited?
4. What information should be defined as 'government policy' in the context of insider trading?
5. What other type of information should be considered 'material non-public information' in the context of insider trading and the NZU market?
6. What are your views on the proposed market manipulation prohibition?
7. In what way could these market manipulation obligations impact any other forms of legitimate conduct?
8. The FMA, as the regulator of financial markets, could oversee and regulate the NZU market where we propose similar regulations would apply. What are your views on the FMA having regulatory responsibility over insider trading and market manipulation?
9. Do you consider it appropriate to expand the FMA's remit to include investigation and enforcement responsibilities to the matters set out in topic 1?
10. Do you agree that operators of facilities for trading NZUs that would meet the definition of a 'financial product market' should be required to be licensed, and to incur and comply with associated costs and obligations?
11. As a market operator who currently does, or would, provide a platform for the trade of NZUs, what is the impact of a licensing requirement on your business (eg, costs and obligations)?
12. If you plan to buy and sell NZUs, how would access to a licensed market platform affect your willingness to participate in the NZU market?
13. For stakeholders, what would be the costs and benefits to your business associated with buying and selling NZUs on a licensed market platform with market rules (eg, new administrative costs, trustworthy market operators)?
14. If you plan to buy and sell NZUs, would a fee to trade on a licensed market platform affect your willingness to participate in the NZU market?
15. Do you have any comments on the impact of the proposals in this topic, given differences in structure between NZU markets and financial markets?

16. What do you expect from the Government in terms of disclosure obligations, including the content of the disclosure and the process of disclosing information?
17. Do you prefer the alternative options (status quo: Crimes Act 1961 or option three: Crimes Act and market manipulation prohibitions) to the preferred option? If so, why? And if so, please describe the aspects that you see as particularly advantageous to achieve the stated policy objectives.
18. Do you have any views on whether market conduct (insider trading and market manipulation) should proceed as a priority to, or instead of, creating a licensing framework for NZU market operators?
19. Can you suggest alternative options that would achieve the stated policy objectives?
20. Do you consider a centralised clearing and settlement system necessary or desirable to manage counterparty, credit and other settlement risks for NZU markets if there are one or more licensed market operators? Why or why not?
21. What are your views on whether it should be limited to on-market transactions or should be available for over-the-counter transactions?
22. How would the availability of a centralised clearing party benefit and/or impact your business in terms of managing credit and counterparty risk?

**Topic 2: Regulating NZU financial advice, transactional and/or custodial services**

23. Can you suggest alternative options that would achieve the stated policy objectives?
24. What are your views on whether these exclusions should, in principle, apply to NZU financial advice? If not appropriate, what modifications or changes do you think are necessary?
25. Do you agree that the 'NZU financial advice' described in the section 'What is intended to be 'NZU financial advice'?' is the type of advice that should be regulated? (Table 11 provides examples.)
26. Do you agree that the advice excluded from the proposed definition of NZU financial advice is the type of advice that should not be regulated? (Table 12 provides examples.)
27. Do you consider that applying the wholesale client definition to NZU financial advice is appropriate? Why or why not?
28. What changes (if any) would you have to make to your business to accommodate the difference in the obligations between these two classes of clients?
29. What are the expected costs and benefits to your business of the proposed new obligations in relation to regulating NZU financial advice, transactional and/or custodial services?
30. What are your views about requiring a minimum qualification requirement to help improve the quality of NZU financial advice, given the types of activities involved in that advice?

31. Are the costs of licensing and other obligations under the FMC Act appropriate for NZU financial advice?
32. Are there likely to be impacts on availability of advice? For example, if you are an NZU adviser, would you consider choosing not to provide NZU advice to avoid the burden of licensing?
33. We have received complaints of NZETR account operators withholding access to NZUs from account holders. As an account holder, do you think there is a risk of NZETR account operators withholding such access? Regulating NZETR account operators may not resolve this type of issue; however, is it reasonable for NZETR operators to be regulated under a client money and property services framework to ensure transparency and integrity when managing NZUs?
34. Is it appropriate to apply client money and property service regulation to persons other than account operators in the NZ ETS? If so, what client money and property service obligations are appropriate in relation to NZUs?
35. Are the existing protections (to the extent applicable) under the FTA and [Trusts Act 2019](#) (including obligations for those holding money or property on trust to act honestly and in good faith, and use powers for a proper purpose) sufficient to address the risks in the NZU market?
36. If applied, would your business be covered by the definition of custodial service or otherwise by the meaning of client money or property service?
37. If you are currently an account operator in the NZETR, how would you be impacted (if at all) by the proposal to regulate client money or property services?

