Submission on the Australian Government's Safeguard Mechanism Reforms

The Australian Sustainable Finance Institute | February 24, 2023

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Introduction

ASFI represents Australian financial institutions – including major banks, superannuation funds, insurers, asset managers, and financial services firms – that are working to align the Australian financial system with a sustainable, resilient, and inclusive Australia. ASFI members collectively hold over AU$18 trillion in assets under management and are committed to allocating capital in a way that supports positive climate, environmental and social outcomes.

Climate change presents serious risks to the financial system and to the ability of financial institutions to meet their obligations to members, investors, clients, consumers, customers and shareholders. Strong, orderly action to reduce emissions – consistent with a 1.5 degree pathway – is critical to reduce these risks, support Australia's economic competitiveness, and ensure Australian financial institutions (FIs), firms and communities maintain access to the cost-effective capital that is essential for the transition.

ASFI welcomes the Government's commitment to reform the Safeguard Mechanism to require Australia's largest emitters decarbonise in line with Australia's climate targets. A credible and robust Safeguard Mechanism will help Australian industry to attract the investment and finance it needs to capitalise on the opportunities of the net zero transition and thrive in a low carbon future.

ASFI's Views and Recommendations

Overall design and ambition

In general, we support the key design elements set out in the Government's Position Paper. By mandating a minimum level of emissions reductions, the Safeguard Mechanism (SM) sets a baseline expectation for reductions by Australia's largest emitters. The proposed credit and trading mechanism should work to incentivise deeper cuts where these are most cost-effective.

Increasingly, global financial markets – including ASFI members – expect clients and investees to actively manage climate risk and to develop and implement transition plans that put them on science-aligned decarbonisation pathways. These pathways likely require steeper and earlier cuts than the pathways implied under the SM. The ability to use ACCUs to meet SM liabilities further dilutes the incentives for industrial emissions reductions. As such, it is important to recognise that the SM sets a floor for facilities' decarbonisation activities and that greater ambition will be required to meet market expectations.

Baselines

We support the proposal to remove headroom by re-setting baselines. On balance, we consider production intensity a reasonable approach but note that the Government will need to guard against overshoot of the emissions reduction budget from increased production and new entrants.

In a global market, it is important that Australian industry performance be benchmarked against global industry performance. The proposed SM would be improved by an immediate shift to industry average baselines, rather than the proposed incremental approach to 2030. This would reward facilities that are already performing better than the industry average and encourage earlier investment to reduce emissions.

We support the proposal to set baselines for new entrants at international best practice. It is important that the definition of 'international best practice' sets a high standard so that any new facilities are genuinely best in class – this will help position Australian industry to be competitive in the future.

Flexibility Mechanisms

We recognise that some sectors have a more difficult decarbonisation challenge than others, and that transition pathways will vary across and within industries. It is therefore appropriate to build in flexibility through crediting and trading of Safeguard Mechanism Credits, which will encourage over-achievement where this is most economic. We support the 10% limit on borrowing and the application of an interest rate as a means of dis-incentivising an extended deferral of decarbonisation.

We also recognise that plant or facility upgrade schedules can be lumpy and that multi-year monitoring may be an attractive way to manage this. To help ensure that multi-year monitoring is not inappropriately used as an excuse to delay investment, we recommend that facilities applying for a multi-year monitoring approach should be required to have in place transition plans that meet best practice transition plan standards. In order to facilitate the production of high-quality transition plans, the Government should:

1. Require entities to develop transition plans consistent with good practice guidance. The requirement should be part of the Government's proposed climate-related disclosure framework. The Government should prioritise the development of guidance for transition plans in 2023, building on international examples such as the UK Transition Plan Taskforce; and
2. Task an appropriate body – such as the Climate Change Authority – to develop indicative sector decarbonisation pathways that can provide a benchmark for industry decarbonisation in each sector and provide a basis for sound policy-making going forward.

For some facilities, carbon offsets will be an important part of their transition strategy. However, the global market expectations for the use of offsets are becoming more stringent:

- Firms should prioritise emissions reductions within their own operations;
- Any use of carbon offsets should not substitute for direct reductions;
- Offsets must represent genuine abatement. There is an increasing focus on the quality of offsets, and a preference for removals over avoidance.

The proposal to allow unlimited use of ACCUs for firms to meet their SM obligations may not be consistent with best practice transition planning for all firms. If ACCUs are readily available at low prices, the incentive to decarbonise is reduced and some firms may opt out. Capping the ACCU price at $75 further dilutes the signal to decarbonise in line with global expectations.

The Government should consider raising or removing the price cap on ACCUs. As part of the 2026-27 review of the Safeguard Mechanism, the Government should assess whether flexibility mechanisms (and in particular, ACCUs) are being used to avoid decarbonisation, and whether there should be limits placed on their use. It should consider ways to incentivise the purchase of SMCs over ACCUs as a means of incentivising direct emissions cuts in line with necessary transition pathways.

Emissions intensive trade exposed facilities

We agree with the Position Paper's observation that economic competitiveness for SM facilities is increasingly correlated with low-emissions operations. Firms that fail to put in place and execute credible transition plans will be less attractive to financiers, investors and insurers and face higher costs of capital – reducing their competitiveness.

We consider the proposal to allocate $600m from the Powering the Regions Fund to help EITEs invest in decarbonisation is reasonable. It is critical for these grants to be merit based and awarded to support genuine investment in decarbonisation. We recommend that eligibility for this grant funding be contingent on the applicant having in place a high-quality transition plan that meets best practice standards. This implies that facilities that do not face a reasonable prospect of continuing to operate in a net zero carbon economy should not be eligible for assistance.

We support the proposed approach to the second category of EITEs assistance (trade-exposed, baseline adjusted, or "TEBA") for the early years of the scheme. As baselines decrease, more facilities may become eligible for TEBA while the justification for assistance will become weaker. We recommend TEBA be phased out and/or the impact assessment become more stringent in the lead-up to 2030. We welcome the proposed review of alternative approaches to assistance, including a carbon border adjustment mechanism (CBAM). A CBAM could be an appropriate replacement for TEBA. Aligning with the EU timeline for introducing its CBAM could support global consistency.

Transparency and Reporting

The current approach to reporting of emissions under the National Greenhouse Emissions Reporting Scheme (NGERS) lacks transparency and makes it difficult to ascertain how facility level emissions relate to corporate performance. We recommend that the SM reforms address this issue, making information more readily available and understandable to investors and the public. Facility information should be linked to responsible entities, and entities should be required to report aggregate facility information. Interactions between NGERS reporting and the proposed climate-related risk disclosure reporting should be carefully considered to promote disclosure of clear and decision-useful information (including relating to companies' transition plans), while also limiting reporting burden (i.e., where possible, entities should not be required to report the same information in multiple different formats, channels, and timeframes).

Safeguard Mechanism review and broader climate policy considerations

We support the proposal for the Government to review the SM in 2026-27. We recommend that this review consider how the SM is situated in the broader Australian climate mitigation policy suite. It should consider opportunities to expand the scope and coverage of the revised scheme, for example by decreasing the eligibility threshold for facilities, and including electricity generation. The Government could also consider the potential to move towards an economy-wide carbon price which offers a more simple, cost-effective, and efficient approach to driving decarbonisation and the investment required to support it.