

28 February 2023

Department of Climate Change, Energy, the Environment and Water
Submitted via website

Dear Sir/Madam

SAFEGUARD MECHANISM REFORM: CONSULTATION ON PROPOSED DESIGN

On behalf of the Australian Council of Superannuation Investors (ACSI), thank you for the opportunity to make a submission to the consultation on the proposed reform of the Safeguard Mechanism.

About ACSI

Established in 2001, ACSI exists to provide a strong voice on financially material environmental, social and governance (ESG) issues. Our members include 26 Australian and international asset owners and institutional investors with over AU\$1 trillion in funds under management.

Through research, engagement, advocacy and voting recommendations, ACSI supports members in managing ESG investment risk and exercising active ownership to strengthen investment outcomes. Active ownership, including the management of climate related risk, allows institutional investors to enhance the long-term value of retirement savings entrusted to them to manage.

This submission draws on ACSI's long-standing practice of detailed engagement with listed companies in relation to their management of climate-related risks and opportunities, as well as detailed research into market practices. Our expertise is primarily in respect of Australian listed equities, with a focus on the ASX300, and our comments reflect that end of the market. ACSI supports the Paris Agreement goal of limiting warming to 1.5°C and net zero emissions by 2050. As part of this transition, policy makers will need to develop credible pathways to ensure an orderly and just transition to a net zero emissions economy. A planned transition will result in better economic outcomes, will better take account of the needs of various stakeholders and will enable better management of uncertainty and volatility.

Summary of ACSI's position

ACSI supports the implementation of a revised Safeguard Mechanism as outlined in the consultation paper. This policy is an essential support to Australia's 43% emissions reduction by 2030 goal. Limiting global warming to 1.5°C will require economy-wide emissions reductions. The Safeguard Mechanism, using baseline levels that encourage industrial decarbonisation consistent with limiting warming to 1.5°C, is one of several policies required for Australia to meet its Paris Agreement targets.

The Safeguard Mechanism is expected to incentivise facilities' decarbonisation by providing both regulatory supports, and a financial incentive, to decrease emissions. ACSI considers that some simple improvements to the Safeguard Mechanism could be incorporated, such as developing guidelines and limits around the use of Australian Carbon Credit Units (ACCUs), that would provide additional protection against dilution of the decarbonisation signal. Given ACCUs do not deliver actual declines in baseline emissions, their use within the Safeguard Mechanism should be carefully considered to ensure decarbonisation objectives are met.

ACSI recommends that the following elements be incorporated into the Safeguard Mechanism as a way to support the use of ACCUs:

- The Safeguard Mechanism rules should align the use of ACCUs with the Oxford Offsetting Principles.¹ This would require facilities start from the premise that use of offsets should be a last resort after all efforts to decarbonise have been exhausted, as well as prioritising use of verifiable, high-quality offsets.
- Safeguard Mechanism facilities should be required to disclose their use of offsets as part of their public

¹ [The Oxford Offsetting Principles | Smith School of Enterprise and the Environment](#)

disclosures of transition plans in line with the draft ISSB Standard on Climate-related Disclosures.² This could be incorporated into the Government's climate-related financial disclosures consultation.³

- The cost containment measure should be removed. Setting a price signal to keep ACCU prices artificially low is likely to dilute the decarbonisation signal.

We also note that, given the unlimited use of ACCUs within the Safeguard Mechanism, the regulator should report annually on the extent to which the total baseline reduction was achieved via offsets. Transparent information on progress is not only needed at an individual company level, but also on the operation of the Safeguard Mechanism as a whole. In this context, we would also encourage the Government to consider capping the number of ACCUs allowed to be used within the Safeguard Mechanism if it finds that their use is not aligned to the Oxford Offsetting Principles.

Finally, ACSI notes that the Safeguard Mechanism's overall success in contributing its proportional share of Australia's 2050 net zero target will be in part dependent on complementary policies, including development of sector pathways for parts of the economy currently not covered by the Safeguard Mechanism. We strongly support the review of Safeguard Mechanism baselines scheduled for 2026-27, as this will allow baselines to be revised in line with sector pathways as well as any updated Nationally Determined Contributions (NDCs). The 2026-27 review should also provide an opportunity to consider whether earlier implementation of industry-average data to set individual facilities' baselines is appropriate, rather than waiting until 2030. An earlier introduction of an industry average approach would support growth of the Safeguard Mechanism Credit (SMC) market.

Our recommendations are outlined in detail below.

Complementary policies

The total emissions reduction baselines assigned to covered entities reflect their proportion of Australian emissions (28%). The determination of the correct proportion of emissions reduction to be delivered by Safeguard Mechanism facilities will only be clear after the Government has developed sector pathways to net zero for other areas of the economy. We note that the Government has committed to deliver sector-specific pathways. These are essential to inform the development of the Safeguard Mechanism, and broader climate policy, as they will identify the appropriate decarbonisation timeframe for relevant sectors. ACSI supports the proposed review of the Safeguard Mechanism in 2026-27 as this will allow consideration of:

- whether baseline reductions are sufficient in the context of sectoral pathways developed for other parts of the economy, and
- changes in Australian climate policy over time, including updated NDCs.

