



Submission to the Department of Climate Change, Energy, the Environment and Water

The Safeguard Mechanism Review 2026-2027

18 September 2026

IGCC acknowledges the Traditional Custodians of Country throughout Australia and the continuing connections to land, sea and community.

We pay our respects to Elders past and present.

Introduction to the Investor Group on Climate Change

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 over A\$4.6 trillion in funds under management in Australia and New Zealand. IGCC's members are the custodians of the retirement savings of more than 15.8 million Australians and millions more New Zealanders.

Climate damage is projected to reduce Australia's Gross Domestic Product (GDP) by 14 per cent annually if current global climate policies continue, wiping \$6.8 trillion from the economy between now and 2050 and cutting thousands of dollars a year out of the pockets of Australians. Delayed decarbonisation escalates physical damage from climate impacts across existing portfolios, while also facing the risk that Australian industries do not decarbonise fast enough to maintain competitiveness.

Papers submitted to the Department's consultation:

1. 'Futureproofing Industry - Investor Priorities for a Reformed Safeguard Mechanism'. This paper is attached to the back of this submission. It gives IGCC's summary of modelling commissioned from EY-Parthenon with accompanying interpretive notes and insights. As well as recommendations on reforms to the Safeguard Mechanism, it includes complementary measures to undertake outside of the scheme and finally a 'for further consideration' section.
2. '20260807 IGCC Submission to CCA on Fossil Methane', lodged separately with the Climate Change Authority. An executive summary is copied further below.
3. Hatfield-Dodds & Jotzo (2026), 'Assessment of Safeguard Mechanism options to motivate on-site abatement and support the transition to competitive, resilient and sustainable low-carbon economy'.

The core challenge for this Review

The Safeguard Mechanism (SGM) works well in delivering abatement while keeping compliance costs low, but it does little to support or incentivise on-site abatement and the transition to resilient and competitive low-carbon industries.

The review of the SGM presents an opportunity to accelerate Australia's energy transition, strengthen energy resilience and support industrial competitiveness and development. This aligns well to investors' goals, to manage transition risk in decarbonising their assets, and grow new industries to invest in.

Without reform the SGM will present cost to industry without developing any new competitive advantage. Our research has found the present design of the SGM will not drive significant on-site abatement and the credibility challenge associated with overreliance on ACCUs will worsen.

Investors understand that ACCUs are meant to reduce average transition costs, allowing companies to decide how to undertake on-site abatement efficiently, when it makes sense for them. However, modelling from EY for IGCC shows that most on-site abatement that should be motivated by the current ACCU price is not materialising. Unpriced costs – learning gaps, local deployment challenges, policy uncertainty, challenging grant funding requirements – all make it simpler to offset.

Waiting beyond this review to address the current and projected overreliance on ACCUs risks locking in emissions-intensive assets with lengthy renewal cycles, meaning less time for the market to prepare and respond to changes. Small incremental price increases do not work well to incentivise expensive, lumpy capital expenditure necessary to decarbonise facilities. Jurisdictions where industrial transformations happen have much higher compliance costs, and much more subsidy than Australian facilities do. A land-sector based approach is only efficient if it supports on-site abatement, not if unfettered access delays it. **ACCUs should be used to reduce average compliance costs, not set the incentive price to decarbonise.**

Investors and companies want policy certainty, set early, with no surprises; not delayed decisions that condense transition timeframes in a higher-cost environment. Capital spent on land sector drawdown is capital not spent on making industrial assets more resilient and productive.

In EY x IGCC analysis, the reform that shifts the most behaviour by far is giving facilities access to low- or no-cost capital; far more impactful than a higher decline rate. IGCC is posing that this can be done in a budgetary neutral way, through a 'Reinvestment Contribution', a small cost on ACCU surrender with proceeds reinvested back into facility transitions. In subsequent analysis by Hatfield-Dodds & Jotzo (2026, forthcoming), **a Reinvestment Contribution achieves the most on-site abatement at negative cost, compared to a base case with no reforms.**

Key findings and insights from IGCC's Futureproofing Industry report¹:

- By 2040, under current ACCU settings, at a 7% decline rate, about half of abatement is met through offsets. **A plateau in additional on-site abatement happens between 2030 and 2035, even under 7% decline rate.** This risks inefficient assets being locked in, leaving a larger land-sector drawdown task for 2050 and beyond.
- Aligning decline rates to the 2035 target is not enough to switch from offsetting ACCUs to on-site abatement. ACCUs are at \$40AUD now and will only get to \$100AUD in 2040 under current ACCU settings, even with a 7% decline rate (2031-2035).
- Fossil fuel facilities have ~2.5x the abatement available under \$120/t than other industry. This is the low-hanging fruit, with most other abatement on-site costing substantially above this for other industry.
- Some low-hanging fruit (methane abatement) should be motivated at the current ACCU price but is not. Unpriced costs of undertaking the abatement activity, when it is simpler and easier not to, are not overcome by a low and incrementally increasing ACCU price.
- Improving the flexibility and durability of financial supports (not just grants) can add another ~20% (an additional 10Mt from 2030-2035) of on-site abatement. The only intervention in our modelling that meaningfully brought forward on-site abatement was the capital subsidy. This demonstrates undertaking on-site abatement is, for the most part, not nearly competitive at the expected ACCU price.
- Differentiated decline rates shift compliance burdens based on ability to transition in the near-term and cost of that activity, without increasing gross abatement or changing the ACCU price.

¹ See Appendix.

Core recommendations

IGCC proposes a package of options, which have been modelled together and synergise. These should be implemented at this review.

Recommendation	Rationale
1. Set a scheme-wide decline rate aligned with a proportional share of the upper end of the 2035 Nationally Determined Contribution (modelled as 7 per cent p.a.) from 2031-2035, with differential decline rates calibrated to sector specific circumstances.	Aligning the decline rate with a proportional share of the 2035 target range and is projected to drive 15 Mt in increased average annual abatement, with around 61 per cent of abatement delivered on-site and without non-compliance concerns. It will support more on-site abatement at facilities where there are near-term, cost-effective options and means that hard-to-abate sectors have more time to find solutions. The proportional share principle of the SGM should be maintained to maintain policy stability. Differentiated decline rates rebalance emissions reductions more equitably across the scheme; they do not force additional gross emissions reductions or increase ACCU prices, compared to a single average decline rate.
2. Implement a Reinvestment Contribution on the surrender of ACCUs.	Changes to use of ACCUs must be made as a result of this Review. Signalling changes early so that the market can respond and facilities have time to plan investments is essential. Of the options to reform ACCU use, IGCC supports most strongly the concept of a Reinvestment Contribution. A Reinvestment Contribution charged on the surrender of ACCUs would generate the capital Industry needs to undertake significant transformations. Application of the Contribution should be differentiated based on the facility's abatement options. Facilities that have near term or immediate abatement options available should pay a contribution that is then pooled and transformed into very concessional finance or other attractive incentive structures. Of all the most popular concepts of changing ACCU surrender rules, this option is the only option that lowers total industry costs (7% lower relative to current ACCU settings) while delivering significant increase in on-site abatement (48-56%). Capital should also be used to motivate nature repair, which current low-priced ACCUs do not meaningfully contribute to.

3. Administer Contracts for Difference to improve long-run price visibility on the ACCU price and guarantee supply.	Facilities and ACCU developers need better forward ACCU price visibility, so that they can plan investment decisions in on-site abatement and generating new supply, respectively. Government should issue CfDs to underwrite new supply for ACCUs, to help prevent against shortages, and to improve market visibility of ACCU price expectations.
4. Consolidate durable and flexible financial support for on-site abatement.	Current grant funding for on-site abatement support is under-utilised, because it is not seen as bankable to facilities or investors. A facility must finance a prospective study for an activity, onboard human resources to deliver it and then undertake the activity – if a grant can disappear in a handful of years, then facilities are not factoring it into their decision-making. Enduring finance legislated into the scheme through a Reinvestment Contribution would create right structure and incentive to support investor confidence in major industrial transformations. This should take the form of blended and concessional finance, grants, accelerated tax depreciation and other novel arrangements.
5. Expand coverage of the SGM by progressively lowering the eligibility threshold.	This will improve policy certainty that large facilities won't drop out of the scheme from their baselines reducing to just-below the threshold, and signal to mid-sized facilities that they will be captured by a given date. This which will motivate industrial transitions in these smaller facilities before they become regulated.

Combined effect

A 70 per cent aligned decline rate, with differentiated decline rates balancing the load, paired with a Reinvestment Contribution on ACCUs, would drive industrial transformation without increasing compliance costs in aggregate. Lower thresholds start expanding that signal. Those with near-term transition options available access enduring, flexible financial support to reduce their long-run compliance burdens, ensuring lower-cost ACCUs are available in scheme for hard-to-abate sectors with no near-term options. Prohibitive but essential prospective technologies can receive funding for R&D from the trust, scaling Australian innovation.

SGM becomes a clear, investible industrial transition scheme that maintains market-based efficiencies while installing guardrails that result in deeper decarbonisation by 2050, improving both the underlying value of Australia's industrial assets and attracting new private finance as industry decarbonises and becomes more productive.

Reinvestment Contribution

Building on the analysis IGCC commissioned from EY, IGCC proposes a Reinvestment Contribution, as an alternative to the concepts of ACCU discounting or caps, to reduce future overreliance on ACCUs while maintaining flexibility for facilities to decide their own transition timelines. **A Reinvestment Contribution would be a small dollar amount collected on ACCU surrender, collected into a trust and recycled back into the scheme. This amount is not designed to increase compliance costs and therefore force a switch from offsetting to on-site abatement. Its primary purpose is to ensure that facilities have access to deeply concessional or attractive finance that they otherwise would not, to help overcome costs that are not priced in (and therefore not motivated by) the ACCU price. The Reinvestment Contribution creates the most on-site abatement at negative cost to government and industry; it reduces long-run compliance costs and on-site abatement costs. It should be differentiated to not negatively impact sectors with no abatement opportunities, either through differentiated decline rates or a differentiated contribution amount.**

How it would work

Following IGCC's work with EY, Hatfield-Dodds and Jotzo (2026) undertook an initial analysis of what changes to cost and on-site abatement the Reinvestment Contribution could produce². The model assumes that 50% of the capital collected would go towards reinvestment in the scheme, and 50% towards bringing forward more and higher quality ACCU supply. This is an illustrative approach, not specifically endorsed by IGCC.

For a \$10 Reinvestment Contribution per ACCU (real, 2025 in 2031)³:

- \$1.8 billion collected for the trust per annum
- A 48% increase in on-site abatement (+19Mt)
- A 7% decrease in long-run compliance costs to 2050 (compared to no policy change)
- A 35% decrease in cost of on-site abatement, on average, subsidised through funding generated by the Reinvestment Contribution

A \$10 (real, 2025 in 2031) Contribution would be the equivalent in price to implementing a 1.25x discount on ACCUs in the short term, although the long run supply effects would change this equivalency over time. The key difference is that \$10 is directed into onsite abatement rather than additional abatement beyond the scheme's proportional share.

² See Appendix.

³ Hatfield-Dodds & Jotzo (2026), 'Assessment of Safeguard Mechanism options to motivate on-site abatement and support the transition to competitive, resilient and sustainable low-carbon economy'. See Appendix.

Benefits over other approaches for industry and investors

It would do several things that are important to the private sector:

- Not change the ACCU price itself, so that hard-to-abate sectors do not experience higher compliance costs that do not result in any shift towards on-site abatement.
- Collects capital for recycling back to SGM facilities, which government should structure into deeply concessional finance, appealing blended finance arrangements, instant tax depreciations, or grants. This capital would be baked into legislation, not subject to shifts in politics or public budgets. It would be bankable, unlike current grant structures.
- Designed not to make using ACCUs substantively more expensive to motivate on-site abatement. Rather, it is a non-punitive amount designed to be just enough to create a pool of capital that can provide access to finance that facilities otherwise could not. The small additional cost is more than made up for in cost saving to industry in bringing forward on-site abatement.
- Can be ratcheted up or down over time.
- Avoids risk of setting facility or system caps incorrectly due to uncertainty in abatement pathways.
- Can be used to finance other transition dependencies like access to firmed renewable energy, or R&D, or prospective studies.
- Provides ultimate flexibility to the facilities about when they undertake on-site abatement; no caps on surrender.
- Delivers the most on-site abatement at the least-cost of all the popularly discussed reform concepts (system caps, facility caps, discount rates).⁴
- Supports stronger returns on Safeguard Mechanism Credits that facilities generate, because they will not have a surrender cost.
- Reduced prices for ACCUs as on-site abatement accelerates over time, contributing to reduced compliance costs (compared to no reform).
- Simple to implement and easy to signpost. Government should set dollar figures well into the future, establish a trust to hold the capital in, and develop a basic criterion for what it can be spent on.
- Can subsidise higher quality ACCU supply that delivers benefits to nature that would otherwise not happen at a low ACCU price.

⁴ Hatfield-Dodds & Jotzo (2026), 'Assessment of Safeguard Mechanism options to motivate on-site abatement and support the transition to competitive, resilient and sustainable low-carbon economy'. See Appendix.

Extended response

IGCC's recommendations are based on substantial modelling and analysis by EYPS, consultation with investor members, industry bodies, corporate engagement and peak body technical advice.

70 per cent emissions reduction-aligned decline rate with sectoral differential decline rates

A 70 per cent aligned decline rate from 2031 to 2035 is projected to drive 15 Mt in increased average annual abatement without non-compliance concerns. There is minimal increase in compliance costs between a 62 per cent and a 70 per cent aligned decline rate⁵, because the ACCU price is, and is projected to remain, very low.

A higher decline rate must be paired with differential decline rates at the sector level, to ensure that those with more ready options take those up, and those that do not, have a longer runway to find solutions. A single scheme-wide decline rate applies the same signal to both. The result is a transfer from manufacturing to extractive industries, as fossil fuel facilities generate credits from comparatively cheap on-site abatement and sell them to facilities with comparatively harder, more protracted transitions.

Differential rates with 2 per cent higher declines for coal, oil, and gas help align the fossil fuel sector's task with their access to attractive on-site abatement, with around 29 per cent of their task available on-site below \$120 per tonne, around 2.5 times the share for manufacturing. Overall, this improves efficiency of capital allocation decisions across SGM facilities and keeps finite ACCU supply available for long-run, hard-to-abate sectors. IGCC supports differentiated decline rates over Sectoral TEBA, because there is no phasing up of decline rate possible with it; a sector would either have TEBA, or not. If a sectoral TEBA approach is taken, then it should be differentiated across sectors, rather than having a single Sectoral TEBA rate. This would help mitigate "cliffs" that introduce uncertainties about transition pathways and any changes to the decline rates would need to be well-telegraphed. The average decline rate would need to be set higher than it otherwise would, to ensure that net emissions reductions are still on track.

While it is not possible to model the exact Marginal Abatement Cost Curves of a particular facility, without that information supplied by the facility itself, IGCC is confident EY's analysis demonstrates that there is a strong divide between extractive industries and manufacturing industries on the cost to transition. This is because the equipment required to decarbonise manufacturing is structural, whereas process changes and efficiencies make up the bulk of the lower-cost abatement for fossil fuels, which is mostly fugitive methane abatement.

⁵ Modelled as 5 per cent and 7 per cent decline rate, respectively.

Local deployment costs of technologies for fugitive methane abatement and facility-specific circumstances must not be understated; government must provide wrap-around support for building knowledge systems and allow access to the capital generated by a Reinvestment Contribution for high-impact abatement that would otherwise not be motivated at the ACCU price.

Investment clarity for on-site abatement

The scale of the industry transformation task is not appropriately supported in current scheme design with the low marginal abatement incentive price of the ACCU. Government has proposed some options to address the ways that facilities use ACCUs to meet compliance burdens, including consideration of ACCU caps or discounting. IGCC strongly urges the Government to commit to reform in this area, in this review, with our preference being a Reinvestment Contribution.

There are many assumptions being made about the quantum and cost of ACCU supply, and **banking the transitions of Australia's heavy industry on the land sector introduces significant sovereign risk**. This cuts both ways; **oversupply of low-cost ACCUs means industrial assets aren't undergoing efficiency and productivity gains through on-site abatement, while too little supply creates price volatility that could undermine the competitiveness of Australian industry**. Either way, betting the competitiveness of Australian industry on reliance of land sector abatement is a risky situation, and risks will only compound over time.

Unpriced risks from ACCUs setting the incentive price:

- Land is a finite, undervalued resource and there will be significant residual emissions that the government is liable to address in and outside of the SGM in 2050, and beyond.
- Reliance on ACCUs in the near-term means facilities are not undertaking investments in their own futureproofing, leaving them exposed to higher compliance costs from potential shortfalls in future supply. This increases the risk of stranded assets and non-compliance.
- Land sequestration is reversible and is more likely to be reversed in future as the climate changes.
- Low-priced ACCUs are generated from projects that have little nature repair or biodiversity value, and their primary market being a compliance scheme (SGM) means that lowest-cost projects are incentivised.
- Other jurisdictions where land credits are not allowed to meet compliance burdens have industries investing in their modernisation, with productivity gains that Australian industries will not experience by relying on ACCUs.
- Investors perceive offset-based compliance schemes as undermining the credibility of Australia's emissions reductions targets and Future Made in Australia ambitions. Investors want improved underlying asset value and futureproofed businesses – current ACCU settings introduce significant sovereign risk and may result in Australian bonds becoming unattractive.

