



Investor Group on
Climate Change

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Submission on discussion paper:

King Review Safeguard Crediting Mechanism

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ABOUT IGCC

The Investor Group on Climate Change (IGCC) is a collaboration of Australian and New Zealand institutional investors focused on the impact of climate change on investments. IGCC represents investors with total funds under management of over \$2 trillion in Australia and New Zealand and \$20 trillion around the world. IGCC members cover over 7.5 million people in Australia and New Zealand.

Introduction

The Investor Group on Climate Change (IGCC) welcomes the opportunity to make a submission to the Department of Industry, Science, Energy and Resources on the issues canvassed in [Discussion Paper: King Review Safeguard Crediting Mechanism](#) (Discussion Paper).

Institutional investors have systemic exposure to climate change risks. A managed transition to net zero emissions by 2050 and actions to build resilience to the impacts of climate change will reduce the cost of climate change and open investment [opportunities](#). Globally, investors have trillions of dollars of capital to deploy towards climate change solutions if the policy settings to support this investment are right.

Need for credible, durable and long-term policy

In September 2021, 587 institutional investors with US\$46 trillion AUM issued their [strongest call ever](#) for governments to raise their climate ambition and implement meaningful policies to support investment in climate change solutions.

Strong climate policies in Australia could unlock [\\$131 billion](#) of fresh investment and job opportunities by the end of the decade.

The emerging gap between Australia's current 2030 emissions target and mainstream global investor practice, and company commitments to action, is a concern to institutional investors. If the Australian economy and companies do not match 2030 and 2050 net zero targets of major trading partners, they will become less competitive in attracting international investment into their economy and industries. Lack of Paris-aligned climate policy and regulatory risk in Australia is creating sovereign risks to investment, including through a high emissions intensity economy and low-quality climate-related financial disclosures.

Australia has access to significant pools of capital, both on and offshore, but large institutional investors will invest where they see the best opportunities for risk-adjusted returns. Significant public and private investment is needed to meet the Government's objectives of achieving net zero emissions and supporting investment across Australia. Australia has significant natural and strategic advantages to produce and capitalise on the existing and new export products that will grow in demand as part of an emissions-constrained world.

In response to current levels of policy risk in Australia, investors are taking a ‘wait and see approach’, delaying their investments particularly for large private investments in infrastructure domestically, while other investors continue to deploy their capital offshore. It’s likely investors do both.

[Investee companies also report](#) that current policy settings make it difficult to confidently invest in the new technologies at the pace and scale they need to remain competitive with global trends and counterparts in other markets. For example, investors already report they are investing in the EU to get a foothold in new emerging technologies because of a lack of policy clarity in Australia. Australian businesses risk losing the race towards the industries of tomorrow, importing technologies, rather than selling them to others.

Long-term investors have a critical role in delivering a more prosperous future and are increasingly changing their investment practices to align with a net zero emissions economy. Governments must also implement policies that are credible, durable, bi-partisan and predictable. This will reduce financial risks and encourage investment in low and zero carbon opportunities.

The required policy signals are not unnecessary subsidies. Rather, strong bipartisan policy is needed to provide a supportive, credible, consistent and stable policy environment that will facilitate private investment by reducing policy-related transition risks and shaping markets for low carbon products and services.

Comments on the Discussion Paper

The proposed Safeguard Crediting Mechanism’s (**SCM**) aims to incentivise deployment of low-emissions technologies by providing revenue to help investments over the minimum rate of return required for them to go ahead.

IGCC supports the broad objectives the SCM as a potential step towards establishing a more comprehensive policy architecture to achieve the emissions trajectory required by the Paris Agreement objectives and to remain internationally competitive. Without clear pathways for binding emissions reduction outcomes, tightening baselines and supporting mechanisms, the SCM policy is highly unlikely to incentivise large-scale investment in low-emissions technology or deliver large-scale emissions abatement.

The absence of these elements raises the prospect of the SCM creating perverse public interest outcomes and crediting for abatement of questionable additionality.

Embedding safeguard crediting considerations in Paris-aligned strategy

[Driving down emissions](#) in the industrial, manufacturing, transport, mining, oil and gas sectors covered by the safeguard mechanism will be critical to achieving the Paris Agreement objectives and remaining internationally competitive. As the Discussion Paper emphasises, the safeguard mechanism covers around one quarter of Australian emissions (excluding grid connected electricity generators), with significant opportunities to reduce emissions below-baseline levels.

To ensure companies remain competitive in global markets, the SCM should be compatible with pathways to reduce industry emissions at rates required in line with the Paris Agreement and expectations of Australia’s key trading partners – i.e., halving emissions by 2030, net zero by 2050, with the overarching objective of limiting temperature rise to 1.5°C.

Low emissions technology deployment scheme

A key design parameter outlined in the King Review recommendation 9.1 is that ‘The crediting mechanism would not be an offset scheme; it would be a low-emissions technology deployment incentive scheme, not unlike the [Renewable Energy Target] RET.’

However, while the Discussion Paper builds from this recommendation, the proposed SCM policy, in contrast to the RET, lacks any binding emissions reduction commitment. This is a critical design flaw to achieving emissions reduction outcomes at scale and attracting institutional capital to large scale investments. Without levers linked to achieving a clear emissions reduction outcome and mechanisms to make that happen, it is unlikely this policy will achieve its objectives at sufficient scale or attract institutional investment. Therefore, the Government should examine linking the SCM to binding targets to incentivise deployment of emissions reductions at facilities in line with Paris-aligned pathways before the SCM commences.