Baselines

ACSI acknowledges the Government's intention in using a hybrid model for baseline setting is to allow facilities time to identify potential sources of emissions reduction. The 2026-27 review provides an opportunity to consider whether an industry average baseline-setting approach could be introduced earlier than 2030. The industry-average approach:

- is more equitable, as it recognises the efforts of early movers in decarbonisation, and transition plans, and
- encourages the development of a more liquid and deep SMC market. SMCs represent actual baseline reductions and are consequently preferable to the use of ACCUs in meeting emissions reduction commitments.

We recognise that significant work will need to be undertaken with industry to establish credible industry averages and that consultation should occur well ahead of 2026-27 if the measures are to be implemented before 2030.

Flexibility measures

The incorporation of flexibility measures into the Safeguard Mechanism recognises that some sectors will have harder abatement tasks than others and that pathways to net zero will often be lumpy rather than linear. Access to flexibility measures will be important in the early years of the revised Safeguard Mechanism as facilities identify carbon abatement opportunities and appropriate technologies to support that task. However, it is also important that any access to flexibility measures is part of an overall plan to lower emissions

² [IFRS - Climate-related Disclosures](#)

³ [Climate-related financial disclosure - Consultation paper \(treasury.gov.au\)](#)

in line with baseline requirements. As the flexibility measures are developed, it will be important to ensure those companies that have undertaken significant decarbonisation activities prior to the implementation of the scheme are not penalised, and conversely, companies that have made limited efforts do not receive more lenient targets (or have an incentive to decarbonise more slowly).

ACSI recommends that Safeguard Mechanism facilities be required to release transition plans that disclose (among other things) how flexibility measures are being used to achieve emissions reduction. This could be managed through climate-related financial disclosures that are currently being developed.⁴ As part of this disclosure requirement, the regulator should issue guidance on the key elements of transition plans for companies reporting under the Safeguard Mechanism. Frameworks for such guidance are readily available, for example, the UK Transition Plan Taskforce has released an implementation guide. ACSI research⁵ found that the information stakeholders require to assess the adequacy of a transition plan includes data that confirms the credibility, ambition and real-world action underpinning the plan.

Information particularly relevant to Safeguard Mechanism facilities would include:

- How the plan addresses a facility's material emissions.
- Short, medium and long-term decarbonisation targets that are aligned with Safeguard Mechanism facility baseline reductions.
- Information on how these targets will be achieved and disclosure of progress against those targets.
- Disclosure of offsets used.

Improving reporting requirements will be important in helping investors and other stakeholders better understand a facility's emissions reduction plans, including how they align with baseline requirements and the extent of reliance on the use of offsets. It is also important that there is consistency between entities' baseline requirements and their public reporting disclosures. For example, where companies have publicly expressed confidence in their strategy and business model's alignment with limiting warming to 1.5°C, this should support a company's ability to meet baseline requirements. In this context, many of the companies with facilities covered by the Safeguard Mechanism have publicly released scenario testing using a 1.5°C model.⁶

ACCUs

The revised design of the Safeguard Mechanism means that facilities could seek to use ACCUs in the early years as they identify and develop decarbonisation measures, recognising that some facilities will not have immediate levers for decarbonisation available.

We note that the Safeguard Mechanism does not place limits on the use of ACCUs. There is widespread investor and scientific concern about the use of offsets to meet emissions reduction targets. In addition, allowing unlimited use of offsets is out of step with emissions trading systems internationally. For example, the EU Emissions Trading System (ETS) places limits on the use of offsets.

Given that ACCUs do not represent emissions reduction of the covered facilities themselves, an over reliance on their use risks diluting the Safeguard Mechanism's decarbonisation objective, by:

- Potentially reducing incentives for investment in decarbonisation technological solutions. If the ACCU price is cheaper than the cost of decarbonisation, there is a risk that incentives to reduce emissions may be reduced.
- There being no requirement for facilities to prioritise emissions reduction over the use of offsets.
- Potentially reduced liquidity and depth in the SMC market due to the selection of a facility-specific baseline calculation rather than industry average.

While offsets are a valuable tool for facilities in hard-to-abate sectors with no immediate technological solution available, guidance and structure should be provided to support their appropriate use. Investors increasingly expect the use of offsets to be a last resort when emissions reduction is not possible, consistent with the Oxford Offsetting Principles (refer more detailed discussion below). Allowing facilities unrestricted access to ACCUs undermines this principle.

As an initial step to managing the use of offsets, ACSI recommends that:

1. The Oxford Offsetting Principles are explicitly incorporated in the use of ACCUs in the Safeguard

⁴ [Climate-related financial disclosure - Consultation paper \(treasury.gov.au\)](#)

⁵ [Promises, pathways & performance – climate change disclosure in the ASX200 | ACSI](#)

⁶ ACSI calculations based on public data.

Mechanism arrangements.

2. Disclosure on the use of offsets is provided at both the company/facility level by reporting entities and, at a broader level, for the Regulator to report on the Safeguard Mechanism as a whole.
3. The Chubb Review recommendations, particularly those concerning transparency and disclosure, are implemented as soon as possible.