- By maintaining current ACCU settings, government would introduce significant policy uncertainty risk. This is because the underlying issues created by unrestricted ACCU use, a far weaker incentive price than required for industrial transformation, will persist if unaddressed. This means more stringent, poorly telegraphed and extreme measures will need to be implemented to meet Australia's targets.

Contracts for Difference: ensuring supply at a floor price and improving market visibility on the long-run ACCU price

Given varying accounts of how much low-cost ACCU supply is possible to be generated, accounting for risk of reversal and other land-use constraints in a climate-changed environment, government should introduce Contracts for Difference (CfDs) for ACCUs. This would entail underwriting ACCU supply at a particular price, and to facilitate price discovery through purchases of the forward contracts. This helps create bankable price paths for when to undertake an on-site abatement activity, and helps ACCU developers prepare now; there is a five-to-seven-year delay from when an investment signal is received to when the investment reaches maturation, so those early signals are needed urgently (this is true for ACCU developers and for SGM facilities).

The current Cost Containment Measure prevents price spikes by ensuring that there is supply from government available at a certain price (the ceiling price). Government could maintain this but also create a price floor by issuing contracts for the bulk of ACCU supply at a future point in time. Government would have control over how much supply it underwrites and at what prices, which ensures that there is not a significant amount of ultra-low-cost ACCUs available (ACCUs that are not contracted would sell at the higher market rate, set by the bulk that have been). Doing this should be well telegraphed, and the CfD prices must be public to enable price discovery and bankable forward price curves.

IGCC supports introducing vintages on ACCUs to ensure that they are not banked by those that can afford to do so, driving up costs to others that cannot. A complementary measure to the SGM reform should be a change to the Diesel Fuel Tax Credit; it is a significant disincentive to electrify mine sites that the SGM cannot otherwise address in-scheme. IGCC has forthcoming research on this.

On-site abatement support:

Current grant funding for on-site abatement support is under-utilised, because it is not seen as bankable to facilities or investors. A facility must finance a prospective study for an activity, onboard human resources to deliver it and then undertake the activity; if a grant can disappear in a handful of years, then facilities are not factoring it into their decision-making. Enduring finance legislated into the scheme through a Reinvestment Contribution would create the structure and incentive to motivate major industrial transformations.

Novel Safeguard Mechanism Credit (SMC) generation method:

There are circumstances where on-site abatement is too cost-prohibitive and would result in several years of paused operations, so the company would find it challenging to recuperate costs of the abatement activity in the near-term. To ameliorate these circumstances, government could also issue SMCs in a novel way; it first pays for some or all of the abatement activity, and then takes the SMCs that the abatement has generated, selling them back to market to recuperate its own costs. This arrangement should be taken on a case-by-case scenario, given the government would not want to open itself up to trailing liability risk, if the facility is not able to operate and generate those SMCs. IGCC has forthcoming research and analysis on the construction of financial supports that would better work for industry.

On methane:

Supporting on-site abatement can't just be from a cost of capital perspective. There are knowledge gaps and local deployment challenges that facilities need active support in reconciling. This is particularly true for methane management. The National Inventory Systems and International Reporting branch has carriage of methane monitoring and reporting rules and reviews but doesn't support mitigation efforts. IGCC suggests that accountability for methane reduction be established and appropriately resourced within the Australian Government.

Consistent with there being no branch or division of the Australian Government assigned to oversee policy measures and efforts relating to methane, there are no agencies or Australian Specialist Investment Vehicles (SIV) leading company-facing outreach at the Commonwealth level. Nor is there the engagement with state-level safety and permitting regulators that is needed to accelerate the deployment of fossil methane reduction solutions. IGCC observes an important opportunity for a government body, potentially directed by DISR and instigated by ministerial direction, to bridge this gap.

Cornerstone elements of ARENA's playbook with relevance here include:

- Insights forums that convene knowledge holders and actors in settings where they are able to collaborate,
- Commissioning of targeted technical and civil society studies, and
- A requirement that Knowledge Sharing Reports are published for each abatement project.

Baselines and flexibility arrangements:

IGCC recommends some adjustments to the administration of the scheme, including improves emissions-intensity reporting disclosure under facility and government public reporting. Tracking overall emissions is important, but emissions-intensity is critical to differentiate clearly, so investors can distinguish on-site abatement from changes in production quantities. This will help investors determine whether their investments are on-track for their transition to net zero emissions.

Government should also consider whether flexibility arrangements for baselines are appropriately calibrated or are resulting in the on-site abatement task being delayed without reasonable grounds (i.e. there are near-term abatement options available, but the facility is not utilising them without reasonable justification).

Under the SGM, baselines for existing coal mine facilities are determined using a hybrid emissions-intensity approach that combines facility-specific emissions intensity with the relevant industry-average emissions intensity, with the weighting assigned to the industry average increasing progressively over time. The industry-average component reaches a 50 per cent weighting in 2029–30. This weighting for coal facilities is out of step with the treatment of other facilities that are required to reach industry average emissions intensity decline rates by 2030 without site-specific relief. We recommend that this progressive weighting continue beyond 2030, so that the industry-average component assumes an increasing role in determining each facility's baseline and continues to provide a strong incentive for facilities to improve their emissions intensity towards the industry average. It would be appropriate to phase out the site-specific component by 2035. In addition, the Government should consider whether separate industry-average emissions-intensity values should be established for above-ground and underground coal mines, having regard to the material differences in their operating characteristics and emissions profiles and the perverse incentive currently applicable to open cut mine emissions abatement.

At the same time as boosting explicit engagement with methane in its own right, it is essential to equip investors, those within companies allocating capital, and policy makers with visibility of methane's potency in simplified terms. IGCC believes that this is best achieved by displaying methane volumes, where methane is converted into carbon dioxide equivalence, on a dual basis, produced by multiplying the raw tonnes emitted by both short-term and long-term Global Warming Potentials. This would enable better monitoring of methane emissions and abatement at SGM facilities.

Scheme coverage:

Expanding coverage of the SGM by lowering the threshold will improve long-run scheme clarity by ensuring that facilities do not drop out of the scheme if their emissions dip below 100,000 tonnes, which has been raised as an issue by some companies, that it introduces uncertainty about decarbonisation trajectories for their assets. Lowering the threshold in predictable increments, capturing new facilities, will mean that mid-sized industry is incentivised to decarbonise before it is captured.

A modelled reduction in the facility threshold in three steps to 25,000 tonnes CO₂-equivalent from 2031 to 2037 would motivate around 5 Mt per year of additional abatement across the economy by 2040.

IGCC at this stage does not specifically recommend that the electricity sector be included in the scheme. Instead, government should apply a SGM liability to coal generators at their stated closure date, to ensure that there is a signal to introduce new, renewable supply to replace that generation. Coal generators should surrender Renewable Electricity Generation of Origin certificates, to support new renewable supply coming online. Surrender of ACCUs would transfer value from the electricity sector to the land sector, which is not productive or transformative and would put increased pressure on the land sector delivering abatement.

Conclusion

IGCC supports targeted reforms to improve the SGM. As much as possible, future reviews should clearly signpost what reforms are being considered. EYPS modelling demonstrates that there is a five-to-seven-year delay between a policy change and a response, both from facilities (undertaking on-site abatement) and ACCU developers (creating more projects), and so five-yearly reviews create uncertainties that stall investment decisions. Implementing moderate reforms early will help safeguard against wholesale changes closer to 2050 in a higher-cost environment.

We will continue to iterate on the Reinvestment Contribution concept and the CfD structure with key partners, to help inform subsequent engagements with government and others in the coming months.

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Investor
Group on
Climate
Change

Futureproofing Industry

Investor Priorities For a Reformed
Safeguard Mechanism

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*Image: A battery-powered earth loader, producing no on-site emissions,
and able to run on renewable electricity.*

About the Investor Group on Climate Change

We are the leading network for Australian and New Zealand investors to understand and respond to the risks and opportunities of climate change.

Our members include our countries' largest superannuation and retail funds, specialist investors and advisory groups. Their beneficiaries include more than 15.8 million Australians, and millions more New Zealanders. Our members manage more than \$4.6 trillion locally.

We are a not-for-profit and our work is funded by members' fees and philanthropy from supporters who understand the power of capital to support climate action.

We acknowledge the traditional custodians of the lands on which we work. They include the Boonwurrung, Gadigal, and Ngunnawal people.

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This acknowledgement should not be interpreted as them or their employers necessarily endorsing any particular part of the final paper.

Evolving the Safeguard Mechanism

The 2026-27 review of the Safeguard Mechanism presents an opportunity to accelerate Australia's energy transition, strengthen energy resilience and support industrial competitiveness and development, with targeted adjustments.

The Safeguard Mechanism is a critical first step in Australia's industrial transformation.

Its reform is an opportunity to improve the scheme's contribution to the government's goals of emissions reduction, industrial competitiveness, new industry and job development, and energy resilience. This aligns well to investors' goals, to manage transition risk in decarbonising their assets, and grow new industries to invest in.

Without reform the scheme will present cost to industry without developing any new competitive advantage.

Our research has found the present design of the Safeguard Mechanism will not drive significant on-site abatement and the credibility challenge associated with overreliance on offsets will worsen. Absent further reforms the Safeguard Mechanism will not improve the competitiveness of existing industry nor support the growth of new industries other than carbon farming.

Near-term opportunity already exists.

A key finding of this report is that significant abatement opportunities are available at incentive prices consistent with existing cost containment settings. Most lower cost abatement available to fossil fuel facilities is fugitive methane. The scheme is not currently capturing this opportunity as the carbon signal sits below the cost of most on-site abatement, so facilities offset instead.

IGCC's proposed reforms would address these challenges, building on the success of the scheme to date:

- Adjustments to Australian Carbon Credit Unit (ACCU) use and reserve pricing which lift the carbon price signal and will help business make the business case for on-site abatement.
- Differential decline rates which allow the scheme to target lowest cost, lowest margin impact abatement, which is presently not accessed.
- Shifting government support mechanisms into a long-term, defined funding structure designed to assist with the most difficult and competitively significant emissions reduction actions with minimum, targeted cost to government.
- Adjustments to decline rates to align with the 2035 target range, and a modest expansion to the scheme's coverage threshold.

Recommendations

IGCC has developed the following recommendations for the Safeguard Mechanism Review based on technical analysis provided by EY, together with industry consultation.

IGCC Objective	No.	Recommendation to Government
The Safeguard Mechanism delivers its proportional share of Australia's 2035 Nationally Determined Contribution	1	Set an average decline rate of 7 per cent from 2031 to 2035, with differential decline rates calibrated to sector-specific circumstances.
	2	Develop a metric to inform setting differential decline rates.
Deliver lowest-cost, most-efficient abatement to the Australian economy	3	Improve long-run price visibility in the carbon market via Contracts for Difference (CfDs).
	4	Improve emissions-intensity disclosure under facility and government reporting.
Encourage more on-site abatement, and earlier	5	Replace the Cost Containment Measure (CCM) – the price cap on ACCUs – with a price corridor.
	6	Build an enduring form of financial support to bring forward investment in on-site decarbonisation.
Expand carbon signals across more of Australia's economy	7	Expand coverage of the Safeguard Mechanism by progressively lowering the facility emission threshold, starting with 75,000 tonnes of CO ₂ -equivalent in 2031.

Key Findings and Insights

A **5-7% p.a.** decline rate from 2031-2035 is proportionate to the **62-70%** 2035 target

But ACCU prices only reach **\$100/t by 2040**

Delivering **almost zero additional on-site abatement** between 2030-2035

Of the low-cost on-site abatement available, **fossil fuel sectors have 2.5x** more than other sectors

Lowering the threshold can deliver **5Mt/year** additional abatement

Better tailored finance vehicles can deliver **20% (10 Mt/year)** additional on-site abatement

The Safeguard Mechanism has **solid foundations but requires additional reforms to deliver industrial transformation through on-site abatement.**

By 2040, almost half of abatement delivered by the scheme is through offsets. With only 10 years left to reach net-zero emissions, this risks emissions-intensive assets being locked-in. Simply put, the ACCU price does not get high enough, soon enough, to motivate a switch from offsetting to on-site abatement.

Continued early reliance on offsets means the same industrial transformation is left to be completed in fewer years, at higher cost to investors and their beneficiaries. Limitations on ACCU surrender would motivate the switch, without depending on price increases.

Without reform, the government similarly risks **failing to meet broader objectives to strengthen energy resilience, support sovereign capability through a Future Made in Australia and remain an attractive destination for investment.**

Strengthening Long-term Investment Certainty

Institutional investors are long-term investors.

IGCC members manage A\$4.6 trillion locally on behalf of more than 15.8 million Australians and millions more New Zealanders. They invest with a multi-decade horizon that aligns the retirement outcomes of their members and investors.

Uncertainty is a barrier to capital deployment.

Investors identify policy and regulatory uncertainty as a leading barrier to deploying capital in Australia. IGCC's 2026 State of Net Zero report saw 56 per cent of respondents highlight this as a barrier, up from 40 per cent in FY24.

Durable policies that will deliver on the government's stated ambition now need to be implemented. The cost being paid today is in deferred investment.

The effectiveness of the Safeguard is financially material to investors' assets and value chains in the short and long term. It impacts their future investment decision making and it's important to get right.

Financial risks from delayed decarbonisation compound over time.

IGCC members are universal owners — invested across the entire economy, with no capacity to diversify away from a system-wide risk. A drag on national productivity is a drag on their investments, and ultimately on the retirement savings of the Australians whose money they manage.

Climate damage is projected to **reduce Australia's Gross Domestic Product (GDP) by 14 per cent annually if current global climate policies continue, wiping \$6.8 trillion from the economy between now and 2050** and cutting thousands of dollars a year out of the pockets of Australians.

Delayed decarbonisation escalates physical damage from climate impacts across existing portfolios, while also facing the risk that Australian industries don't decarbonise fast enough to maintain competitiveness.

Simply put, the cost of inaction is far greater than the cost of action.

The Abatement Task Is Unevenly Distributed

The Safeguard Mechanism's present design relies on offsets.

Eliminating industrial emissions means changing the energy inputs Australian industry runs on: electrifying mine fleets and process heat, using low-carbon liquid fuels, and supplying facilities with firmed renewable electricity in place of gas and diesel.

This highlights a key tension that the review must grapple with: how facilities should demonstrate compliance with the Safeguard Mechanism into the future. Currently, this is balanced between two pathways that are not equivalent in what they leave behind:

- **On-site abatement** is capital spent inside the facility. It modernises the asset, lowers its operating energy costs, and reduces exposure to fossil fuel price and supply shocks.
- **Offsetting** is real abatement, but nothing about the facility changes. Money leaves the facility and can be invested in nature-based offsets, supporting economic opportunities in regional communities and nature repair.

Facilities that continue to offset instead of investing do not develop that capability and risk capital being deployed elsewhere.

Ultimately, strengthening Australia's energy security and resilience demands more focus on incentivising on-site abatement.

Reform is required to avoid industry competitiveness challenges.

Extractive sectors have the strongest margins and the most readily available transition options. This report finds around 29 per cent of their abatement task is available on-site below \$120 per tonne, roughly 2.5 times the share available to manufacturing. Manufacturing facilities generally have thinner margins and fewer feasible on-site options.

A single scheme-wide decline rate applies the same signal to both. The result is a transfer from manufacturing to extractive industries, as fossil fuel facilities generate credits from comparatively cheap on-site abatement and sell them to facilities with harder transitions.

The Safeguard Mechanism will require more nuanced design into the future to avoid significant industry competitiveness challenges and to preserve Australian industry with a future in a net zero emissions economy.

Remaining an Attractive Destination for Capital as Our Trading Partners Transition

What it builds

Facilities that transition their energy inputs become the platform for the industries Australia is trying to grow — critical minerals processing, green metals, low-carbon liquid fuels, low-emissions cement. These are regional jobs, export revenue, and sovereign industrial capability, and they are where transition capital is looking to go.

Australia has the abundant and cheap renewable energy resources to support increased sovereign energy security as well as the increasing demand from our neighbours for low-emissions energy, materials and products to meet their own development goals.

Australia's major trading partners are decarbonising their own industrial bases and pricing carbon at their borders. Over the period of 2030-2035, the question of competitiveness will shift from what compliance costs are to whether Australian exports still enter those markets, and whether capital is still committed here.

Australia's ability to seize the economic upside from this transformation depends on having the right policy settings in place early enough to drive an efficient, least cost transition of fossil-fuel based exports to renewables-based exports.

The Safeguard Mechanism 2026-27 Review

What the Safeguard Mechanism does.

The Safeguard Mechanism is Australia's primary policy for reducing emissions from its largest industrial facilities. It covers facilities emitting more than 100,000 tonnes of CO₂-equivalent a year across mining, manufacturing, oil and gas, and transport – around 30% of national emissions.

Each covered facility is set an emissions baseline that declines annually. Facilities must cut emissions intensity over time or pay for the difference. Those that reduce emissions below their baseline earn tradeable Safeguard Mechanism Credits (SMCs); those that exceed it surrender ACCUs or SMCs to cover the gap. A Cost Containment Measure caps the price facilities pay for compliance.

Reformed in 2023, the scheme is designed to help Australia meet its 2030 and 2050 emissions targets while limiting competitiveness impacts on trade-exposed industries.

What the review will decide.