### **Topic 3: Improved transaction reporting**

38. How would the additional transaction-reporting requirements impact your business?
39. How would publishing more market information about NZU prices help you understand overall supply and demand conditions in the NZU market?

### **Topic 4: Applying the AML/CFT Act framework**

40. How can we support you to better understand your AML/CFT obligations?
41. Are the current AML/CFT settings that apply to the NZU market appropriate to safeguard against risks of money laundering and the financing of terrorism? If not, how could they be improved?

# Have your say

The Government welcomes your feedback on this discussion document. The questions posed throughout this document can also be found on our website. These questions should also be used as a guide, and all comments are welcome. You do not have to answer all the questions.

To ensure your point of view is clearly understood, please explain your rationale and provide supporting evidence where possible.

## Timeframes

This consultation starts at 8am on 17 November 2022 and ends at 11.59pm on 24 December 2022.

When the consultation period has ended, officials will analyse submissions and provide advice to the Government on the proposed policies that are discussed in this document.

## How to provide feedback

You can make a submission in two ways:

- via Citizen Space, our consultation hub, available at <https://consult.environment.govt.nz/>
- by writing your own submission.

We request that you do not email or post submissions, because this makes analysis more difficult. However, if you need to, please send written submissions to New Zealand Emissions Trading Scheme, Ministry for the Environment, PO Box 10362, Wellington 6143 and include:

- your name or organisation
- your postal address
- your telephone number
- your email address.

If you are emailing your feedback, please send it to [etsconsultation@mfe.govt.nz](mailto:etsconsultation@mfe.govt.nz) as a:

- PDF, or
- Microsoft Word document (2003 or later version).

Submissions close at 11.59 pm on 24 December 2022.

## Publishing and releasing submissions

All or part of any written submission (including names of submitters) may be published on the Ministry for the Environment's website, [environment.govt.nz](https://environment.govt.nz). Unless you clearly specify otherwise in your submission, the Ministry will consider that you have consented to website posting of both your submission and your name.

Contents of submissions may be released to the public under the [Official Information Act 1982](#) following requests to the Ministry for the Environment (including via email). Please advise if you have any objection to the release of any information contained in a submission and, in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this document under the Official Information Act 1982.

The [Privacy Act 2020](#) applies certain principles about the collection, use and disclosure of information about individuals by various agencies, including the Ministry for the Environment. It governs access by individuals to information about themselves held by agencies. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that the Ministry for the Environment may publish.

# Glossary

Term	Meaning
AML/CFT Act	<a href="#">Anti-Money Laundering and Countering Financing of Terrorism Act 2009</a> . This Act and its regulations place obligations on Aotearoa New Zealand’s financial institutions to detect and deter money laundering and terrorism financing in captured activities.
AML/CFT Regulations	There are multiple sets of regulations governed by the AML/CFT Act. This discussion document refers to the <a href="#">Anti-Money Laundering and Countering Financing of Terrorism (Prescribed Transactions Reporting) Regulations 2016</a> .
Captured activities	Activities that are specified under the definition of ‘designated non-financial business or profession’ in the AML/CFT Act
CCC	Climate Change Commission
CCRA	<a href="#">Climate Change Response Act 2002</a> . This Act puts in place a legal framework for Aotearoa New Zealand to meet its international obligations under the United Nations Framework Convention on Climate Change, the Kyoto Protocol and the Paris Agreement.
CDD	Customer due diligence. Part of the obligations of a reporting entity under the AML/CFT Act.
Client money	At a high level, a person provides a client money or property service by: <ul style="list-style-type: none"> <li>receiving money from a client (or from a person on the client’s behalf) in connection with the acquiring, holding or disposing of a financial advice product</li> <li>receiving property (that is a financial advice product or a beneficial interest in a financial advice product)</li> <li>holding, paying or transferring that client money or client property.</li> </ul> Refer to <a href="#">subpart 5B of Part 6 of the FMC Act</a> for more information.
Derivative	A type of contract that derives its value from the performance of underlying assets.
EPA	Environmental Protection Authority
Financial advice relating to NZUs	Advice relating to NZUs that would be financial advice, if NZUs were financial products.
Financial instrument/product	The FMC Act defines four types of financial products: debt securities, equity securities, managed investment products and derivatives. Anyone offering financial products for issue or sale needs to comply with the FMC Act and other financial markets legislation.
Financial product market	A facility where financial products are bought or sold, or where offers or invitations to buy or sell financial products are made.
FMA	Financial Markets Authority. An independent Crown entity that regulates and supervises financial markets participants and provides guidance and information on how to comply with obligations.
FMC Act	<a href="#">Financial Markets Conduct Act 2013</a> . One of the Acts that governs how financial products are created, promoted and sold, as well as the ongoing responsibilities of those who offer, deal and trade them.
Forests Act 1949	<a href="#">Forests Act 1949</a> . The Act under which log traders and forestry advisers are required to register.

