

REGULATORY IMPACT STATEMENT

EMISSIONS TRADING SCHEME – CLIMATE CHANGE RESPONSE (PRESCRIBED RATE OF INTEREST) ORDER 2010

AGENCY DISCLOSURE STATEMENT

- 1 This Regulatory Impact Statement (RIS) has been prepared by the Ministry of Economic Development.
- 2 An analysis of options for prescribing a rate of interest to be applied on unpaid penalties under section 137 of the Climate Change Response Act 2002 (“the Act”) is provided in this RIS.
- 3 The key consideration in the RIS is the determination of an appropriate interest rate that will create an incentive for participants to pay penalties within statutory timeframes.
- 4 In relation to implementation of the New Zealand Emissions Trading Scheme the preferred option will not;
 - Impose additional costs on businesses who are complying with the Act;
 - Impair private property rights, market competition, or the incentives on business to innovate or invest; or
 - Override fundamental common law principles.

Neville Harris
Deputy Secretary
Ministry of Economic Development

STATUS QUO AND PROBLEM DEFINITION

- 5 Section 137 of the Climate Change Response Act 2002 (“the Act”) provides for interest on the late payment of penalties at the rate prescribed by the Governor-General by Order in Council. An interest rate on penalties not paid within prescribed timeframes ensures that there is an incentive for penalties to be paid. At present there is no interest rate prescribed.
- 6 Under the New Zealand Emissions Trading Scheme (“NZ ETS”), participants are required to submit emissions returns and surrender or repay emissions units as determined in the participant’s assessment. Forestry participants are required to submit their emissions returns to the Chief Executive of the Ministry of Agriculture and Forestry, all other participants are required to submit their emissions returns to the Chief Executive of the Ministry of Economic Development.
- 7 Where a participant does not comply, or comply in full, with a requirement to surrender or repay units they may be liable to pay a penalty under the Act. Penalties also arise where a participant does not file an emissions return and the chief executive makes an assessment of the units that a participant is required to surrender. The excess emissions penalty is set out in section 134 of the Act as \$30 per unit for each unit that a participant fails to surrender or repay by the due date.
- 8 Where section 137 applies a person is liable to pay interest on the full amount of the penalty at the prescribed rate. Interest is payable for the period from the date the penalty was due to be paid until the associated liability to surrender or repay units has been met, and until the penalty and any interest due have been paid in full.
- 9 Because the interest rate is required to be imposed under the Act and the value of penalties is already set out in the Act, this proposal is considered to be an administrative matter.
- 10 Officials consider that the interest rate will be applicable in rare circumstances, as we expect a high level of compliance with the Act and the penalties regime.

OBJECTIVES

- 11 It is considered that the primary objective of prescribing an interest rate under the Act is to encourage a participant to pay a penalty within the statutory timeframe.
- 12 The following factors should also be taken into account in choosing the appropriate methodology for prescribing an interest rate:
 - a The Crown should be compensated for the loss of the use of its money;
 - b Participants in the NZ ETS will range from large corporate entities to small businesses and individual landowning participants who face differing costs of finance. The appropriate rate should be higher than the finance costs that are generally faced by participants to ensure there is an incentive for all participants to pay a penalty; and

- c The Crown is an unsecured creditor with respect to any penalty owed and is unable to assess the credit worthiness of participants liable for penalties.

REGULATORY IMPACT ANALYSIS

Alternative options

- 13 It is considered appropriate that the methodology for prescribing an interest rate be based on a suitable benchmark interest rate with an added margin to ensure there are incentives for penalties to be paid.
- 14 There are currently Orders in Council in force prescribing interest rates for the purposes of other legislation such as under the Tax Administration Act 1994 for unpaid taxes. Existing interest rates prescribed by Order in Council are also based on a benchmark rate plus a margin.
- 15 Of available Reserve Bank of New Zealand series, the 90-day bank bill rate, the official cash rate (“OCR”) and the floating first mortgage new customer housing rate (“FFM”) were considered the most appropriate rates for consideration as possible benchmark rates.