The Australian Government's review of the Safeguard Mechanism has two objectives:

1. Determine whether the 2023 reforms are working as intended and calibrated to deliver emissions reductions in line with Australia's targets.
2. Inform the best policy settings to achieve the Safeguard Mechanism's share of the 2035 target, in the context of the government's plan to achieve net zero emissions by 2050.

The review will run over the financial year 2026-27. Key issues being examined include setting the decline rates for the 2031-35 period, the extent to which on-site abatement is being driven by the scheme, coverage, arrangements for emissions-intensive and trade-exposed facilities, and further consideration of findings in the government's Carbon Leakage Review.

Through the review, the government is seeking to establish post-2030 policy settings and strengthen long-term investment certainty.

IGCC Goals for the Review

The current settings of the Safeguard Mechanism will not drive the transformation necessary to secure Australia's energy security and industrial competitiveness in an environment of increased competition for investment.

To understand the potential impacts and effectiveness of different reform options, IGCC engaged EY-Parthenon Strategy to model a range of scenarios that deliver against IGCC members' key objectives.

The following core objectives for the review of the Safeguard Mechanism were identified by IGCC members:

1. Deliver lowest-cost, most-efficient abatement to the Australian economy.
2. Encourage more on-site abatement, and earlier.
3. Expand carbon signals across more of Australia's economy.
4. Ensure the Safeguard Mechanism delivers its proportional share of Australia's 2035 NDC, ensuring alignment with the Net Zero Plan.

A 7 per cent decline rate

from 2031-2035 would align with the top of the 2035 NDC target range of 62-70 per cent.

Australia's 2035 Nationally Determined Contribution (NDC) includes a target range of 62-70 per cent emissions reduction by 2035, on a 2005 baseline. IGCC members consider that the top of this range should be used to calibrate the Safeguard Mechanism's average decline rate from 2031 to 2035 – which is a 7 per cent decline each financial year.

The following reforms not only make this achievable but would allow Australia to achieve emissions reductions at a lower average cost and with lower scheme-wide emissions, compared to a base-case without these reforms.

Achieving reductions aligned with this target range will require action across the full breadth of the economy. Other sectors outside of the Safeguard Mechanism must support and keep pace with the decarbonisation happening under Safeguard-regulated facilities.

IGCC recommends that the government adopt reforms detailed on pages 11-14 in the 2026-27 Safeguard Review and proposes several additional reforms for government's further consideration on page 15.

Recommendations: Ensure the Mechanism Delivers its Proportion of Australia's 2035 NDC

What IGCC is recommending	Supporting modelling and analysis
1. Set an average decline rate of 7 per cent from 2031 to 2035, with differential decline rates calibrated to sector-specific circumstances.	An average decline rate of 7 per cent aligns with the top of the 2035 target range and is projected to drive 15 Mt in increased average annual abatement, with around 61 per cent of abatement delivered on-site without non-compliance. Frontloading on-site abatement at facilities where there are near-term, cost-effective options means that hard-to-abate sectors have more time to find solutions. Differential decline rates rebalance emissions compliance burdens more equitably across the scheme. They don't force more emissions reductions or increase ACCU prices, compared to a single average decline rate. Differential rates with 2 per cent higher declines for coal, oil, and gas help align the fossil fuel sector's task with their access to attractive on-site abatement, with around 29 per cent of their task available on-site below \$120 per tonne, around 2.5 times the share for manufacturing. Overall, this improves efficiency of capital allocation decisions across Safeguard facilities and keeps finite ACCU supply available for long-run, hard-to-abate sectors.
2. Develop a metric to inform setting differential decline rates.	Decisions on differential decline rates should be informed by expert analysis and evidence on abatement potential for a given price, with government setting out a transparent process for implementing changes to decline rates. There is no universally accepted source of truth that determines what facilities are ready to transition, and when. IGCC recommends implementing differential decline rates based on the Marginal Abatement Cost Curves underlying the EY model. Drawing on existing expert analysis, including as part of the Carbon Leakage Review, the government should assess sector (and relevant sub-sector) abatement options, accounting for their cost effectiveness and relative technology readiness, to develop metrics that underpin differential decline rates and an ongoing process for review.

Recommendations: Deliver Lowest-Cost, Most-Efficient Abatement to the Australian Economy

What IGCC is recommending	Supporting modelling and analysis
3. Improve long-run price visibility in the carbon market via Contracts for Difference (CfDs).	<i>Qualitatively assessed by EY.</i> Currently, it is challenging for the market to predict the long-run price of ACCUs, both due to policy uncertainty (the future of the Cost Containment Measure) and uncertainty of future supply and demand. Being able to trade CfDs at a lower and a higher price allows traders to reveal roughly where within that range they think that the mostly likely future price sits and competition between them narrows in on the best estimate. Government should broker these CfDs, in a similar way that it regarding the Capacity Investment Scheme. Appropriately designed, these could be budget neutral and fungible with ACCUs in a given year. IGCC does not recommend a specific design. Better price discovery on the scheme's implicit carbon price will provide greater clarity for investment decision-making, helping facilities plan for when to make on-site abatement investments. This would also support ACCU developers to start new projects now, so that supply is available when it is needed most.
4. Improve emissions-intensity disclosure under facility and government reporting.	Tracking overall emissions is important, but emissions-intensity is critical to differentiate clearly, so investors can distinguish on-site abatement from changes in production quantities. This will help investors determine whether their investments are on-track for their transition to net zero emissions.

Recommendations: Encourage More On-Site Abatement, and Earlier

What IGCC is recommending	Supporting modelling and analysis
5. Improve certainty for investors and ACCU project developers by replacing the Cost Containment Measure (CCM) with a price corridor.	The CCM – the price cap on ACCUs – protects facilities from significant volatility. However, it curtails the long-run carbon price and diminishes the incentive to decarbonise early. Reforming the CCM to act as a price corridor, where prices are able rise predictably over time in response to market demand signals, but are supported by a price floor, would provide increased certainty for buyers and suppliers of ACCUs. We ask government to consider the design of this. This might look like government taking any value above a price ceiling, or paying any value below a floor price, which would create a collar. A price corridor would give facilities clarity on when to make decarbonisation investments and allows ACCU project developers to plan with certainty, providing welcome support for regional economic growth.
6. Build an enduring form of financial support to bring forward investment in on-site decarbonisation.	Without additional and better targeted financial support, modelling results show that decisions to bring forward on-site abatement and make significant capital expenditures with long asset lifetimes largely don't happen before 2040. An illustrative scenario modelling a 50 per cent capital subsidy could lift on-site abatement by around 20 per cent (up to 10 Mt per year) to 2035 without impacting industry competitiveness. This demonstrates that meaningful financial support does bring forward on-site abatement and reduces compliance costs for facilities to reach net-zero emissions. Short-lived or one-off grant programs are subject to shifting political and budget imperatives and can't be relied on by investors and companies planning over decades-long asset replacement lifecycles. The task of industry decarbonisation out to 2050 demands establishment of a more enduring framework of financial support to bring forward capital expenditure for on-site abatement. This should redirect funding from established, under-utilised sources and could include a focus on production subsidies, complemented with tax concessions or concessional and blended finance. Industries that are part of a net zero economy with genuine transition pathways should be prioritised for this support. IGCC is undertaking further work on this recommendation and will produce further analysis to support a proposed detailed design.

Recommendations: Expand Carbon Signals Across More of Australia's Economy

What IGCC is recommending	Supporting modelling and analysis
7. Expand coverage of the Safeguard Mechanism by progressively lowering the facility emission threshold, starting with 75,000 tonnes CO₂-equivalent in 2031.	Currently, facilities could drop out of the scheme at just below 100,000 tonnes CO₂-equivalent and the signal to decarbonise would cease. Lowering the threshold in predictable increments, capturing new facilities, will mean that mid-sized industry is incentivised to decarbonise before they're captured. A modelled reduction in the facility threshold in three steps to 25,000 tonnes CO₂-equivalent from 2031 to 2037 would motivate around 5 Mt per year of additional abatement across the economy by 2040.



For the Government's Further Consideration

IGCC recommends the government further consider the following measures, noting some measures were only partially modelled, were outside the scope of our modelled analysis or were assessed qualitatively.

- **Consider capping the surrender of ACCUs at a system-level.** EY's analysis found that higher baseline decline rates are not enough to motivate a switch from offsetting to on-site abatement in most cases, and other interventions will be needed. A modelled scenario of a 50 per cent cap on ACCUs, at the facility level, lifts on-site abatement but increases compliance costs and results in non-compliance. This was anticipated as a simplistic way of modelling a cap. IGCC suggests government assesses capping the surrender of ACCUs at the system-level. This would offer more flexibility to facilities in meeting their obligations than a facility-level cap and could be designed with differentiation at the sector-level. This would strengthen the signal to decarbonise earlier, without the ACCU price needing to increase dramatically in price in the short-term.
- **Remove or phase out Diesel Fuel Tax Credits.** Diesel Fuel Tax Credits discourage mine fleet electrification by keeping diesel trucks cheaper to run. Offsetting this would require a much higher ACCU price, raising compliance costs scheme-wide.
- **Extend the Safeguard Mechanism to include a carbon signal for electricity generators to support the energy transition.** This was beyond the scope of EY's modelling, however IGCC members note stalling renewables rollout and uncertainty on closure dates for coal fired power stations necessitating further action.

IGCC supports implementation of the NEM Review's recommendations and changes to improve the Capacity Investment Scheme (CIS). Further action in the Safeguard Mechanism may be warranted.

- **Apply a Safeguard liability to coal generators from their stated closure date, discouraging state governments from further extending plant life and signalling renewables to fill the gap.** Costs would be predictable and avoidable. Coal closure delays have hampered the CIS and put the 82% renewables target by 2030 at risk.
- **Allow facilities eligible for the R&D tax incentive to get access to higher ACCU limits, if an ACCU surrender cap is introduced.** R&D spend isn't rewarded under Safeguard despite its role in industrial transition.
- **Tie SMC crediting more closely to emissions-intensity improvement against appropriate benchmarks,** rather than generous baselines, so credits require genuine on-site abatement.
- **Model a public cost-recovery mechanism where government funds upfront decarbonisation costs and recoups them by selling SMCs once the facility is operational.** This addresses the "double whammy" hard-to-abate facilities face — long delays plus high upfront costs — and should apply only where government is confident of recovering costs.

Complementary Measures

The Safeguard Mechanism is one lever to achieve the government's 2035 NDC. Safeguard facilities must be supported in lockstep with decarbonisation accelerating across the rest of the economy. Frontloading on-site abatement early means that costs are kept lower for hard-to-abate sectors in the long term, keeping industry in Australia.

IGCC suggests the government implement complementary measures, between now and 2030:

- Create a level playing field for Australian industry by implementing a border carbon adjustment, aligned with the Carbon Leakage Review's recommendations – this should focus initially on cement, clinker and lime as the most trade-exposed commodities, and then consider hydrogen, ammonia and derivatives, steel and iron, and glass.
- Implement measures outside of the Safeguard Mechanism to accelerate methane abatement, recognising the many near-term opportunities for fugitive methane emissions reductions, which are over 80 times more potent than carbon dioxide over a 20-year period. Measures should include dual representation of NGER reported methane emissions, using both a 100-year and 20-year GWP conversion.
- Implement enduring electricity market reforms that will bring forward more renewable energy capacity and storage, in line with the National Electricity Market (NEM) review.
- Consider near-term opportunities to improve the Capacity Investment Scheme's remaining tender rounds, to bring more renewable energy capacity and storage online before 2030.
- Support the rapid acceleration of energy efficiency and electrification of buildings, heavy transport, and industry.
- Implement a policy package to support Low Carbon Liquid Fuel demand, as well as production, supporting sectors that cannot readily electrify.

IGCC will continue engaging with government and other stakeholders on the 2026-2027 Safeguard Mechanism Review as part of its policy advocacy program and stewardship activities with investee companies.

IGCC will release new analysis for consideration in the Review on adjacent policies that impact on-site abatement at Safeguard-regulated facilities.



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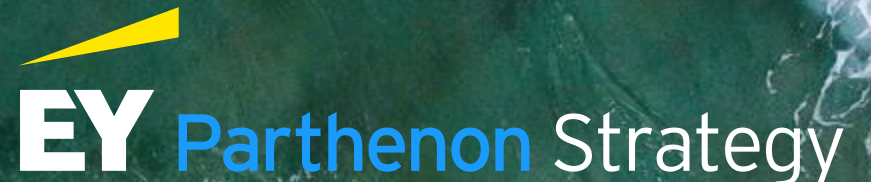
Analysis of Safeguard Mechanism (SGM) policy options

Report to the Investor Group on Climate Change
(Australia and New Zealand)

TECHNICAL REPORT

12 August 2026

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The results of EY's work, including the assumptions and qualifications made in preparing the report, are set out in this EY report dated August 2026 ("**Report**"). The Report should be read in its entirety, including the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report.

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The analysis and Report do not constitute a recommendation on a future course of action.

Readers are advised that the outcomes provided are based on many detailed assumptions underpinning the scenarios, and the key assumptions are described in the Report. The modelled scenarios represent a range of possible future options for the development and operation of the Safeguard Mechanism and Australian Carbon Credit Unit (SGM-ACCU) market, and it must be acknowledged that many alternative futures exist. Alternative futures beyond those presented have not been evaluated as part of this Report.

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Contents

- **Introduction and summary of key findings**
- Project context and process
- Overview of modelled policy options
- Key results and insights
- More details on the modelling framework

This document reports key insights and results from EY-Parthenon Strategy analysis of potential SGM reform options using the EY-CARBON VIEW model

Context and purpose

- The Investor Group on Climate Change (IGCC) has identified the Safeguard Mechanism (SGM) as a key Australian emissions reduction policy, which has material impacts on the assets, value chains and future decision making of IGCC members
- The Australian federal government is conducting a review of a range of SGM settings over coming months, including:
 - the 2031-2035 decline rate for baselines
 - whether the scheme is appropriately incentivising onsite abatement
 - scheme coverage arrangements
- To understand the potential impacts and effectiveness of potential reform options the IGCC engaged EY-Parthenon Strategy (EYPS) to analyse a range of options using the EY CARBON VIEW model, developed by the EY Net Zero Centre
 - The specific options analysed were developed by EYPS to illustrate potential responses to issues identified by IGCC and wider climate policy discussions. The options are stylised and do not seek to represent detailed policy proposals.
 - The analysis aims to capture complex interactions between long-term investment decisions made by both SGM facilities and ACCU project proponents. As with any modelling exercise, this involves a number of simplifying assumptions and limitations (see slide 12 and slides 44-51 for more details)
- This report presents key findings and insights from that analysis under a range of scenarios, reflecting different contexts and assumptions
- The results presented are general in nature and should not be interpreted or relied on as financial advice

We find current SGM settings provide a sound foundation for net emissions reductions but refinements could support improved market outcomes

Overview of key findings by goal

IGCC HIGH LEVEL GOALS	IMPLICATIONS	KEY FINDINGS
Ensure SGM and heavy industry make an appropriate contribution towards national targets	Calibrate SGM decline rate to 2035 national emissions target	Annual decline rate of 5-7% for 2031-35 achieves substantial national abatement and lifts the projected ACCU incentive price from \$50-60/t to around \$100/t, but involves higher total costs to industry
	Recognise how the aims and implications of the net zero transition differ across sectors	Differentiated decline rates with higher rates for fossil fuel extraction reduce the risk of competitive pressures on margin-based processing and support orderly national transition consistent with global climate goals
Deliver efficient low-cost abatement	Maintain market-based approach to motivating decarbonisation	SGM design provides a sound foundation for industrial decarbonisation but would benefit from refinements to improve investor confidence and risk management, and support an orderly transition
	Support market function via improved forward price risk management	Market participants have low forward price confidence, which discourages desired investment, suggesting a case for government auction of forward contracts for difference for ACCU prices (perhaps linked to new on- or off-site abatement) to support investor risk management and the delivery of the SGM's objectives
Support on-site abatement and orderly long-term decarbonisation	Ensure incentives and support are sufficient to drive long-term abatement planning and implementation	Lifting on-site abatement over time is essential for the net zero transition but could be economically challenging in the short term as off-site ACCU abatement accounts for around two thirds of available cost-effective abatement
		Government financial support (such as through grants, tax provisions or concessional finance) could accelerate on-site abatement, reduce compliance costs, and strengthen national economic resilience
		Current cost containment settings help manage price risks in a maturing market, but extending these could dampen incentives for deep decarbonisation. Policy should explore alternative approaches.
Expand carbon signals and abatement incentives across the economy	Broaden SGM coverage over time	Expanding coverage by lowering the SGM threshold contributes to meeting national emissions targets, motivates additional on-site abatement in newly covered facilities, and lifts SGM abatement incentives over time
	Strengthen abatement policies in other sectors	Not assessed: The EYPS modelling is focused on SGM facilities and ACCU supply, and does not assess abatement policies in other sectors

We find higher decline rates would be required to drive emissions consistent with the 2035 target range, and that policy refinements could increase on-site abatement and improve price visibility, investor confidence, and alignment to polluter pays

