CLIMATE ENERGY FINANCE

Safeguard Mechanism Reforms | November 2022

Key points

- Legislation[1] not regulation is required. This is a key plank of Federal government policy.

- Carbon Border Adjustment Mechanisms (CBAM) are coming, as Emissions Intensive and Trade Exposed (EITE) facilities that need to act on emissions are making exceptional war-profits on exported scope 3 emissions, and have had a free carry for over a decade. Giving EITE facilities even more concessions just leaves domestic industry to do even more heavy lifting, even as they are smashed by hyper-inflation of all fossil fuel energy prices.

- The ERF ACCU governance debacle has undermined investor and public confidence. Beyond the Chubb review, the Safeguard Mechanism must restore Federal credibility; site-specific monitoring (given that satellites and the IEA report massive under-estimation) rather than industry norms, with real time public disclosure and independent verification is needed.

- The Government should mandate an Avoid>Minimise>Mitigate>Offset hierarchy. Given the need for permanent sustained reductions, strict limits on offsets will be required.

- A phase 2 threshold facility reduction to >25,000tpa should be introduced effective June 2025, widening industrial action and facilitating action of our Global Methane Pledge.

- After a decade of inaction, all headroom should be removed. The move from 137Mtpa in FY2023 to 99Mtpa by FY2030 needs to be mandated, with a reduction straight line of 4.5% pa (higher if production linked). New entrants need to have a zero allocation and pay their way, otherwise the 99Mt target is eroded, or every other facility has to lift their ambition accordingly. We are in a carbon constrained world, well behind the science.

- ACCU-Safeguard Mechanism Credits (SMC) linkage should be a phase 2 target. International linkage could follow as a phase 3, only with high ambition countries and highly credible schemes[2]. Global capital (like KKR/Ontario Teachers/GreenCollar) can massively lift Australia's global reduction contribution, but will only mobilise with credibility and policy integrity certainty.

- An interim review should be scheduled in 2 years in i.e. FY2025, rather than end 2023.

Discussion

The passing of the Climate Change Act 2022 setting a 43% emissions reduction target for 2030 is a major step forward for Australia, even if not fully aligned with the climate science. Meanwhile, the cost of delay and inaction over the last decade is smashing Australian communities with increased frequency and severity of extreme weather events, meaning insurance access is rapidly eroding. The

[1] Legislation by inclusion in the updated National Greenhouse and Energy Reporting Act (NGER Act) would boost integrity.

[2] Linking these two schemes medium term could be a valuable in building an effective economy wide carbon price proxy, and international linkage to the ET ETUS (~ €72/t) and/or Asian regional leaders like Singapore (S$25/t from 2024, but targeted to rise to S$50-80/t by 2030), but restoring ACCU credibility is key pre-requisite, if GSFI are to play ball under the GFANZ US$150 trillion 1.5°C pledge & SBTi. A shortfall fixed charge might work near term, raising revenue to fund schemes.

82% renewables by 2030 target is critical for decarbonisation (underpinned and enabled by the $20bn Rewiring the Nation from the 2022 Federal budget).

Giving the Safeguard Mechanism a real impact is a second key Federal initiative, one that should be embodied in legislation, not left to regulations. Australia's 30% reduction by 2030 Global Methane Pledge requires action and the Safeguard Mechanism does this, particularly if the threshold is reduced to facilities of >25,000tpa, in conjunction with $3bn commitment from the $15bn National Reconstruction Fund.

Along with the 82% renewables by 2030 (Rewiring the Nation), the SGM is absolutely key to delivering the Albanese Government's Climate Act 2022. Restoring domestic and global integrity and confidence and regulatory oversight is absolutely a prerequisite to delivery. Credible sustained emissions reductions are key, whereas offsets are a last and interim solution, given the clear need for the ratcheting up of the Australian NDC and 2035 pledge.

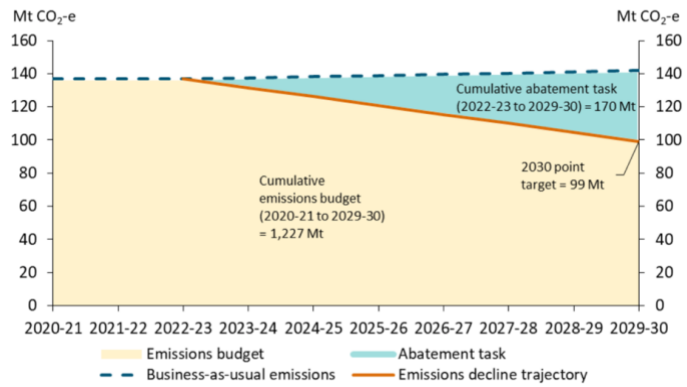
Assuming the 43Mtpa of headroom is cancelled, no 'soft start' in action, no EITE exemptions, ensuring no gaming by multi-year monitoring and delay, and zero emissions for new entrants, the 7 year rate of absolute reduction (production linkage would require a faster decline rate) is 4.5% pa FY2024-FY2030 to get from 137Mtpa to 99Mtpa, given no progress in prior years. This gives a 28% cumulative reduction on 28% of national emissions, considerably less than the 43% national target and leaders like FMG's Real Zero by 2030 and Rio Tinto's 50% by 2030 pledges.[3]

Figure 1: Safeguard Mechanism Annual & Cumulative Targets, Decline Rates

Rate of Reduction	CO2 Mtpa	Year	Difference	Rate of Reduction	BAU Mtpa
Nil	137.0	2021			
Nil	137.0	2022			
Nil	137.0	2023			137.0
4.5%	130.8	2024		-0.5%	137.7
4.5%	124.8	2025		-0.5%	138.4
4.5%	119.2	2026		-0.5%	139.1
4.5%	113.8	2027		-0.5%	139.8
4.5%	108.6	2028		-0.5%	140.5
4.5%	103.7	2029		-0.5%	141.2
4.5%	99.0	2030	-28%	-0.5%	141.9
Cummulative	936.8		178.6	Cummulative	1,115.4
Taeget 2030	**99.0**			**BAU Reported**	**1,127.0**

Source: Safeguard Mechanism Reforms Consultation paper August 2022, CEF Calculations

Figure 2.2: Proposed emissions budget and indicative abatement task for Safeguard facilities



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[3] Rio notes the step change to inert anodes in aluminium smelting could reduce Scope 1 emissions by 95%; while early in development, practical deployment of this technology in Australian smelters might require CEFC support.