Official cash rate

- 16 The OCR is the rate at which banks borrow from the Reserve Bank of New Zealand. The OCR and expectations about where it will be set in the future influence market interest rates.
- 17 The OCR is not considered to be the most appropriate benchmark because few institutions (only major banks) are able to borrow at this rate, and these institutions are unlikely to be participants in the NZ ETS.
- 18 The OCR is not likely to meet the objective of incentivising payment as participants in the NZ ETS will face costs of finance higher than the OCR.

90-day bank bill rate

- 19 The 90-day bank bill rate is influenced by the OCR. The 90-day bank bill rate is considered to be an indication of a rate at which large business can obtain finance.
- 20 As participants in the NZ ETS will include small business and individual landowning participants who face higher costs of finance than large business, the 90-day bank bill rate is not considered to be an appropriate benchmark to use. The 90-day bank bill rate will not create an incentive for all participants to pay penalties.

Preferred option

Floating first mortgage new customer housing rate

- 21 The FFM series reflects the variable first mortgage interest rate offered to new borrowers for residential property, weighted by each surveyed institutions total lending outstanding for housing purposes.
- 22 The rate of interest on unpaid taxes is based on the FFM with a margin of 250 basis points (2.5%).
- 23 The process that a participant must undertake to prepare emissions returns under the NZ ETS requires a level of self assessment akin to the system of self assessment for tax. It is considered that the methodology used to calculate the rate of interest on unpaid tax should be followed.
- 24 The Reserve Bank of New Zealand has a high level of confidence in the FFM series and considers that it would be an appropriate benchmark to use in calculating the prescribed interest rate.
- 25 The FFM rate is more likely than the alternative options to reflect the higher costs of borrowing faced by small businesses than the other Reserve Bank series considered, therefore creating an incentive for all participants to pay penalties on time.
- 26 A margin added to a benchmark interest rate is likely to ensure that participants who have different risk profiles that effect their borrowing have incentives to pay any penalty within the statutory timeframe. A 250 basis point (2.5%) margin is considered appropriate to add to the benchmark rate.
- 27 The current FFM is 6% (November 2009). Allowing a margin of 2.5% it is therefore it is proposed that the rate of 8.5% per annum is prescribed by Order in Council for the purposes of section 137 of the Act.

CONSULTATION

- 28 The following departments and agencies were consulted on the preferred option: Reserve Bank of New Zealand, Ministry for the Environment, Ministry of Agriculture and Forestry, Treasury, Department of Conservation, Te Puni Kōkiri, Ministry of Justice and the Inland Revenue Department.
- 29 No concerns with the preferred option have been raised.
- 30 Because a rate of interest is required to be imposed under the Act, and the proposal is an administrative matter and minor and technical in nature, wider consultation was not considered necessary.
- 31 Wider consultation on the penalty regime and the application of an interest rate on unpaid penalties has previously been undertaken as part of the implementation of primary legislation.

IMPLEMENTATION

- 32 The prescribed interest rate will be implemented by an Order in Council. The enactment of an Order in Council prescribing an interest rate will be advertised in the New Zealand Gazette.
- 33 Penalty notices will be issued by the Chief Executive of the Ministry of Economic Development.
- 34 Any participant issued with a penalty notice under section 134 of the Act will be advised, by way of the penalty notice, that unless both units are surrendered or repaid and the penalty paid in full by the due date then interest will accrue in accordance with section 137.
- 35 Penalties and any interest that may accrue in accordance with section 137 will be payable into a bank account administered by the Ministry of Economic Development.

MONITORING EVALUATION AND REVIEW

- 36 The New Zealand Emission Unit Register team within MED, will monitor changes in interest rates by reviewing the prescribed rate of interest on an annual basis. If it is considered necessary to amend the prescribed interest rate to ensure that it continues to meet the objectives the prescribed rate of interest will be amended.
- 37 Officials will also review the effectiveness of the preferred option after one year. In reviewing the effectiveness of methodology for prescribing a rate of interest Officials will consider:
 - a Whether any penalty notices were issued under the Act and any penalties were not paid within prescribed statutory timeframes;
 - b If applicable, the reasons why any penalties have not been paid;
 - c Whether the prescribed interest rate is considered relevant to any participants decision not pay a penalty within the statutory timeframe;
 - d Whether another methodology would be more appropriate in prescribing an interest rate of the purposes of section 137.