Summary of key findings and results

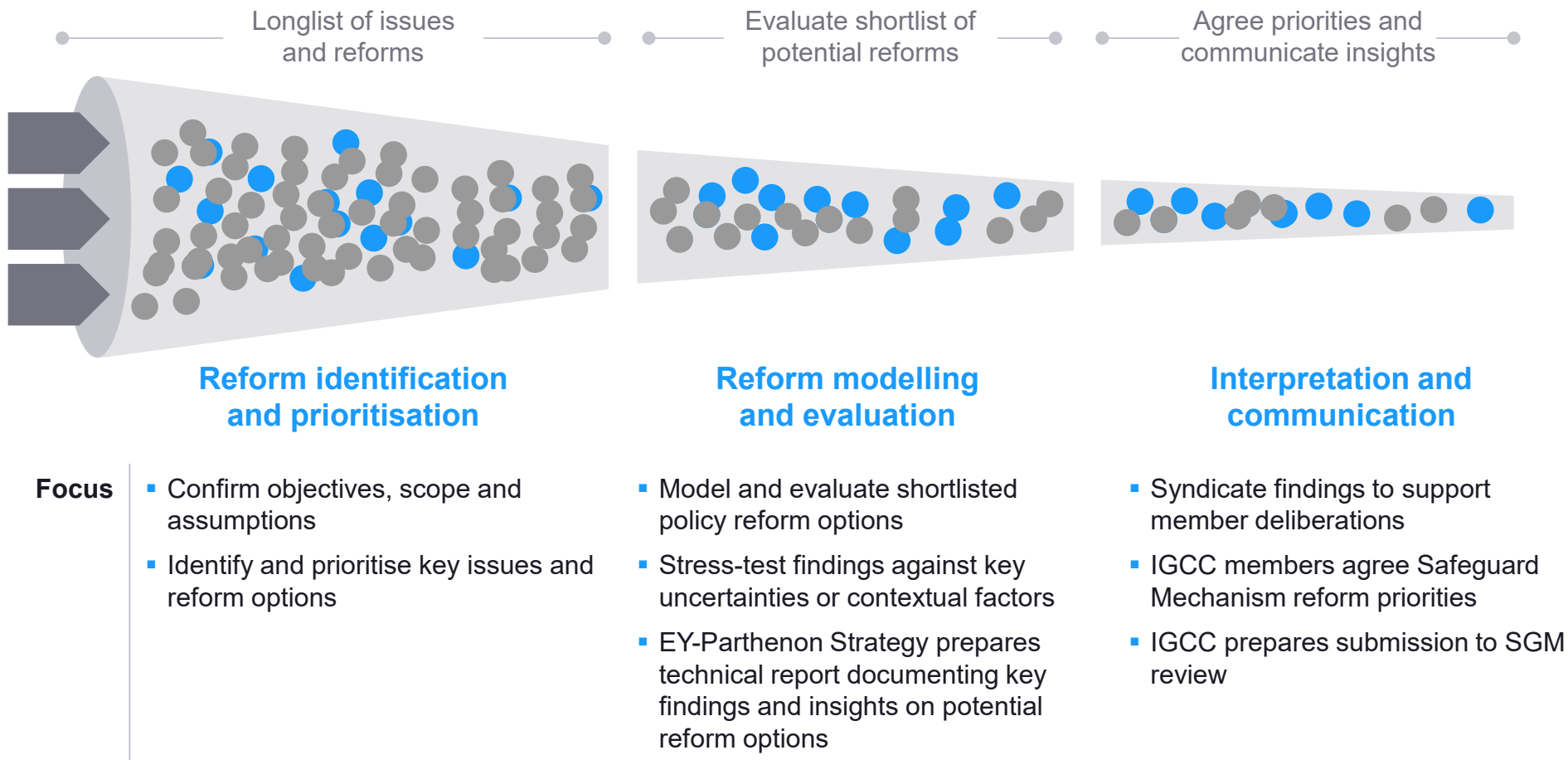
- **Baseline decline rates around ~5-7% p.a. from 2031-35 would be consistent with meeting the national 62-70% emissions reduction target for 2035**
 - Reverting to the statutory 3.3% decline rate after 2031 is projected to result in ACCU prices and abatement incentives around \$50-60/tCO₂e (real) to 2040, while falling short of the 2035 target range by ~10 Mt CO₂e.
 - **Higher decline rates** (of 5-7% p.a.) are projected to drive 7-15 Mt in increased average annual abatement from 2031-40, with ~57-61% of abatement delivered on-site. This lifts ACCU prices and abatement incentives to around ~\$100/t, increasing the likelihood that cost containment settings (CCM) will be triggered. While average costs per tonne are similar, the larger abatement volumes mean the 7% decline rate has ~5% higher compliance costs than the 5% decline rate.
 - **Differentiated decline rates** across sectors could reduce competitive pressures on margin-based manufacturing and be more consistent with polluter pays principle, without affecting abatement incentives or efficiency of the SGM. Lower decline rates for processing and other mining could help align different sectors task with their access to attractive on-site abatement, with ~29% of fossil fuel sectors' task available on-site below \$120 / t, ~2.5 times the share for manufacturing.
- **SGM design provides a sound foundation for reducing net emissions but would benefit from refinements to improve investor confidence and risk management, and support an orderly long-term transition**
 - **The market lacks forward price visibility** and bankable risk management options, suggesting a case for government auction of forward contracts for difference (particularly for new ACCU supply and on-site abatement) to support investor confidence and improved market function.
 - **Lifting on-site abatement over time** is essential for the net zero transition but could be economically challenging in the short term, as off-site abatement from ACCUs account for around two thirds of available cost-effective abatement, and attractive new on-site industrial abatement options will take time to emerge.
 - **Government financial support** through grants or tax provisions could lift on-site abatement by ~20% (up to 10 Mt p.a.) to 2035 and reduce industry costs.
 - **Cost containment settings** help manage risks of ACCU price spikes and excessive industry costs in a maturing market, but extending current arrangements could dampen incentives for deep decarbonisation. Policy should explore alternative approaches to managing price spikes and industry costs.
 - **Capping facility level ACCU use** at 50% of pre-abatement emissions could drive increases in on-site abatement but could also see large increases in compliance costs (~3x) and significant non-compliance, suggesting any consideration of limits on ACCU use could be framed at a system level.
- **Progressively expanding SGM coverage** by lowering the facility emission threshold in three steps to 25,000 tCO₂e from 2031 to 2037 could motivate ~5 Mt p.a. of additional abatement by 2040 and improve the efficiency of climate policy, but is only projected to have modest effects on ACCU prices

Contents

- Introduction and summary of key findings
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This project used a staged approach to gathering evidence and building consensus

Process for identifying priorities for analysis and action



Consideration of key issues helped prioritise a shortlist of policy options for evaluation, which were mapped to high level goals

Issues, options and high-level goals

General issues considered

- Reducing industry emissions and supporting on-site abatement
- Supporting industry competitiveness
- Burden sharing across sectors
- Supporting investment and managing credit price risk
- Methane accounting and abatement incentives
- Orderly transition away from fossil fuels

Options short listed for evaluation

- SGM decline rates
- SGM coverage
- Differential decline rates aligned to sector context
- Forward credit price visibility and risk management
- Support for on site abatement
- Constraints on ACCU use
- ... ***and options that were not short listed***
- SGM coverage of transport fuel (outside covered facilities)
- Scope 2 emissions
- Use of international credits

High-level goals

Ensure appropriate contribution to national targets

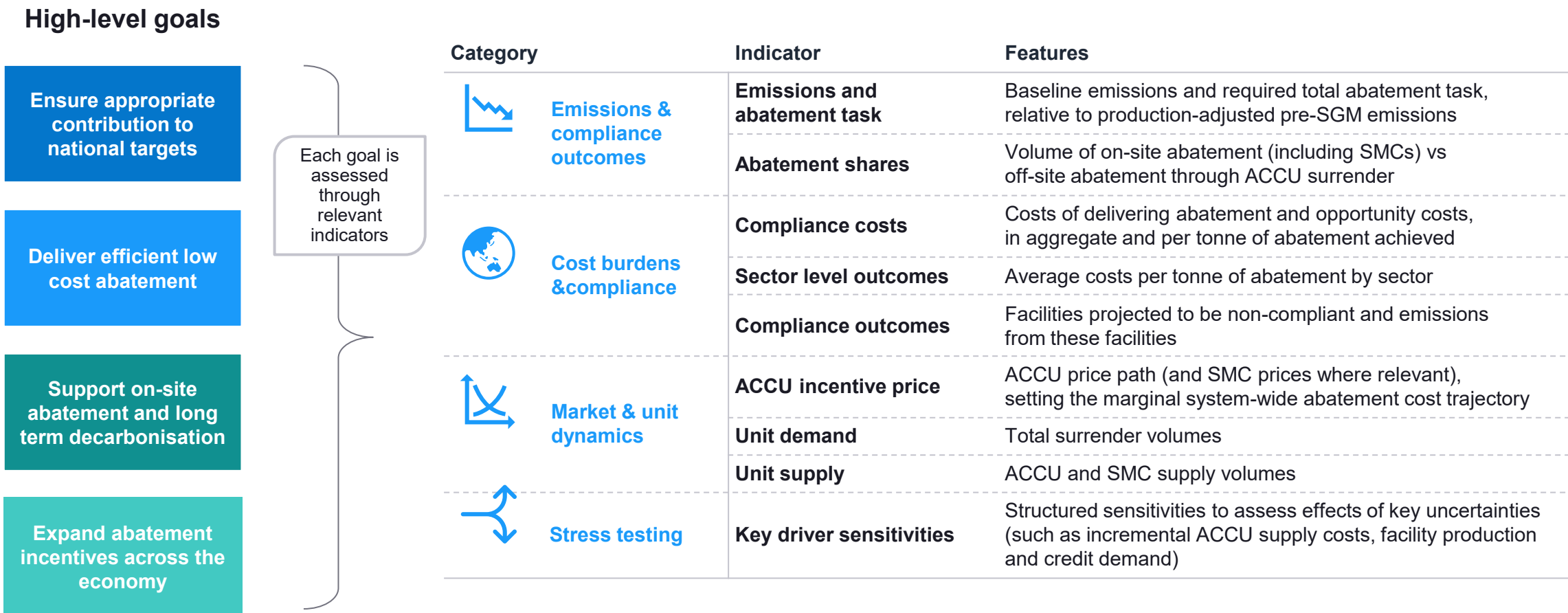
Deliver efficient low cost abatement

Support on-site abatement and long term decarbonisation

Expand abatement incentives across the economy

Shortlisted options were assessed against a broad suite of indicators

Reform goals and associated performance metrics



Contents

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- Key results and insights
- More details on the modelling framework

The analysis provides useful insights into SGM-ACCU market dynamics and likely broad outcomes, but precise effects of policy variations remain uncertain

Modelling approach and limitations

The modelling aims to capture complex market dynamics

- The modelling framework represents the complex interactions and dynamics that drive SGM and ACCU outcomes, reported as scenario projections
- The model represents the behaviour and financial decision making of forward-looking facilities and ACCU suppliers with good but not perfect information and foresight
 - This includes decisions on abatement investment and the timing of credit supply to the market
- The framework is based on current SGM and ACCU policy settings, published data on facility emissions and ACCU generation, information and estimates on sector-relevant international abatement options and costs, and long run land sector abatement potential from the CSIRO LUTO model
- The model was developed by the EY Net Zero Centre (EY NZC) and used for EY NZC publications and EYPS client engagements

But has inherent limitations

- The modelling does not assess the effects of compliance obligations on facility production or profits, and assumes production levels are determined by external circumstances
- A key finding from the modelling is that ACCU and SMC prices are very sensitive to relatively small variations in supply and demand balance, which is shaped in turn by a large number of market characteristics and decisions
 - In addition, projected outcomes are sensitive to forward price expectations, which have a significant impact on investment decisions and credit purchases
 - This implies specific scenario results should be treated as indicative, with close attention to sensitivity analysis to assess the effects of different assumptions

We have analysed higher decline rates and five other policy options, and two combinations of measures

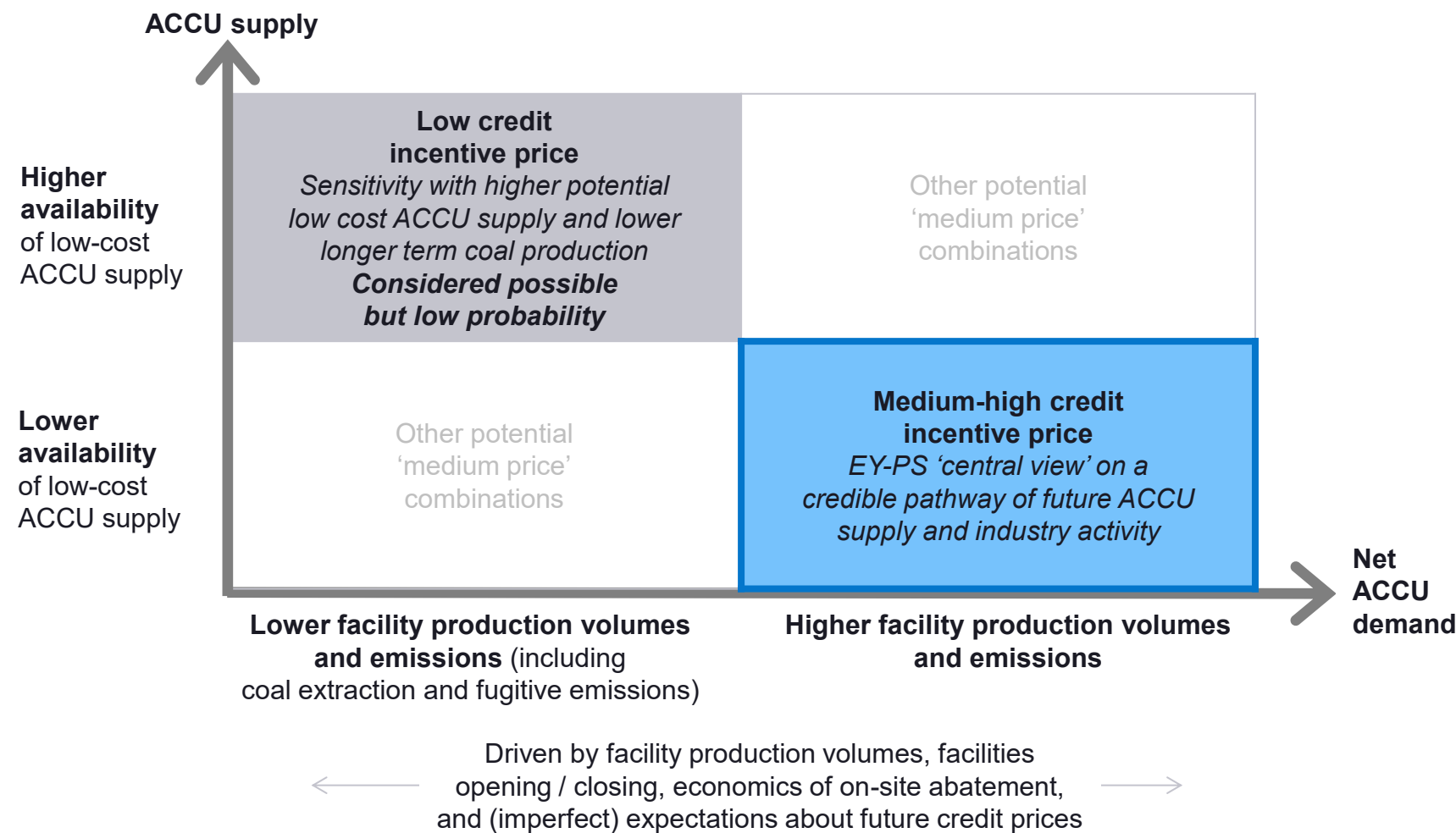
Reform option overview

Option		Implemented as
Higher baseline decline rates	HD	4 baseline decline rates: 3.285%, 5%, and 7% from FY31-35, and 7% FY31-35 then 5% FY36-40. All treatments decline linearly to net zero afterwards, with TEBA ¹ adjustments until FY40
Lower SGM facility threshold	LT	SGM coverage is progressively extended to facilities below the current 100 kt p.a. emissions threshold, including ≥75 kt p.a. from 2031, ≥50 kt p.a. from 2034 and ≥25 kt p.a. from 2037
Sector-differentiated decline rates	DD	From FY31-35 fossil fuel extraction (coal and O&G) facility decline rates are 2% pts points higher than other facilities' decline rates, with other facilities' decline rates eased to maintain same aggregate SGM baseline
Support to manage price risk	SR	Analysed qualitatively
Support for on-site abatement	SA	Government funds 50% of on-site abatement capital expenditure for SGM facilities
Cap ACCU use at facility level	AC	Facility level ACCU use capped at 50% of pre-SGM abatement task, with SMC generation as per current rules
Core options package (HD LT DD)		Combination of measures to drive deeper and wider abatement (HD+LT), and share average abatement costs more evenly across sectors (DD)
Core options plus external support (HD, LT, DD + SA)		Core options package plus on-budget financial support

1. TEBA refers to Trade Exposed Baseline Adjusted facilities, which qualify for slower baseline decline rates.

We complement our central reference case for ACCU supply-demand conditions against a second ‘low price’ context to test sensitivity of projected outcomes

Context | Central ‘medium-high price’ and alternative ‘low price’ contexts for modelled scenarios



The analysis involves modelling ~80 scenarios combining different decline rates, other policy treatments and multiple underlying contexts