Term	Meaning
FSPR	Financial Service Providers Register. A searchable list of individuals, businesses and organisations registered to offer financial services in Aotearoa New Zealand.
FTA	<a href="#">Fair Trading Act 1986</a> . The FTA promotes fair competition, makes sure consumers get accurate information before buying products and services, and promotes product safety.
Insider trading	The practice of buying or selling financial products while in possession of material information that is not generally available to the market, or of passing on and sharing material information that is not generally available to the market.
Licensed market	A facility where financial products are bought or sold, or where offers or invitations to buy or sell financial products are required to be licensed under the FMC Act.
Licensed NZU exchange	A licensed market for buyers and sellers to trade NZUs.
Market governance	The processes, policies and rules for managing risks of misconduct in a market and protecting users from financial harm.
Market manipulation	Where someone misleads (or attempts to mislead) a market by giving a false appearance of trading activity, supply, demand or the value of a relevant product, such as through false information or rumours, or deceptive trades. Includes spreading false market information, cornering or squeezing the market, or giving false impressions of market conditions – typically with the aim of influencing the market price for profit
Material information	Information that is not generally available to the market, and that a reasonable person would expect to have material effect on the price of the financial product on the licensed market, if the information was generally available.
NZ ETS	New Zealand Emissions Trading Scheme. A market-based approach to reducing emissions of greenhouse gases. The NZ ETS puts a price on emissions, charging certain sectors of the economy for the greenhouse gases they emit and rewarding others for carbon sequestration, destruction and capture.  When referred to in this discussion document, the 'NZ ETS' is the emissions activity-based scheme under the CCRA in which carbon-emitters and removers surrender and become entitled to NZUs.
NZ ETS advice	Advice about current or prospective NZ ETS participants' obligations or entitlements under the CCRA.
NZ ETS participant	A registered person who carries out an activity listed in the CCRA, or a person carrying out a mandatory activity (whether or not they are registered).
NZETR	New Zealand Emissions Trading Register. The national registry for NZUs and other emission units, including those owned by the Crown. Anyone wanting to own or trade NZUs in Aotearoa New Zealand must have an account in the NZETR.
NZU adviser	A person who gives financial advice on NZUs in their ordinary course of business.
NZU information insider	A person who holds material non-public information about government policy.
NZU market	The commercial activity in which buyers and sellers exchange NZUs on the primary markets (eg, auctioning, allocation) and secondary markets (eg, trade between account holders within the NZETR).