As noted above, guidelines around the use of ACCUs could be underpinned by the Oxford Offsetting Principles (Principles), a widely accepted framework for the use of offsets in transitioning to net zero. At a high level the Principles⁷ advise organisations to:

1. Start from the principle that decarbonisation is always preferable to offsets. Aligning with this principle would require Safeguard Mechanism facilities to explain why they have used offsets. This could be most simply achieved through the mandated disclosure of a facility-specific transition plan.
2. Only use high quality offsets, e.g., offsets should be verifiable, correctly accounted for and have a low risk of non-additionality, reversal and creating negative unintended consequences. Carbon removal offsetting and long-lived storage should be prioritised. This requires transparent disclosure around the nature of offsets being used.

The ISSB Draft Climate-related Disclosure Standard ('the Standard')⁸ provides a helpful framework for the types of disclosure around offsets that would be required to confirm that ACCUs are being used in line with the Principles. The draft Standard requires the reporter to explain the intended use of offsets in achieving emissions targets. The information disclosed should include:

- the extent to which carbon offsets are being used to meet targets,
- whether the offsets have been verified (and by whom) and whether they are part of a certification scheme,
- the type of carbon offset, including whether the offset will be nature-based or based on technological carbon removals and whether the amount intended to be achieved is through carbon removal or emission avoidance, and
- any other significant factors necessary for users to understand the credibility and integrity of offsets intended to be used by the entity (for example, assumptions regarding the permanence of the carbon offset).

Requiring Safeguard Mechanism facilities that use ACCUs to disclose how their use fits into their overall emissions reduction plans may provide some guardrails around the use of ACCUs and ensure that they are part of an overall credible transition plan.

The disclosure of the use of offsets in meeting baselines is required not only at facility level but also for the overall Safeguard Mechanism. The Safeguard Mechanism is a key lever in Australia's orderly transition to net zero and failure to meet baseline step changes with actual emissions reduction represents significant market risk. In addition to individual facility reports on the use of offsets, ACSI recommends that the regulator publish information on the extent to which offsets are contributing to baselines reductions as a whole.

Finally, if ACCUs are to play an integral role in the Safeguard Mechanism, it is important that they are, and perceived to be, credible. As noted in [ACSI's response to the Chubb Review](#), there is limited public information about ACCUs and their use.⁹ This lack of transparency was acknowledged by the Chubb Review as contributing to concerns about the credibility of ACCUs. It is therefore important to incorporate the Chubb Review recommendations that are designed to improve transparency of, and disclosures around, ACCUs before the start of the new design of the Safeguard Mechanism. The Government should release a timeline for implementing the Chubb Review recommendations as soon as practicable.

ACCU Strategic Reserve

ACSI acknowledges that the cost containment measure set by the Government has been designed as a last resort strategic reserve in the event that facilities are unable to access sufficient SMCs or ACCUs in the reporting period. However, we are concerned that the cap of AU\$75 is priced relatively low and risks disincentivising investment in decarbonisation. For example, the vast majority of shadow carbon prices disclosed in the financial reporting of companies covered by the Safeguard Mechanism are set at higher

⁷ [The Oxford Principles for Net Zero Aligned Carbon Offsetting 2020](#)

⁸ [IFRS - Climate-related Disclosures](#)

⁹ [Australian carbon credit units \(ACCU\) framework | ACSI](#)

levels than AU\$75.¹⁰ If retained, the price cap must be decided with reference given to other carbon markets globally for avoidance of any risk of cross-border leakage.

At present there is a lack of clarity about how this reserve will be managed, including the response if the reserve is empty. We recommend that the Government provide more guidance around the management of the reserve.

EITE

ACSI acknowledges the request by Emissions Intensive Trade-exposed Entities (EITEs) for funding support to invest in decarbonisation technologies. It is important that funding is designed to support decarbonisation and does not distort market outcomes by prolonging activities that are not sustainable in the long term. Consequently, we would expect that access to such funding will be dependent on disclosure of a credible transition plan that links the funding received to the implementation of decarbonisation technology or process improvements.

CBAM

Many Australian asset owners have substantial offshore investments including in companies with high emissions-intensity industrial facilities. For Australian asset owners that have portfolio-level decarbonisation ambitions, it would be counterproductive to shift emissions from one part to another of their portfolios. The discouragement of offshoring of emissions should be a governing principle of the Safeguard Mechanism.

Government support to de-risk investment in decarbonisation technologies and the introduction of a Carbon Border Adjustment Mechanism (CBAM) are two levers to ensure that the Safeguard Mechanism discourages offshoring of emissions. We support the plan to hold a consultation on the development of an Australian CBAM. We expect that this would mean that the special treatment of baselines for EITEs especially at risk of carbon leakage would be time-limited and only operate until the introduction of an Australian CBAM.

I trust our comments are of assistance. Please contact me or Kate Griffiths, Executive Manager – Policy and Research (kgriffiths@acsi.org.au), should you require any further information.

Yours faithfully



Louise Davidson AM
Chief Executive Officer
Australian Council of Superannuation Investors

¹⁰ ACSI calculations from public data