Overview of modelled scenarios | Context and policy combinations

		Other policy treatments						Combinations	
Credit price context	Decline rates 2031-35	No other changes	Cost containment ^	Lower threshold LT	Differentiated decline rates DD	Support for on-site abatement SA	Facility level ACCU cap AC	Core options LT + DD	Core options + external support LT + DD + SA
		4 decline rates	CPI +6% trajectory	Three tranches 2031-34-37	Higher decline for fossil fuel sectors	50% capital subsidy	50% pre-ERC baseline		
Medium-high price context	3.285%								
	5%								
	7%								
	7%+5%								
Low price context	3.285%								
	5%								
	7%								
	7%+5%								

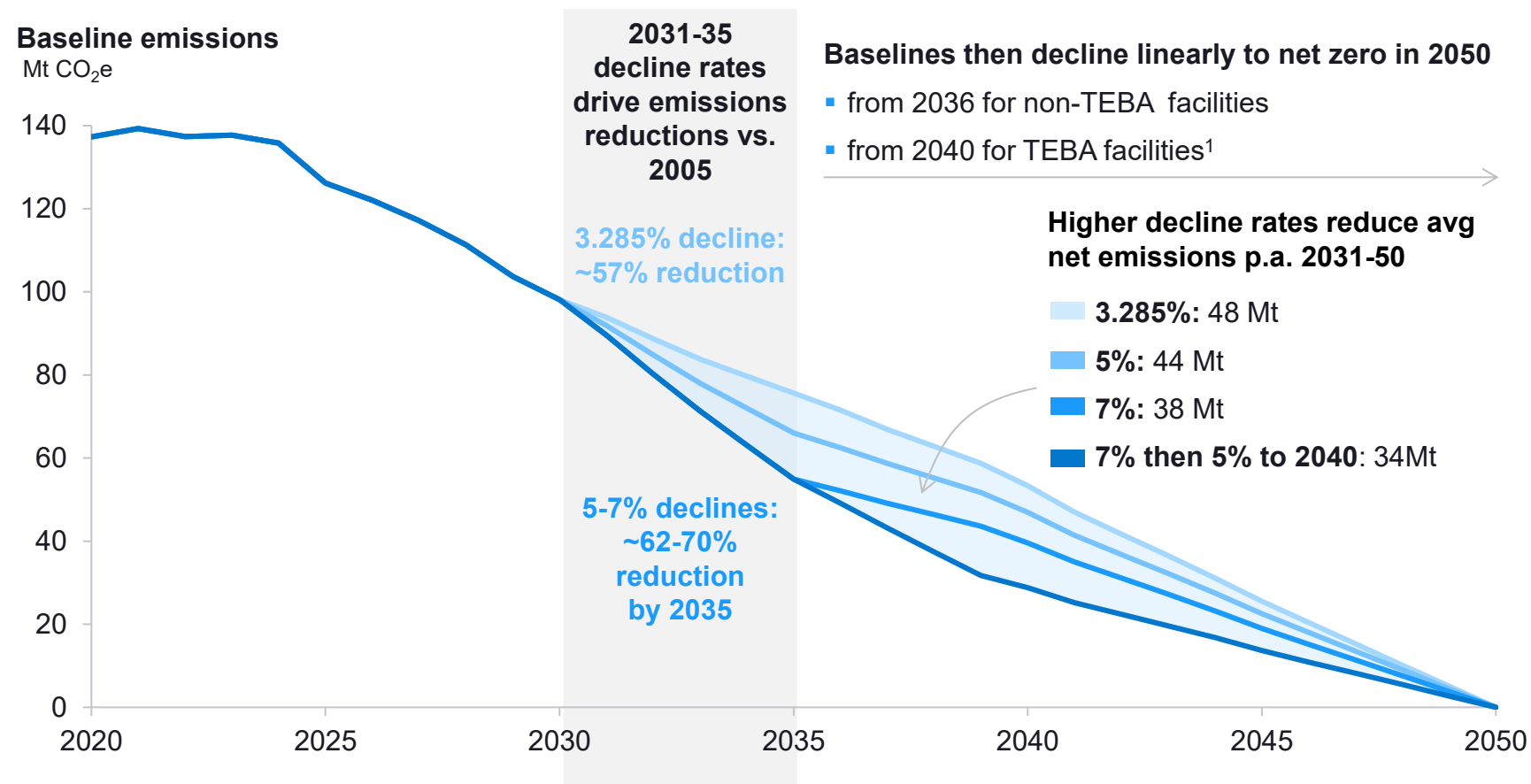
The modelling assumes current cost containment settings are extended to 2050, rather than lapsing, rising at **Current CPI +2%**. Many scenarios are also modelled with a **Higher CPI +6%** trajectory

Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - **Higher baseline decline rates**
 - Sector differentiated decline rates
 - Price visibility and investment risk
 - Context of on-site abatement, and financial support
 - Cost containment
 - Capping ACCU use
 - Lower SGM facility threshold
 - Combinations of measures
- More details on the modelling framework

Baseline decline rates around 5-7% p.a. would be consistent with the 2035 national target range, with the SGM reaching net zero in 2050 in all scenarios

Decline rates | Overview

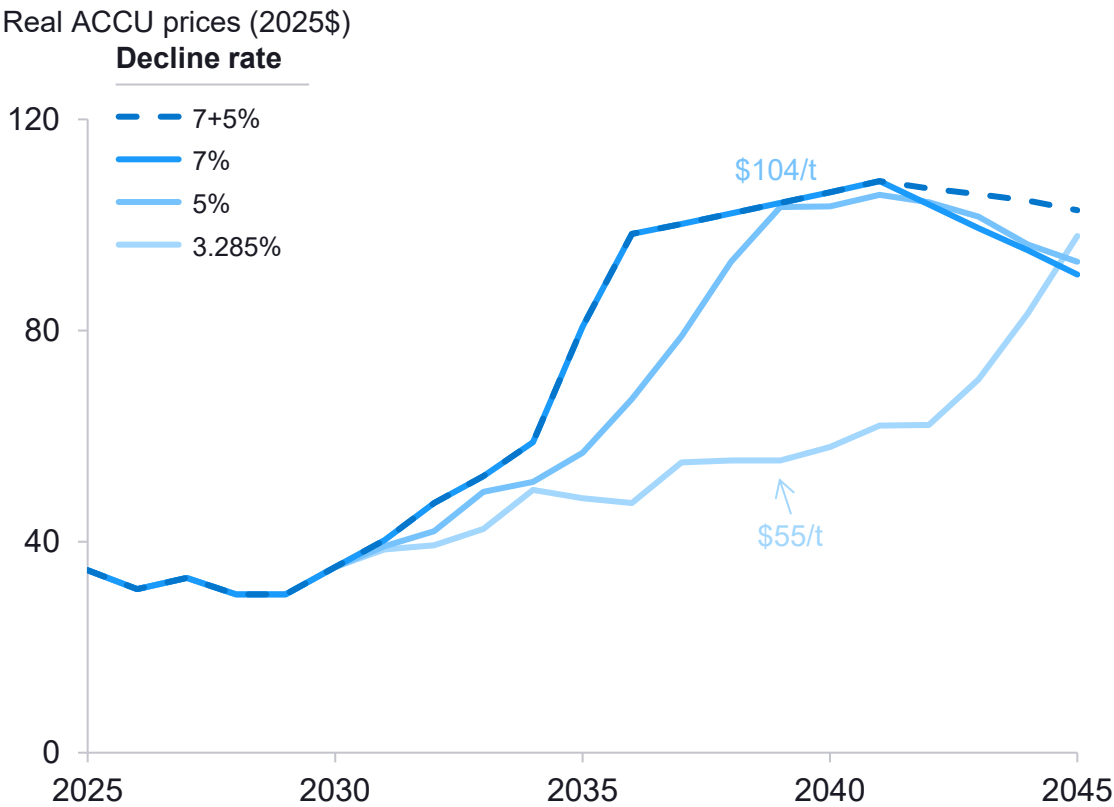


1. TEBA facilities continue under the 2031-35 rules to 2040 (i.e. receive discounts vs. the 2031-35 non-TEBA decline rates, where these are more advantageous than linear decline)
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

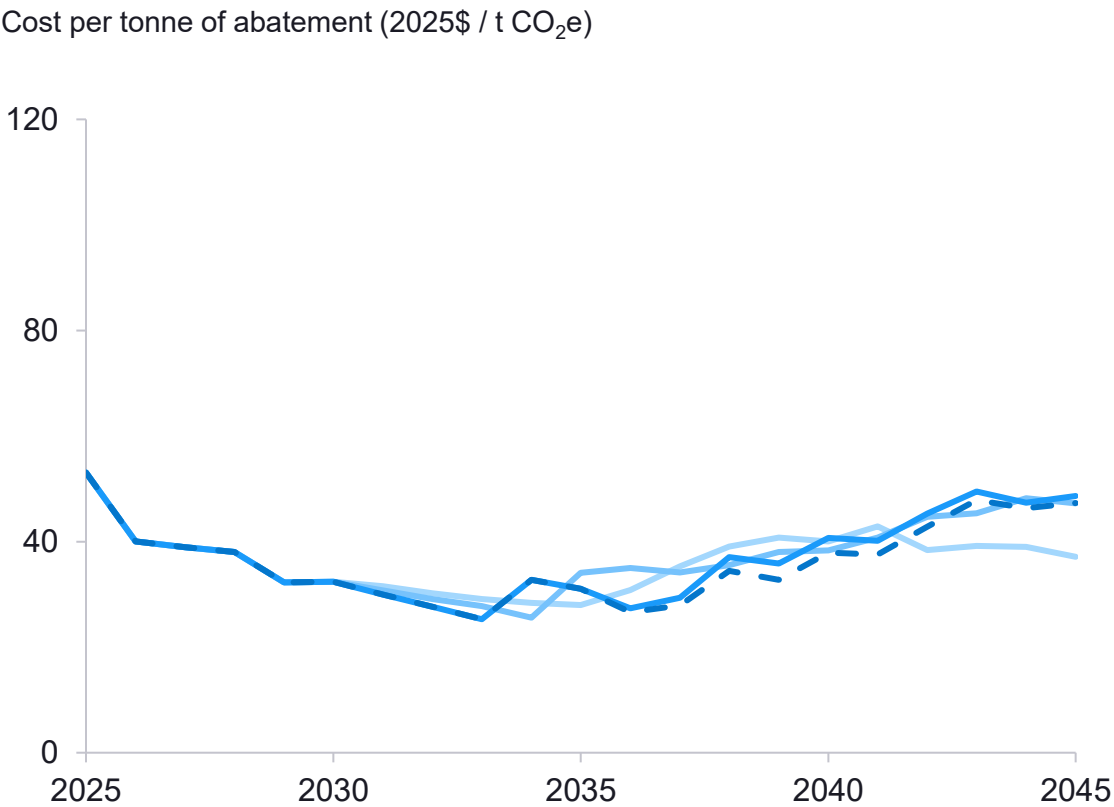
Baseline decline rates of 5-7% p.a. lift abatement incentives from \$50-60/t to around \$100/t, but have only modest impacts on average abatement costs

Decline rates | Impact on ACCU prices and average abatement costs

Decline rates ~5-7% p.a. lift projected ACCU prices to ~\$100/t from 2035



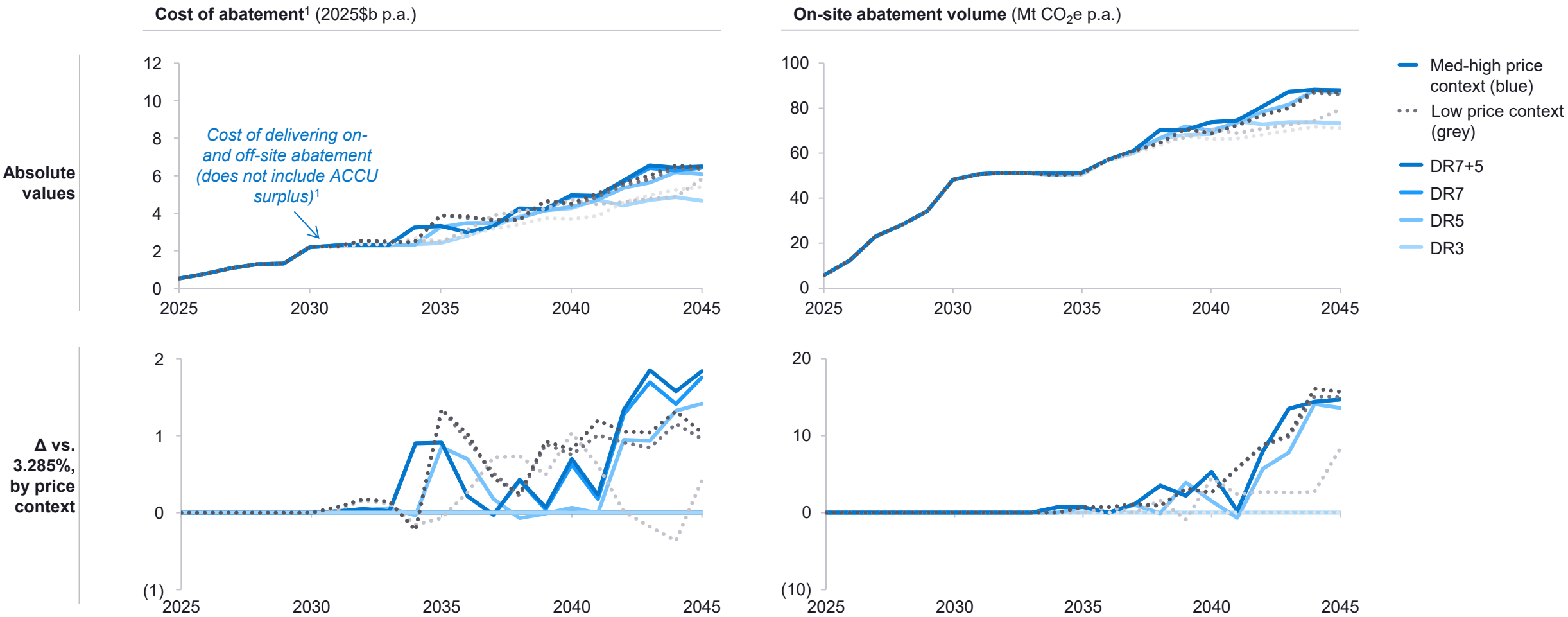
Average abatement costs are up to ~\$70/t lower than ACCU prices and marginal abatement incentives before 2040



Note: All results shown for medium-high price context
Source: EY-CARBON VIEW Model (July 2026)

These increased abatement volumes drive higher total compliance costs, with much of the additional abatement projected to be achieved off site

Decline rates | Impact on compliance costs and on-site abatement



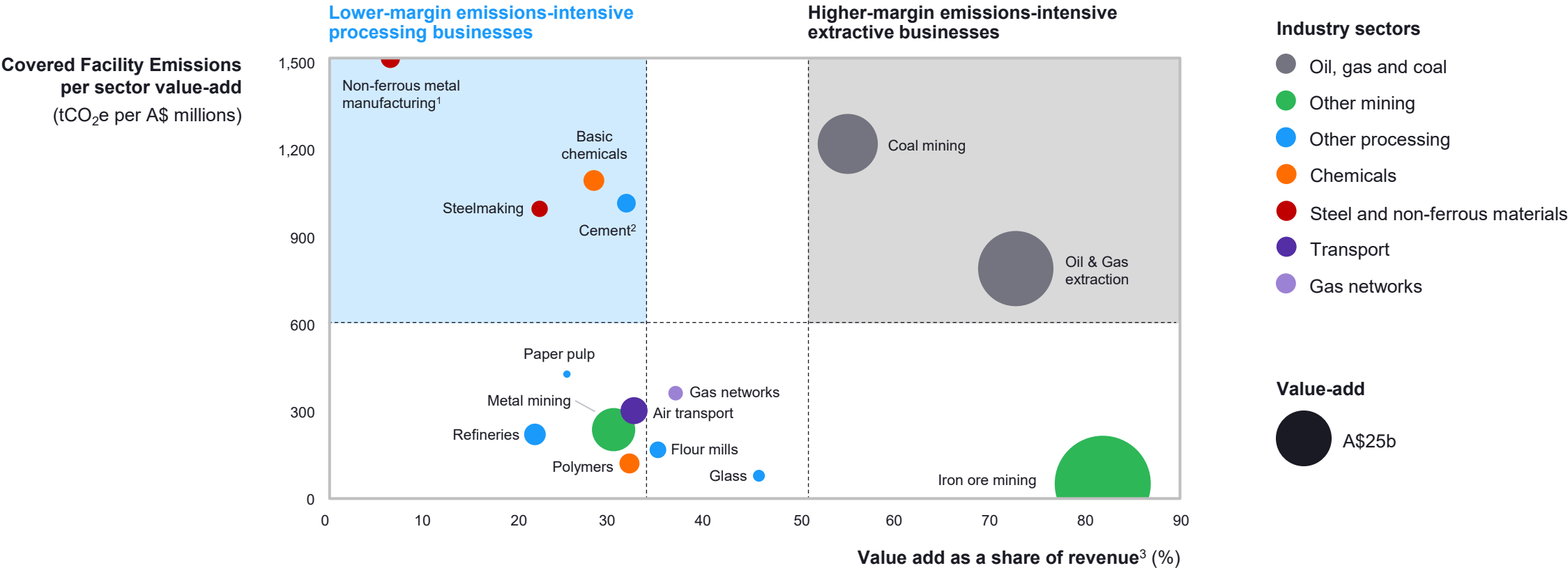
1. Cost of abatement = cost of delivering on-site abatement (annualised) plus ACCU delivery costs, and does not include the 'book value' of ACCU surplus or margin where market prices in the year surrendered are higher than the incentive price required to induce ACCU supply and project establishment. Opportunity costs (reported elsewhere) includes value of ACCU surplus in the year surrendered. See slide 48 for details.
Source: EY-CARBON VIEW Model (July 2026)

Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - **Sector differentiated decline rates**
 - Price visibility and investment risk
 - Context of on-site abatement, and financial support
 - Cost containment
 - Capping ACCU use
 - Lower SGM facility threshold
 - Combinations of measures
- More details on the modelling framework

Emissions intensive trade-exposed processing facilities have significantly lower margins than extractive industries

Sector emissions intensity vs sector margins



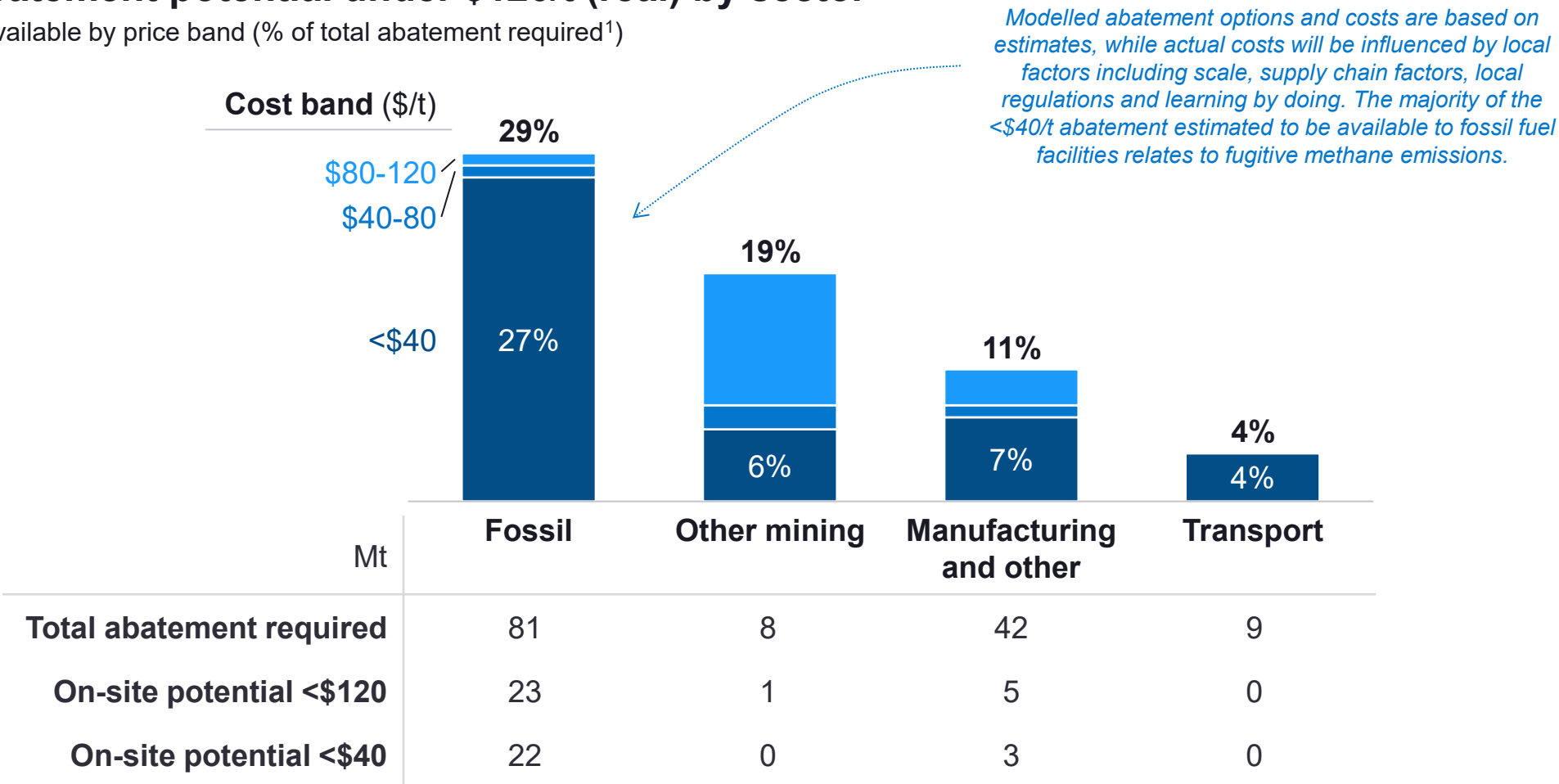
1. Emissions intensity of basic non-ferrous metal manufacturing is approximately 3,000 tCO₂e per A\$ million value add but shown lower than this to increase readability. 2. Clinker import exposure not captured in allocation to Cement segment in import export table. Treated as “non-metallic mineral mining”. 3. Value added as a share of revenue is effectively based on cash flow and does not account for depreciation or required rates of return to previous investments.

Source: EY Net Zero Centre, *A time for clarity and confidence: Australian carbon market outlook 2026*, Exhibit 05.

Coal, oil and gas also have more access to early low-cost abatement opportunities as a share of their abatement task, relative to other sectors

On-site abatement potential under \$120/t (real) by sector

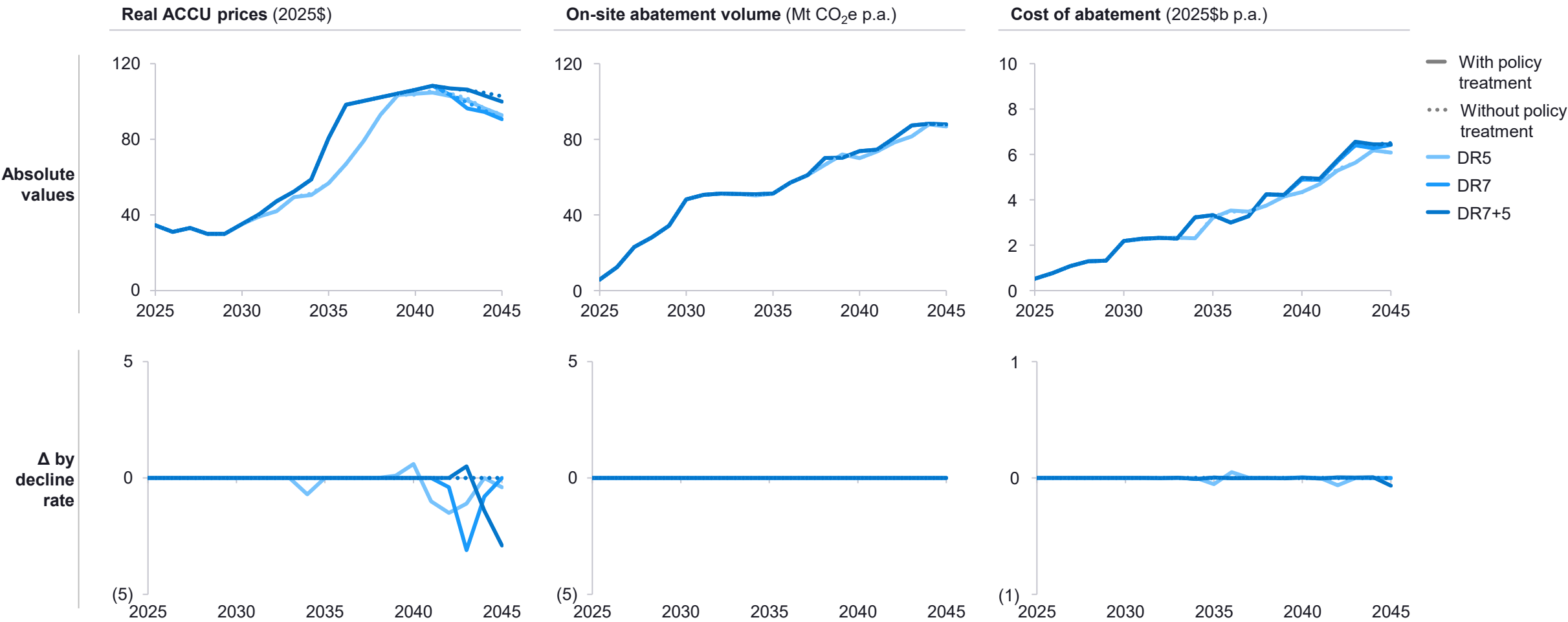
Mt CO2e p.a. available by price band (% of total abatement required¹)



1. Costs are real 2025\$. Total abatement required is defined here as pre-2025 unabated gross emissions. This is the amount that would need to be abated by 2050 if production volumes were unchanged from pre-2025 levels.
Source: EY-CARBON VIEW Model (July 2026)

Differential decline rates for different sectors have little or no effect on system-wide abatement incentives, market function and efficiency, or total compliance costs

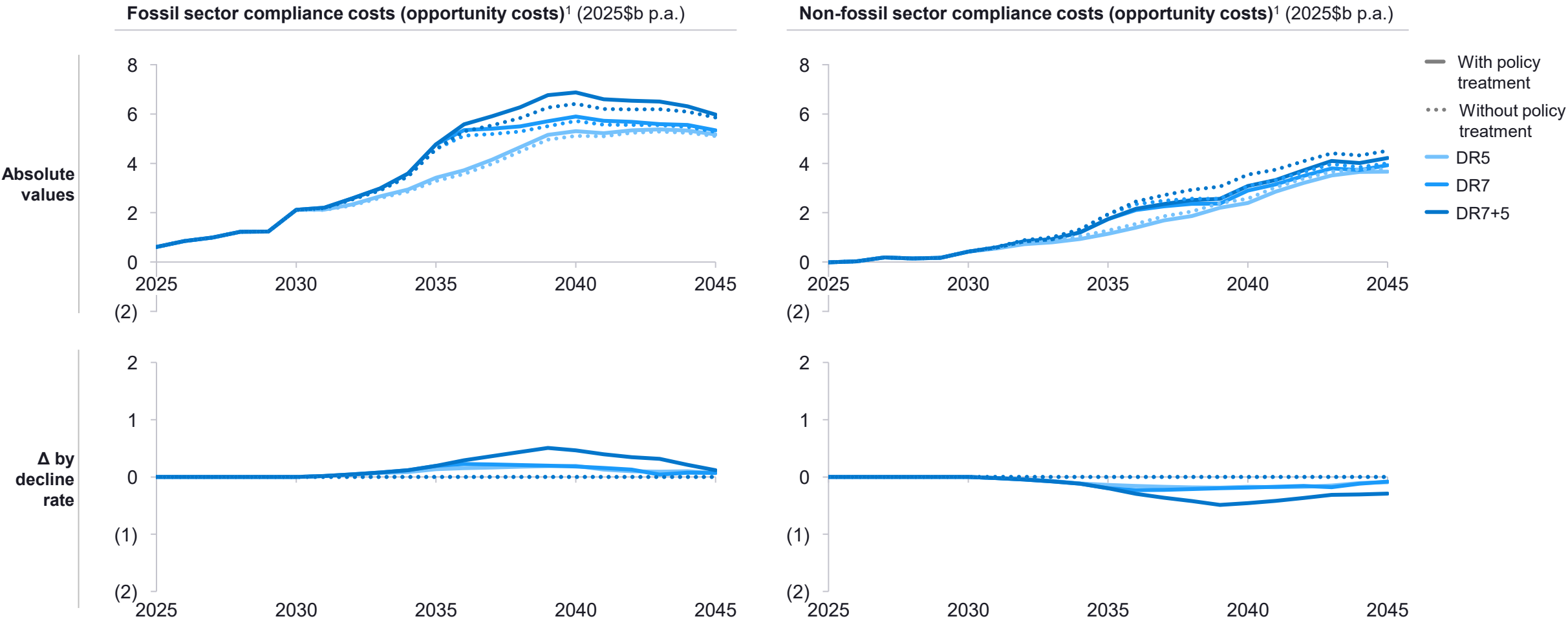
Differential decline rates¹ | Impact on ACCU prices, on-site abatement and gross costs



1. Modelling assumes decline rates for fossil fuel sectors are 2 percentage points higher than system-wide average, and reduces rates for all other sectors to achieve the same system-wide net emissions trajectory.
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

But differential decline rates can help to align sector abatement tasks more closely to available low-cost abatement, with relatively modest impacts on sector costs

Differential decline rates | Impact on opportunity costs for sector groups¹



1. Opportunity cost perspective on compliance costs includes the book value of ACCU margin in the year surrendered, in addition to the cost of delivering on- and off-site abatement. See slide 48 for details.
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

EY Parthenon Strategy 24

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Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - Sector differentiated decline rates
 - **Price visibility and investment risk**
 - Context of on-site abatement, and financial support
 - Cost containment
 - Capping ACCU use
 - Lower SGM facility threshold
 - Combinations of measures
- More details on the modelling framework

Current settings do not provide price visibility, discouraging abatement investment, suggesting consideration to government auction of contracts for difference

Price visibility and investment risk

Current settings do not provide forward price visibility

- **SGM and ACCU arrangements are still maturing** following major SGM reforms in 2023, and there is limited visibility and experience of credit supply and demand drivers
- **The SGM and ACCU reviews are themselves a source of policy uncertainty**, preventing informed and bankable investment decisions in on-site and off-site abatement
- SGM facilities and ACCU project proponents have a shared interest in negotiating long term offtake price and volume agreements, which can help derisk new projects and facility abatement decisions.
 - However, **existing agreements are generally commercial-in-confidence and not disclosed.**
- **The ACCU market provides only limited visibility of forward prices** and does not provide bankable forward price risk management (in contrast to traditional commodity markets)

Government auction of contracts for difference (CfD) is one option to consider

- **Forward price risk could be addressed through government auction of forward-dated contracts for difference**, particularly for new ACCU supply
 - Auctions of CfDs reallocate risk in return for payment, providing bankable risk management for investors, and could generate net government revenues
- **The case for de-risking is strongest for near term supply** given lags in credit delivery and likelihood of higher volumes of ACCUs required for SGM decline rates aligned to the 2035 national target
- **Issuing contracts for at least two price levels** could support improved future price discovery and visibility
- **Contracts for difference could also be used to support the lower end of an ACCU price corridor**, depending on the chosen price level

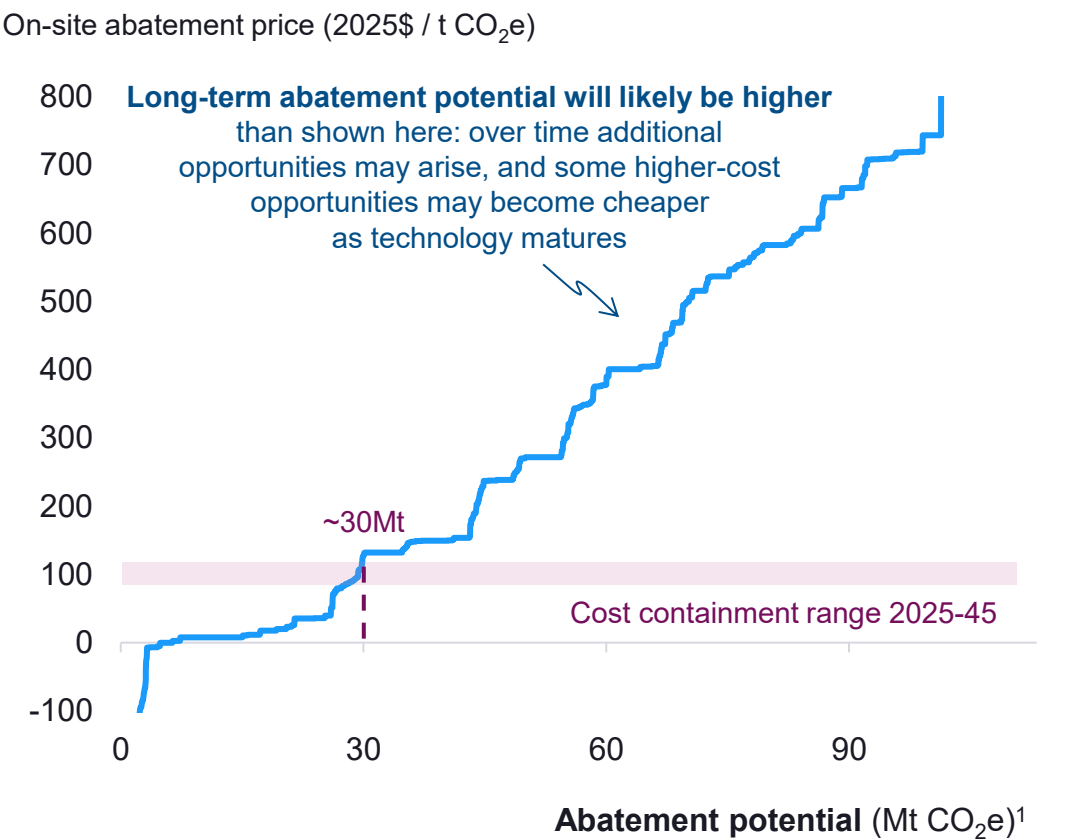
Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - Sector differentiated decline rates
 - Price visibility and investment risk
 - **Context of on-site abatement, and financial support**
 - Cost containment
 - Capping ACCU use
 - Lower SGM facility threshold
 - Combinations of measures
- More details on the modelling framework