Term	Meaning
	Note that for the purposes of this engagement, NZU secondary markets do not include trading in NZU derivatives (such as forward contracts), which are regulated as financial products under the FMC Act.
NZU market user	Persons who engage in the NZU market through buying or selling NZUs, such as (but not limited to) traders, consultants, advisers, NZ ETS participants.
NZUs	New Zealand Units. The currency of the NZ ETS, with one 'emissions unit' being equal to one tonne of carbon dioxide equivalent emissions/removals. NZUs can be traded among anyone with a holding account in the NZETR.
Over-the-counter (OTC) trades	Direct, bilateral trades between two NZ ETS users, without supervision or using an exchange.
Primary market	The distribution of NZUs from the Government to NZ ETS users, through auctions, industrial allocation and any other form of issue or transfer.
Product disclosure statement	A product disclosure statement provides essential information to help investors decide whether to invest in a financial product. See <a href="#">Part 2 of the FMC Act</a> .
Retail client	Retail client is a person who falls outside of the meaning of wholesale client as set out under clauses 37–41 of <a href="#">Schedule 1 of the FMC Act</a> .
Secondary market	The market in which previously issued NZUs are bought and sold.
Wholesale client	<p>The meaning of wholesale client is set out under clauses 37-41 of <a href="#">Schedule 1 of the FMC Act</a> as a person that meets any one of the following summarised criteria, including:</p> <ul style="list-style-type: none"> <li>• <b>Investment business:</b> A person who is, for example, a principal business investing in financial products, a registered bank, a financial adviser or issuer of derivatives.</li> <li>• <b>Investment activity criteria:</b> A person who has, within the previous two years, owned a portfolio of (or carried out one or more transactions to acquire) specified financial products<sup>50</sup> of a value of (or where the amount payable under those transactions was) at least \$1 million (in aggregate).</li> <li>• <b>A large person:</b> A person who had net assets in excess of \$5 million as at the last day of each of the two most recently completed financial years</li> </ul>

<sup>50</sup> This currently includes equity securities (eg, shares), debt securities (eg, bonds), managed investment products and derivatives, but excludes interests in retirement schemes and some other simpler financial products such as bank term deposits. See full list of exclusions at [clause 46A, Schedule 8 of the Financial Markets Conduct Regulations 2014](#).

# Appendix A: Summary of 2021 consultation options

Summary of governance of advice options	
<b>Status quo</b>	No new tools to address governance of advice risks.
<b>Education campaign and information pack</b>	Develop an education campaign and information pack to improve knowledge and understanding of the NZU market. For foresters and landowners there will be an additional section regarding forestry-specific matters.
<b>Sector guidelines for NZU advisers</b>	Develop guidelines to benchmark the expected level of service from NZU advisers and to guide the development of quality advice.
<b>Code of conduct, licensing, and registration of NZU advisers</b>	Introduce a mandatory licensing, public registration, and code of conduct package to raise the standards of advice in the NZU market and increase NZU market-user protection.
Summary of governance of trading options	
<b>Status quo</b>	No new tools to address governance of trading risks.
<b>Voluntary reporting of trades</b>	Introduce a mechanism for NZU market users to voluntarily report market transactions to increase post-trade transparency. This reporting allows a regulator to monitor market developments and investigate suspected market abuse.
<b>Participant position reporting</b>	Require NZU market users to disclose the number of NZUs they are holding or borrowing. Position reporting increases transparency of the distribution of market power, counterparty risk and market conditions.
<b>Requiring exchange-based trading</b>	A regulated exchange that could be licensed and that would subject NZU market users to certain registration and conduct obligations, to increase oversight of trades, reduce counterparty risk and help detect market misconduct.
Summary of governance of market conduct options	
<b>Status quo</b>	No new tools to address governance of market conduct risks.
<b>Position and purchase limits</b>	Position limits restrict the number of NZUs an NZU market user can hold at any one time, limiting their ability to exercise market power. Similarly, purchase limits restrict the maximum number of NZUs any NZ ETS user can purchase at primary NZU auctions. Typically, NZ ETS participants with surrender obligations can purchase more units than speculative traders.

<b>Price reporting</b>	Require price disclosure to the regulator for all NZU trades, to increase transparency and protect against fraudulent activity and price manipulation.
<b>Full transaction detail reporting</b>	Require full transaction disclosure and reporting to the regulator, to increase transparency and protect against fraudulent activity, price manipulation, money laundering and financing of terrorism.
<b>Summary of options to appoint a regulator</b>	
<b>Status quo</b>	Do not appoint a regulator.
<b>Self-regulating body</b>	Establish a voluntary framework led by a self-regulating body to oversee market governance.
<b>Advisory regulator</b>	Establish an advisory regulator to provide independent advice to the Government, without investigative or enforcement powers.
<b>Market monitoring regulator</b>	Establish a market monitoring regulator with investigatory powers to collect information from NZU market users and monitor compliance with existing Acts and regulations. The regulator does not have enforcement powers and reports its findings to the Government.
<b>Market compliance regulator</b>	Establish a market compliance regulator with investigatory powers to collect information from NZU market users, monitor compliance with existing Acts and regulations, and enforce compliance.
<b>Market design regulator</b>	Establish a market design regulator with the power to design and administer an industry participation code that defines the obligations of industry participants. The regulator may also amend and update the participation code to ensure the governance framework remains fit for purpose.