Delivering genuine abatement and incentivising emissions reductions

Using updated baselines that are significantly lower than current safeguard baselines (compliance baselines) may be an appropriate way to ensure Safeguard Mechanism Credits (SMCs) represent genuine abatement.

Significantly ratcheting down compliance baselines would give confidence that performance below baseline is genuine. This could involve evolving the safeguard mechanism to a baseline and credit scheme consistent with an investable pathway to achieve the Paris Agreement objectives.

Strengthening compliance baselines and ratcheting them down over time should be prioritised. But in the absence of this option, establishing SMC-specific baselines or thresholds that are substantially lower than current emissions profiles would help to ensure genuine abatement. Applying the same percentage factor across all facilities rather than sector-by-sector approach would reduce complexity. That being noted, this threshold should be set with consideration to science-based pathways for achieving Paris-aligned emissions reductions across the sectors covered by the safeguard mechanism.

To incentivise deployment of abatement activities by allowing sufficient credits to be generated while ensuring genuine abatement, this SMC threshold could establish an eligibility threshold. If the eligibility threshold is achieved, the quantity of crediting could then be measured against a business-as-usual “BAU” reference baseline (as outlined in the Discussion Paper, an updated reference baseline would be more appropriate than existing historic compliance baselines for assessing SMC eligibility and quantities. This is in part recognising existing historic baselines are often well above ongoing facility emissions). I.e., if the SCM threshold is 10 per cent below the reference baseline and a facility demonstrates a 12 per cent emissions reduction from that baseline, it would be eligible for crediting for the full 12 per cent. In contrast, if the facility achieves seven per cent reduction below the reference baseline, it would not be eligible to receive SMCs.

A percentage discount (determined at a general rate across all facilities to promote simplicity) could also be applied to the total below baseline amount to further ensure additionality of all credits.

Crediting above baselines

In no circumstance should SMCs be credited for facilities emitting above their compliance or reference baseline or that are on a multi-year monitoring period. Current compliance baselines only require facilities

to avoid exceeding BAU emissions. Existing compliance requirements under the safeguard mechanism should be sufficient to incentivise facilities to not exceed these baselines. If they are not, then further disincentives for exceeding baselines should be introduced, rather than rewarding the worst performing facilities with SMCs.

Demand considerations for stimulating deployment

Successful abatement outcomes at scale will require sufficient and sustainable demand for SMCs over time. Currently the primary demand for SMCs appears to be from government purchasing, with a committed budget of \$279.9 million over 10 years. In the absence of other drivers, this may stimulate only modest outcomes in comparison to scale of the emission reductions required and associated investment.

Private compliance demand is limited under current policy (i.e., under existing safeguard mechanism compliance requirements). Further, compliance demand under the safeguard mechanism for SMCs would displace demand for Australian Carbon Credit Offset Units (ACCU) in that market, causing [concern](#) for ACCU market participants.

Steps to promote the SCM's objectives and increase demand could include:

- Ratcheting down safeguard compliance baselines to stimulate private demand, also reducing additionality and market share concerns.
- Higher long-term public demand, which is separate and not directly competing with government purchasing of ACCUs. Ideally this would be combined with a binding target for decarbonisation.

Such steps would also help to address concerns regarding potential adverse impacts of the SCM on other Australian carbon credit markets. These demand considerations and drivers should be informed in a Paris-aligned pathways to reduce emissions.

Avoiding excess units and compromising existing carbon credit markets

Measures including limiting the life of credits and limiting issuance (i.e., via thresholds and discounts) are appropriate, including to reduce concerns of over-crediting or contaminating other carbon credit markets. Particularly at pilot phase, shorter-lived credits and crediting periods, while possibly requiring a higher unit price, would help to address this issue. The life of credits could be re-assessed and potentially lengthened in subsequent phases.

Evolving the Safeguard Mechanism

The Government should give close attention to strengthening the safeguard mechanism to support increased investment in low-carbon technologies throughout industry. For example, by updating it to a baseline and credit emissions trading scheme with baselines aligned with pathways to achieve the Paris Agreement objectives.

Conclusion

IGCC supports the SCM objective to incentivise deployment of low-emissions technologies. However, without strong pathways linked to the SCM (e.g., in the form of ratcheting down baselines or an alternative

mechanism like binding targets similar to the RET), it is unlikely the SCM will promote transformative emissions reduction projects at the scale required to attract institutional investment.

Using SCM baselines or thresholds that are substantially lower than existing safeguard baselines may be an appropriate way to ensure SMCs represent genuine abatement. It will also be important to ensure concerns regarding excess SMCs and contamination of existing carbon credit markets are addressed.

To be successful, demand for SMCs will need to be sustained and increased over time. Stimulating private demand by ratcheting down safeguard baselines would create additional incentives for emissions reductions and would reduce the pressure on tax-payer funds. Alternatively higher long-term public demand via government purchasing will be necessary.

The Government must embed SCM considerations and other changes to evolve the safeguard mechanism in a robust, Paris-aligned pathway to halve emissions by 2030 and reach net zero by 2050 at the latest. This is critical to unlock private capital in a broad range of technologies on the scale required. Without credible, durable long-term policy including strong Paris-aligned short- and medium-term targets, Australian businesses risk losing the race towards the industries of tomorrow.