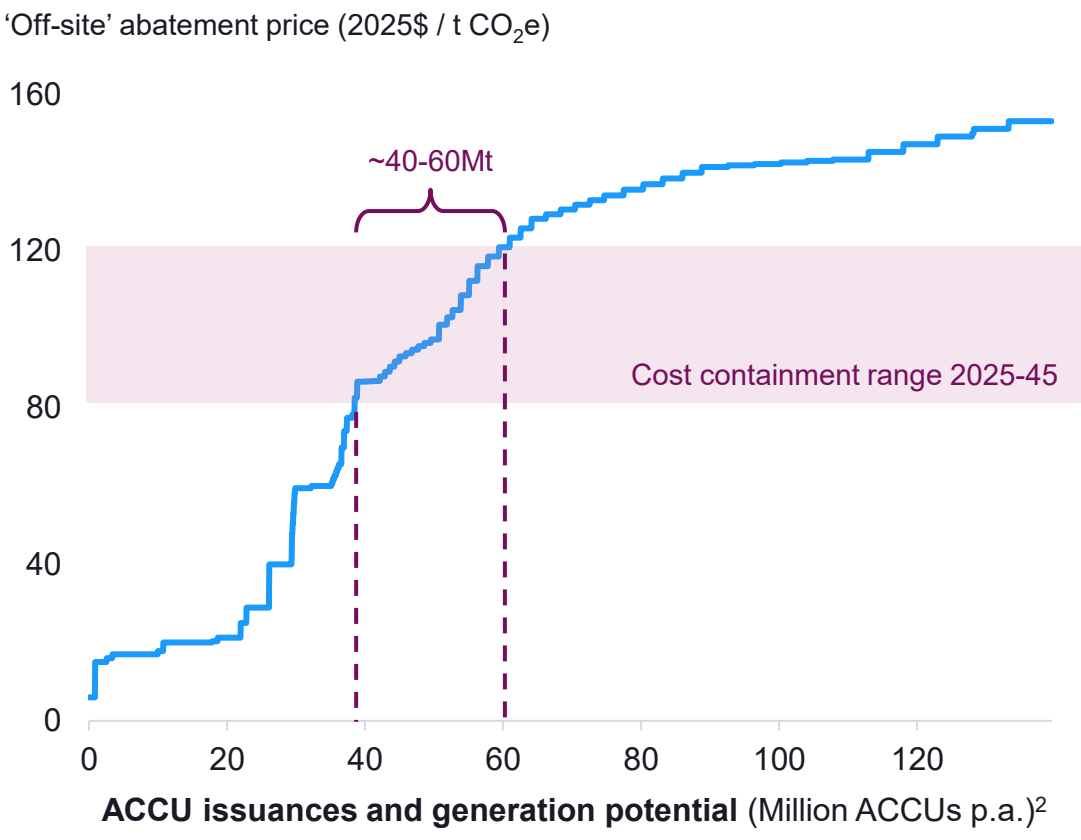
Lifting the share of on-site abatement is essential but challenging in the short term, with ACCUs accounting for up to two thirds of cost-effective abatement potential

On-site MACC vs. off-site ACCU abatement potential

~30Mt of early onsite abatement potential is available at incentive prices consistent with existing cost containment settings



Total potential ACCU supply within the same price range is ~40-60Mt – and there is significant additional potential below \$200/t



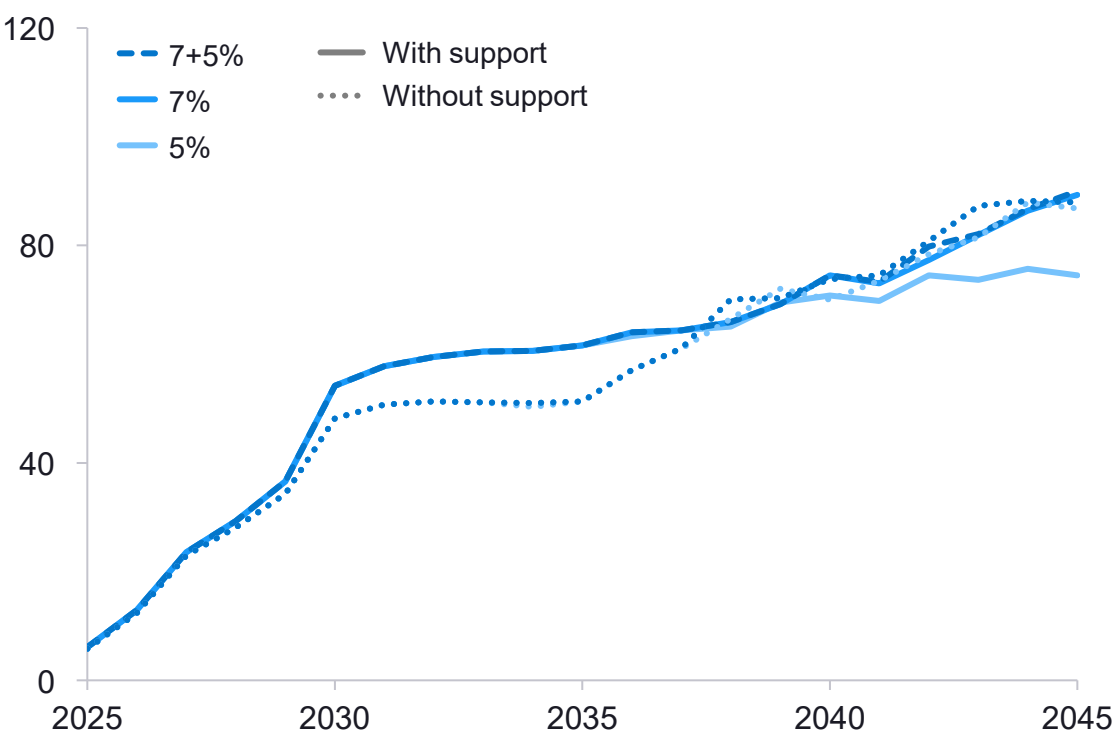
1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

Additional grant or tax support for on-site abatement is projected to lift and bring forward on-site abatement, without impacting industry competitiveness

Support for on-site abatement | Impact on on-site abatement

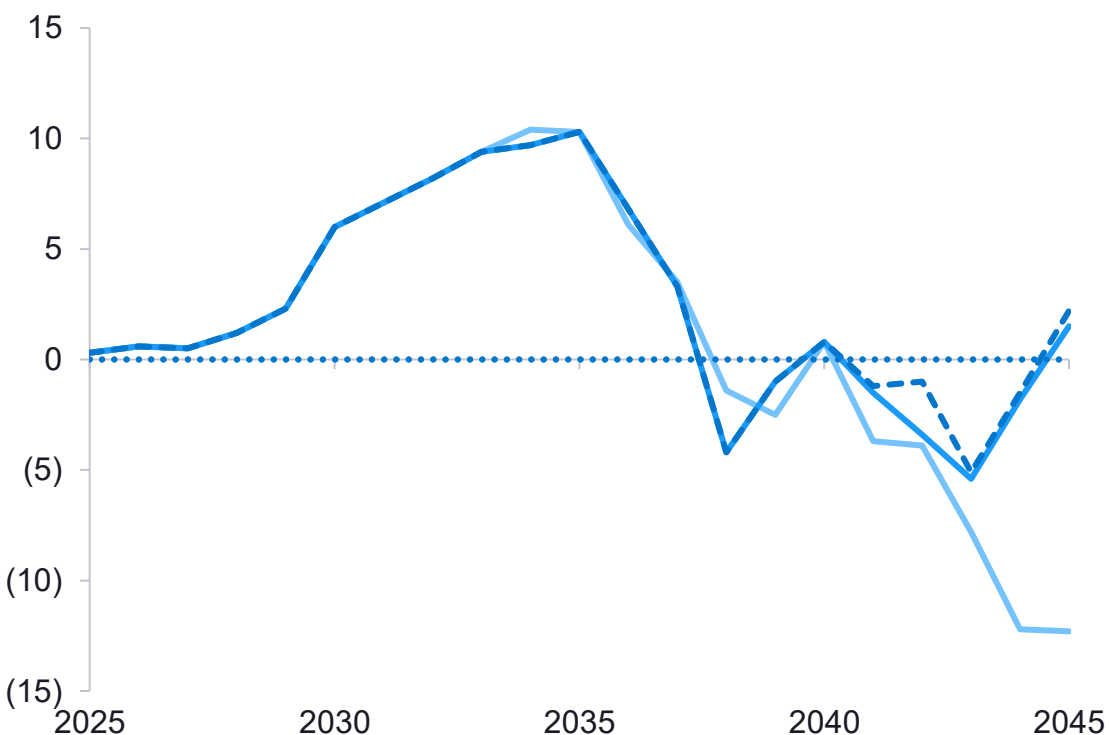
A 50% capital subsidy could lift and bring forward on-site abatement

On-site abatement (Mt CO₂e p.a.)



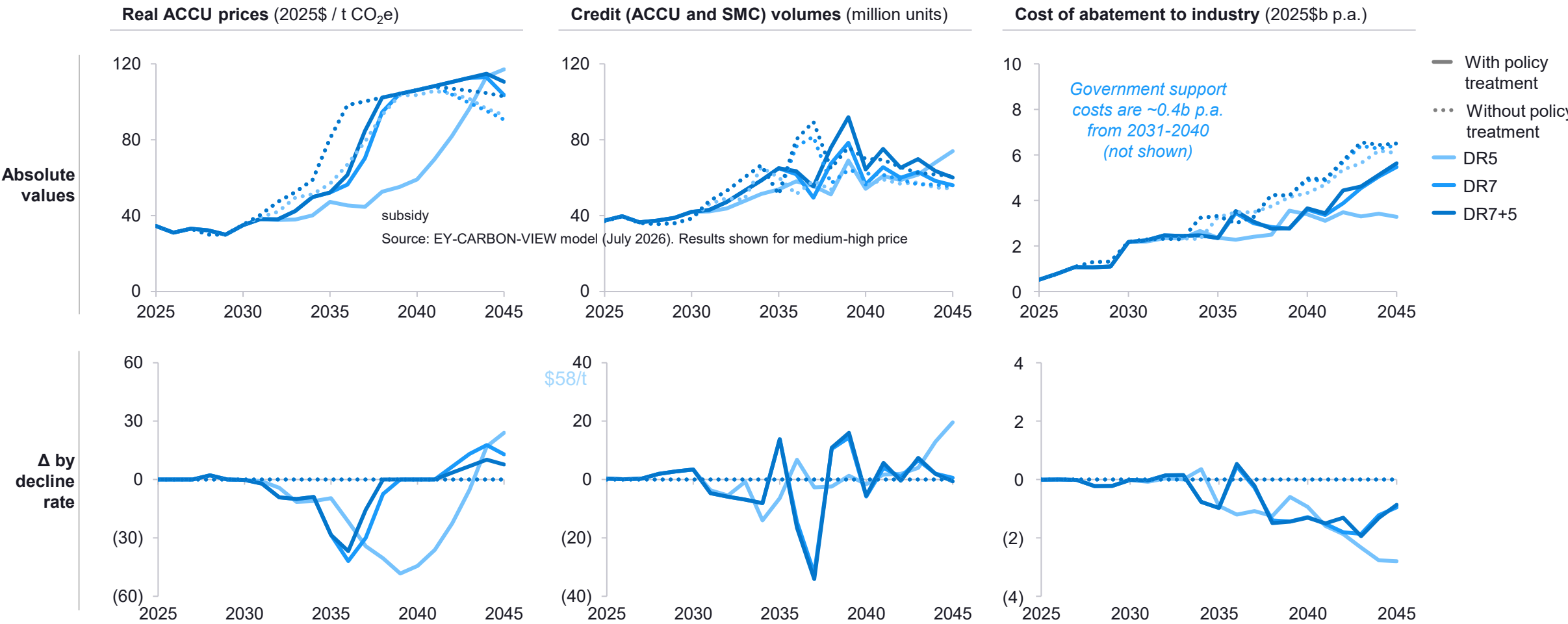
With increases of up to 10Mt p.a. to 2035

Change in on-site abatement vs. corresponding decline rate scenario (Mt CO₂e p.a.)



Government funding for abatement lowers early ACCU and SMC demand and incentive prices, and reduces SGM credit volumes before 2035

Support for on-site abatement | Impact on ACCU prices, credit volumes and industry abatement costs¹



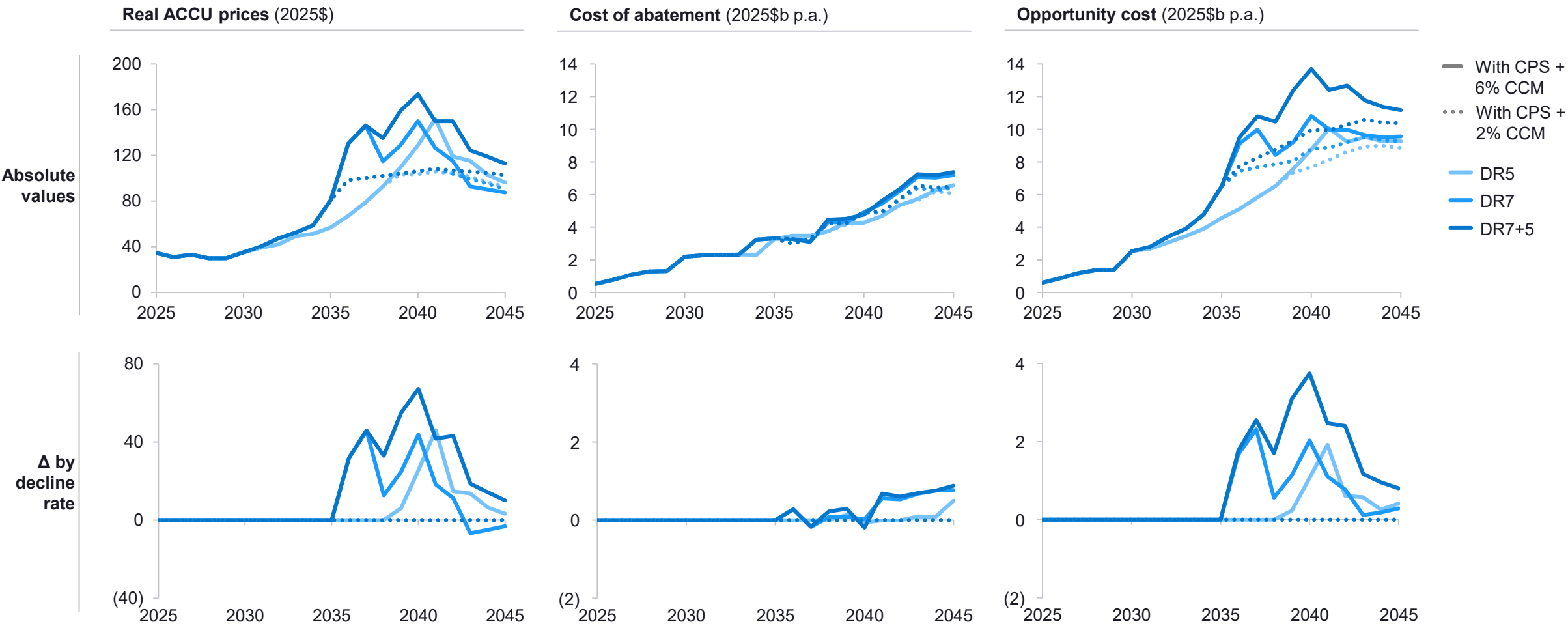
1. Industry abatement cost excludes cost to government of providing 50% capital subsidy
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - Sector differentiated decline rates
 - Price visibility and investment risk
 - Context of on-site abatement, and financial support
 - **Cost containment**
 - Capping ACCU use
 - Lower SGM facility threshold
 - Combinations of measures
- More details on the modelling framework

Continuing current cost containment settings would help manage the risk of price spikes in a maturing market, but could impact incentives for deep decarbonisation