# Appendix B: Topic 1 options and risk analysis

Options are assessed for how well they perform for each criterion, against the status quo. Table 16 provides a key of symbols representing the results of the assessment.

**Table 16: Key to criteria analysis assessment**

Symbol	Meaning
++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
--	much worse than doing nothing/the status quo/counterfactual

## Options analysis

Table 17 below provides the impact analysis of the topic 1 options.

**Table 17: Impact analysis for insider trading and market manipulation**

	Option one (status quo): Crimes Act 1961	Option two: FMC Act with suitable modifications	Option three: Crimes Act 1961 and market manipulation prohibitions
<b>Integrity</b>	0	++ Provides highest integrity. Well tested in financial markets	+ Slight improvement in integrity by prohibiting market manipulation.
<b>Minimal complexity and administrative cost</b>	0	+ Costs to administer are minimised by leveraging existing frameworks. Rules and impacts are clear, well tested and understood (although application to NZU markets will need to be considered, given different market structures and to account for parties with surrender obligations that are required to trade). There may be licensing costs for unlicensed market operators. Those who use the market might be subject to compliance costs (but some unnecessary obligations are removed).	0 Relies on NZ ETS market users to identify and detect market manipulation, and report to the regulator. Lack of access to information held by the market operator may lead to difficulty in investigating insider trading and market manipulation.
<b>Consistency and proportionality</b>	0	++ Most of the rules are consistent with other financial markets. Carve-outs relating to disclosure obligations differ from financial markets. However, this approach provides the most proportional response to risks in the NZ ETS market	0 Treats insider trading and market manipulation in the NZ ETS differently to domestic financial markets and international carbon markets. May not be proportional, given government officials are treated differently to others.
<b>Clarity and transparency</b>	0	++ High clarity and transparency, as all relevant market information is already public (or licensed market operators can collect the information). Understood by many stakeholders. Structured guidance from the regulator provides clarity.	0 Low transparency about operations of secondary market.

	<b>Option one (status quo): Crimes Act 1961</b>	<b>Option two: FMC Act with suitable modifications</b>	<b>Option three: Crimes Act 1961 and market manipulation prohibitions</b>
<b>Market efficiency</b>	<b>0</b>	<p style="text-align: center;">+</p> <p>Creates rules and oversights to guard against the risks of price manipulation and insider trading. Produces a reliable price signal that helps inform investment decisions. Supports efficient carbon price discovery. Unclear whether costs of using licensed markets would inefficiently discourage use of that market.</p>	<p style="text-align: center;">+</p> <p>Increased protection against market manipulation. No change in oversight to guard against the risks of market manipulation</p>
<b>Overall assessment</b>	<b>0</b>	<p style="text-align: center;">++</p> <p style="text-align: center;"><b>(Preferred option)</b></p> <p><b>Provides the most proportional response to the risks of market misconduct by leveraging existing financial market frameworks, but tailors some obligations to be proportional to NZ ETS market risks.</b></p>	<p style="text-align: center;"><b>0</b></p> <p>Prohibits market manipulation but provides no robust mechanisms to detect price manipulation. No substantial change in insider-trading scope or obligations.</p>

## Risk analysis

Table 18 below provides the risk analysis of the topic 1 options.

**Table 18: Risk analysis for insider trading and market manipulation**

	Option one (status quo): Crimes Act 1961	Option two: FMC Act with suitable modifications	Option three: Crimes Act 1961 and market manipulation prohibitions
Risk 3: Potential lack of transparency, oversight, and monitoring of trades in the secondary NZU market	0	++ A licensed market operator is responsible for detecting potential insider trading and market manipulation, and the FMA is responsible for overseeing those operators.	+ Market manipulation is prohibited. However, there are no licensed market operators to detect potential misconduct.
Risk 4: Credit and counterparty risk	0	+ Licensed market operators are responsible for running their market in a fair and orderly manner. The FMC Act requires they must develop market rules. These typically include rules that deal with credit and counterparty risk. The FMA must approve these market rules.	0 No change to credit and counter party rules from the status quo.
Risk 5: Insider trading and information asymmetry	0	++ Insider trading by the public using government policy information is prohibited, reducing the risk of misconduct, increasing confidence and integrity.	0 No change to insider-trading prohibitions from the status quo.
Risk 6 : Manipulation of NZU prices	0	++ Market manipulation is prohibited, and licensed market operators are monitoring for manipulation.	+ Market manipulation is prohibited, reducing the risk of misconduct, increasing confidence and integrity.
Overall assessment	0	++ <b>(Preferred option)</b> <b>This option is much better than the status quo, as it provides a notable increase in mitigating every risk.</b>	+ This option is better than the status quo at addressing the market risks, but it still leaves vulnerabilities in the market.

# Appendix C: Topic 2 options and risk analysis

## Options analysis

Table 19 below provides the impact analysis of the topic 2 options.

**Table 19: Options analysis for regulating NZU financial advice, transactional and/or custodial services**

	Option one (status quo): Existing legislation	Option two: Regulating NZU financial advice, transactional and/or custodial services	Option three: Applying FMC Act wholesale client settings
<b>Integrity</b>	0	++ Provides highest integrity by ensuring all providers, whether licensed or not, are regulated to comply with fair-dealing provisions. Provides greater level of protection for consumers.	+ Obligations to prioritise client's interests and exercise care, diligence and skill increase integrity in the market.
<b>Minimal complexity and administrative cost</b>	0	+ Lower complexity through clearer obligations on parties. More statutory obligations and licensing conditions if servicing retail clients, which means higher compliance costs. Some compliance costs may be passed onto clients.	++ Lower complexity through clearer obligations on parties. Lower cost through no licensing and lighter obligations.
<b>Consistency and proportionality</b>	0	+ Treats NZUs consistently with other financial products under the FMC Act. Likely to be more proportional, given the risk of poor and misleading financial advice. Obligations in relation to retail clients may be burdensome, given relatively narrow scope of advice proposed to be regulated. The impact is expected to be minimal for providers who already adhere to FMC Act rules. Maximum penalties more proportional given current and increasing values of NZUs.	+ More aligned with financial product obligations, but fewer protections for retail clients compared to other financial product markets.

	Option one (status quo): Existing legislation	Option two: Regulating NZU financial advice, transactional and/or custodial services	Option three: Applying FMC Act wholesale client settings
Clarity and transparency	0	<p style="text-align: center;">+</p> <p>Market rules are clearly presented, and stakeholders better understand their obligations, protections and what type of conduct is expected of them.</p>	<p style="text-align: center;">+</p> <p>Market rules are clearly presented, and stakeholders better understand their obligations, protections and what type of conduct is expected of them.</p>
Market efficiency	0	<p style="text-align: center;">++</p> <p>Allows for better market participation through increased protections suitable for retail and wholesale clients, and provides stakeholders with comprehensive coverage from misconduct. However, there is a risk that providers will stop providing NZU financial advice to avoid the burden of licensing or that compliance costs will be passed onto clients</p>	<p style="text-align: center;">+</p> <p>Improved market participation through increased protections suitable for wholesale clients, and provides stakeholders with comprehensive coverage from misconduct.</p>
Overall assessment	0	<p style="text-align: center;">++</p> <p style="text-align: center;"><b>(Preferred option)</b></p> <p><b>Provides a comprehensive protection framework for misleading and deceptive conduct in relation to financial products and financial advice service. Both retail and wholesale clients are protected.</b></p>	<p style="text-align: center;">+</p> <p>Better than the status quo, by providing obligations and protections similar to wholesale client obligations in financial markets.</p>

## Risk analysis

Table 20 below provides the risk analysis of the topic 2 options.

**Table 20: Risk analysis for regulating NZU financial advice, transactional and/or custodial services**

	Option one (status quo): Existing legislation	Option two: Regulating NZU financial advice, transactional and/or custodial services	Option three: Applying FMC Act wholesale client settings
<b>Risk 1: Inadequate, false or misleading advice relating to NZUs</b>	0	<p style="text-align: center;">++</p> <p>Same protections as currently apply to retail and wholesale clients under the FMC Act.</p> <p>Provides additional protection for retail clients compared to wholesale clients and alternative options. Advisers giving NZU financial advice to retail clients are required to be licensed by the FMA, meet minimum competence requirements and comply with <a href="#">Code of Professional Conduct for Financial Advice Services</a>.</p>	<p style="text-align: center;">+</p> <p>Some statutory duties apply (eg, to exercise care, diligence and skill). No licensing, minimum competence or code of conduct requirements.</p>
<b>Risk 2: Conflicts of interest involving the NZETR</b>	0	<p style="text-align: center;">++</p> <p>Provides some additional protection for retail clients compared to alternative option, including requirement to disclose conflicts of interest to retail clients.</p>	<p style="text-align: center;">+</p> <p>Advisers must give priority to client's interest if there is a conflict.</p> <p>Unlike preferred option, advisers are not required to provide retail clients with disclosure information about conflicts of interest.</p>
<b>Overall assessment</b>	0	<p style="text-align: center;">++</p> <p style="text-align: center;"><b>(Preferred option)</b></p> <p><b>Addresses risks and can minimise risks of poor advice and conflict of interest in the NZ ETS.</b></p>	<p style="text-align: center;">+</p> <p>Provides minimum statutory obligations for wholesale and retail clients.</p>

# Appendix D: Topic 3 options and risk analysis

## Options analysis

Table 21 below provides the impact analysis of the topic 3 options.

**Table 21: Options analysis for improved transaction reporting**

	Option one (status quo): Current reporting obligations	Option two: Improved transaction reporting	Option three: Full transaction detail reporting
<b>Integrity</b>	0	++ Improves integrity relative to the status quo by collecting key market information.	++ Provides the greatest integrity overall through increased transparency for monitoring and oversight of the market.
<b>Minimal complexity and administrative cost</b>	0	- Low administrative cost, as reporting has been minimised to key information only.	-- High administrative cost, as reporting on several fields is likely to be too burdensome for traders.
<b>Consistency and proportionality</b>	0	+ Likely to be more proportional to the risks faced in the NZU market. Data collection is tailored to information gaps in the NZU market.	-- Inconsistent with financial market reporting and unlikely to be proportional, given the level of risk of misconduct.
<b>Clarity and transparency</b>	0	+ Clear reporting obligations and provides high levels of transparency for the regulator. However, not all information is useful for markets.	+ Clear reporting obligations and provides high levels of transparency for the regulator. However, not all information is useful for markets.

	Option one (status quo): Current reporting obligations	Option two: Improved transaction reporting	Option three: Full transaction detail reporting
Market efficiency	0	++ Captures key market information which supports price discovery. Supports oversight to guard against price manipulation, insider trading and anti-competitive conduct.	++ Some information useful for price discovery. Supports oversight to guard against price manipulation, insider trading and anti-competitive conduct.
Overall assessment	0	++ <b>(Preferred option)</b> Captures key data gaps in the NZU market and provides a more proportional response to the market risks.	+ Provides the greatest integrity but inconsistent with other carbon and financials markets and not proportional to the risks in the NZU market.

## Risk analysis

Table 22 below provides the risk analysis of the topic 3 options.

**Table 22: Risk analysis for improved transaction reporting**

	Status quo: Current reporting obligations	Option two: Improved transaction reporting	Option three: Full transaction detail reporting
Risk 3: Potential lack of transparency, oversight and monitoring of trades in the secondary NZU market	0	+ Provides key information relating to OTC trades, contributing to transparency in the market.	++ Provides a complete, detailed oversight of OTC trades occurring in the NZU market.
Overall assessment	0	+ Additional fields of information will enable greater transparency and detection of possible misconduct.	++ Significantly more information to detect misconduct, which will improve transparency and overall market efficiency.