Cost containment¹ | Impact on ACCU prices and compliance costs



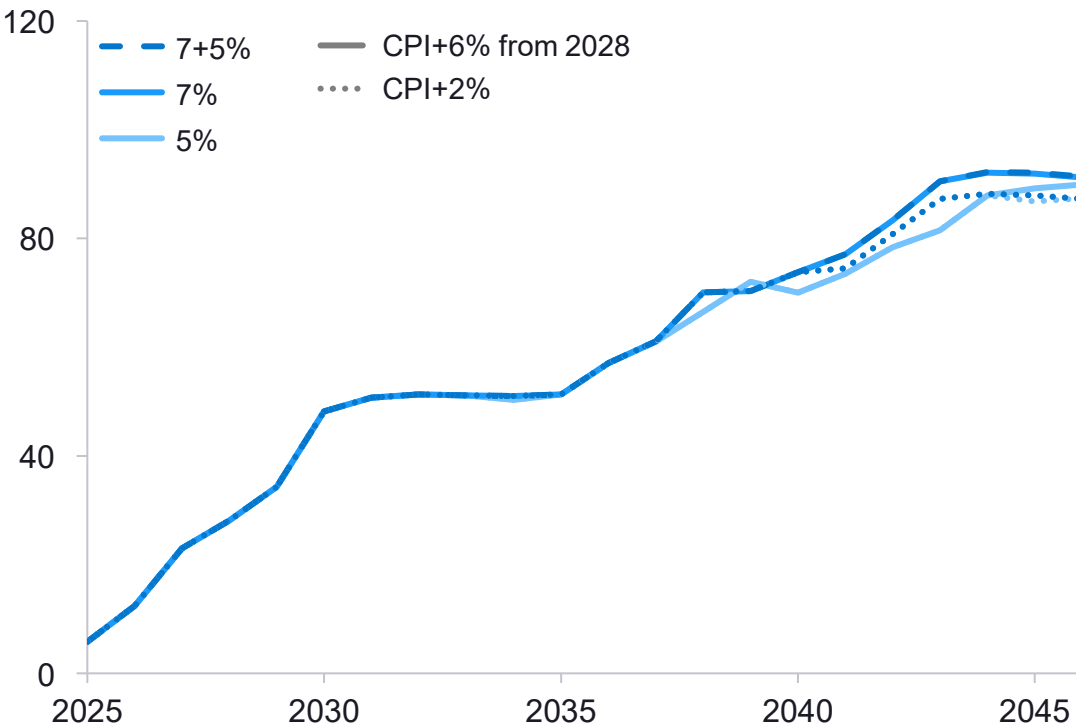
1. The modelling assumes current settings continue rather than lapsing, rising at CPI+2% and contrast this with an alternative trajectory rising at CPI+6% after 2028.
2. Opportunity cost perspective on compliance costs includes the book value of ACCU margin in the year surrendered, in addition to the cost of delivering on- and off-site abatement. See [slide 45](#) for details.
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

Relaxing the cost-containment results in higher ACCU prices from 2035 in the option analysed, increasing on-site abatement by ~2-4Mt p.a. beyond 2040

Cost containment¹ | Impact on on-site abatement

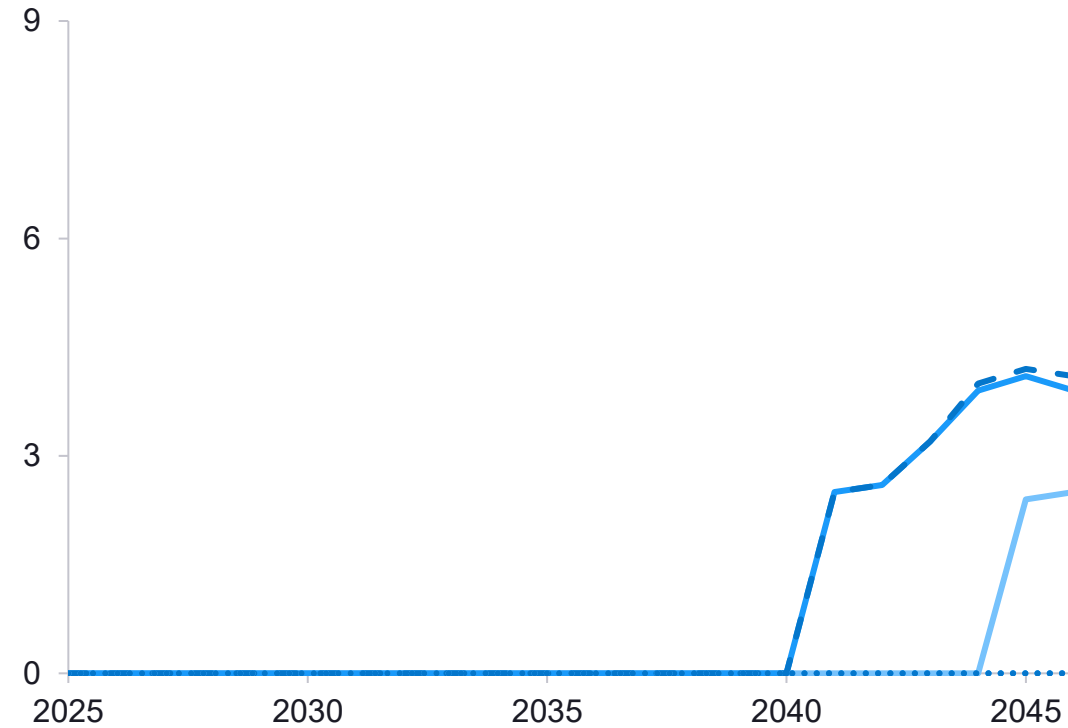
A looser cost containment threshold could lift incentives for on-site abatement

On-site abatement (Mt CO₂e p.a.)



Resulting in ~2-4Mt p.a. additional on-site abatement after 2040

Change in on-site abatement vs. corresponding decline rate scenario (Mt CO₂e p.a.)



1. The modelling assumes current settings continue rather than lapsing, rising at CPI+2% and contrast this with an alternative trajectory rising at CPI+6% after 2028
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

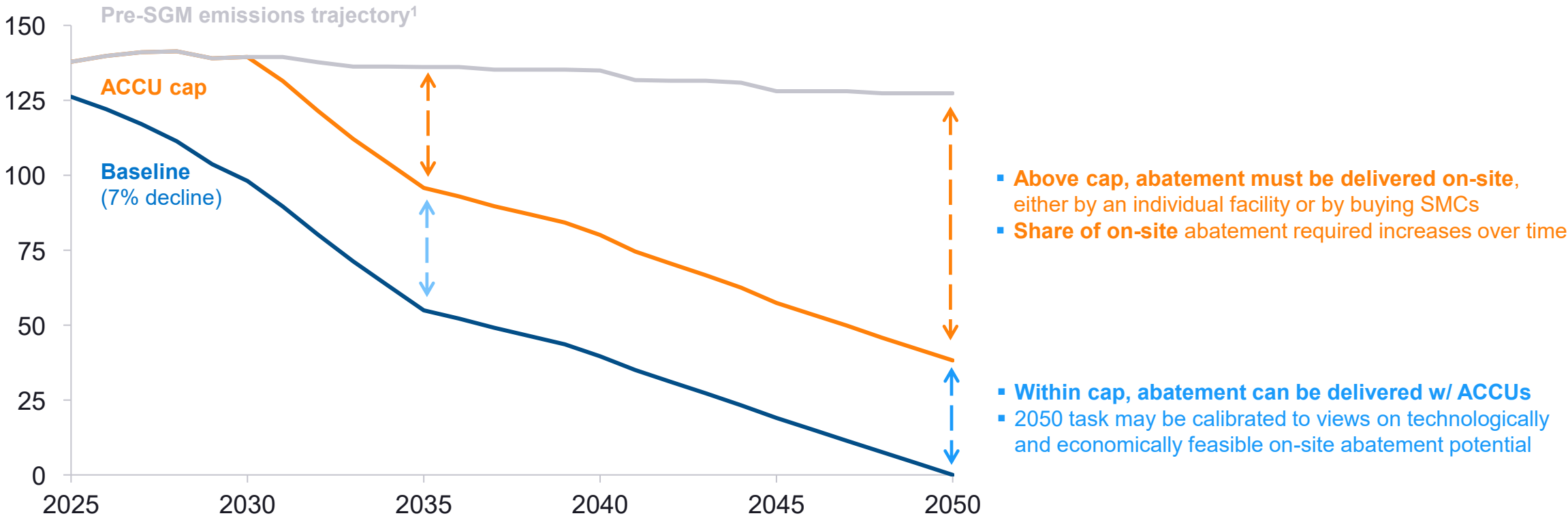
Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - Sector differentiated decline rates
 - Price visibility and investment risk
 - Context of on-site abatement, and financial support
 - Cost containment
 - **Capping ACCU use**
 - Lower SGM facility threshold
 - Combinations of measures
- More details on the modelling framework

Capping ACCUs as a percentage of pre-SGM emissions trajectories could increase on-site abatement, while allowing some ACCU use

ACCU caps | Overview

Aggregate baselines and caps (Mt CO₂e)



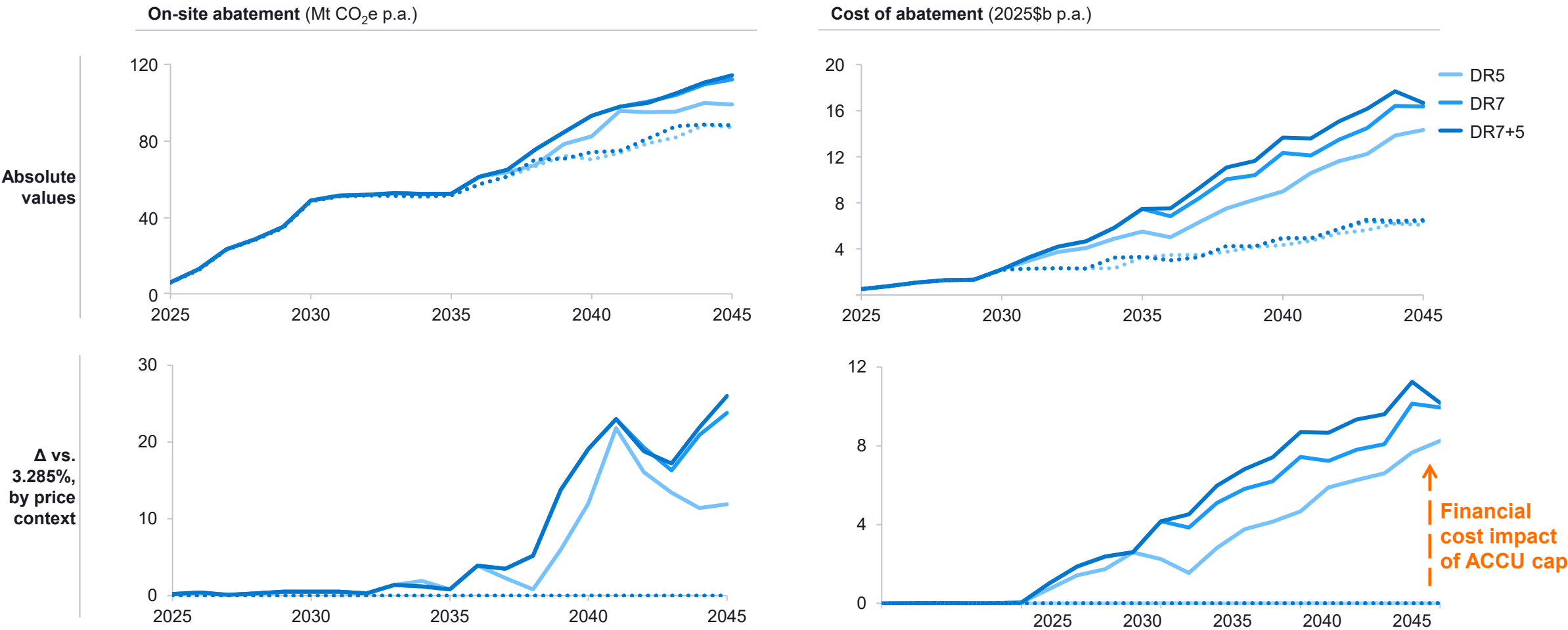
1. 'Pre-SGM emissions trajectory' is equivalent to 'pre-ERC' baselines (or Baseline / Emissions Reduction Contribution).

Source: EY-CARBON-VIEW model (July 2026)

Capping facility ACCU use at 50% of pre-SGM emissions lifts on-site abatement but increases compliance costs by around ~3x

ACCU caps | Impact on ACCU prices, on-site abatement and gross costs

— With policy treatment
... Without policy treatment

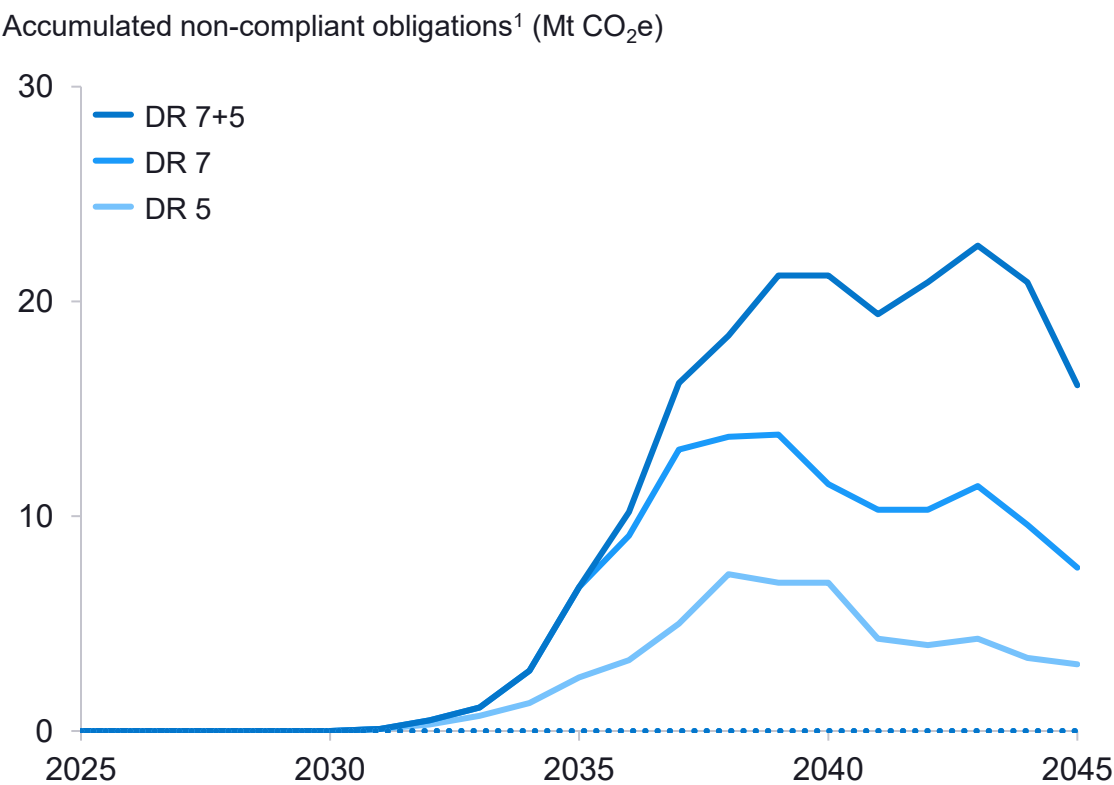


Note: Costs include per-tonne non-compliance penalties (but not daily non-compliance penalties, which are not feasible to model reliably, but could be material).
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

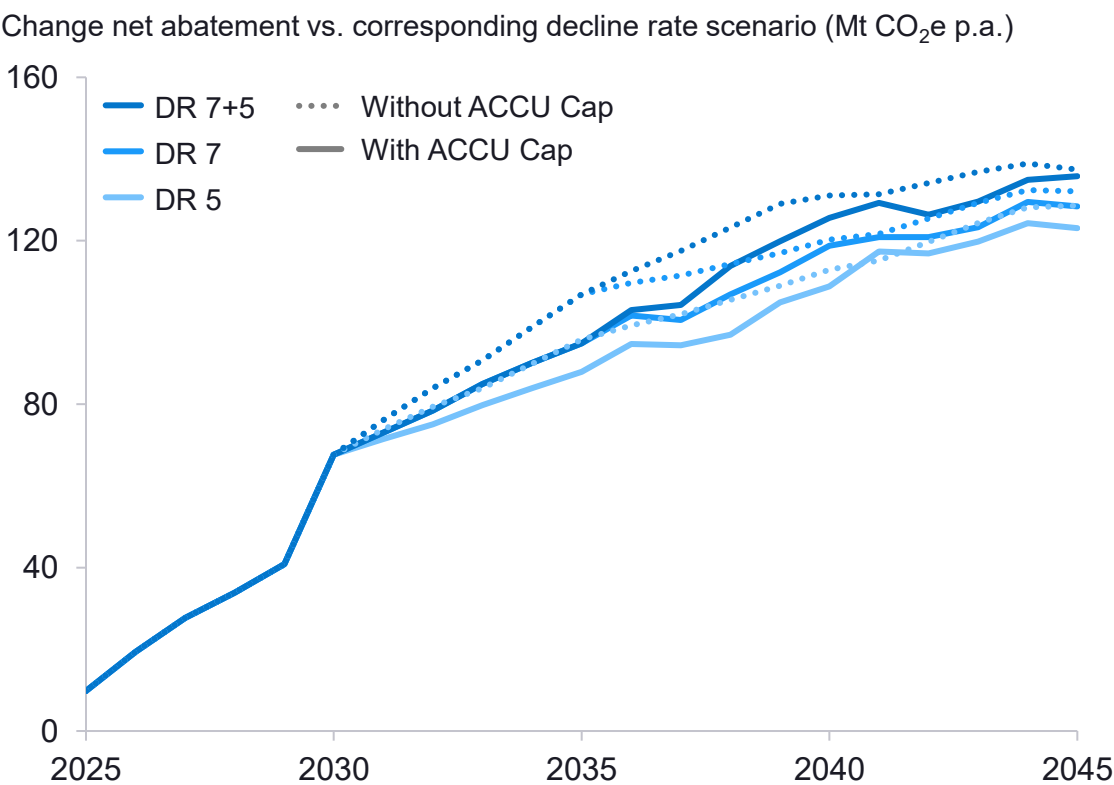
We find a 50% facility-level cap on ACCU use would see total abatement fall due to increased non-compliance, due to a lack of cost-effective abatement options

ACCU caps | Impact on projected non-compliance

Capping ACCUs results in material non-compliance



Which reduces actual net abatement achieved vs. uncapped scenarios



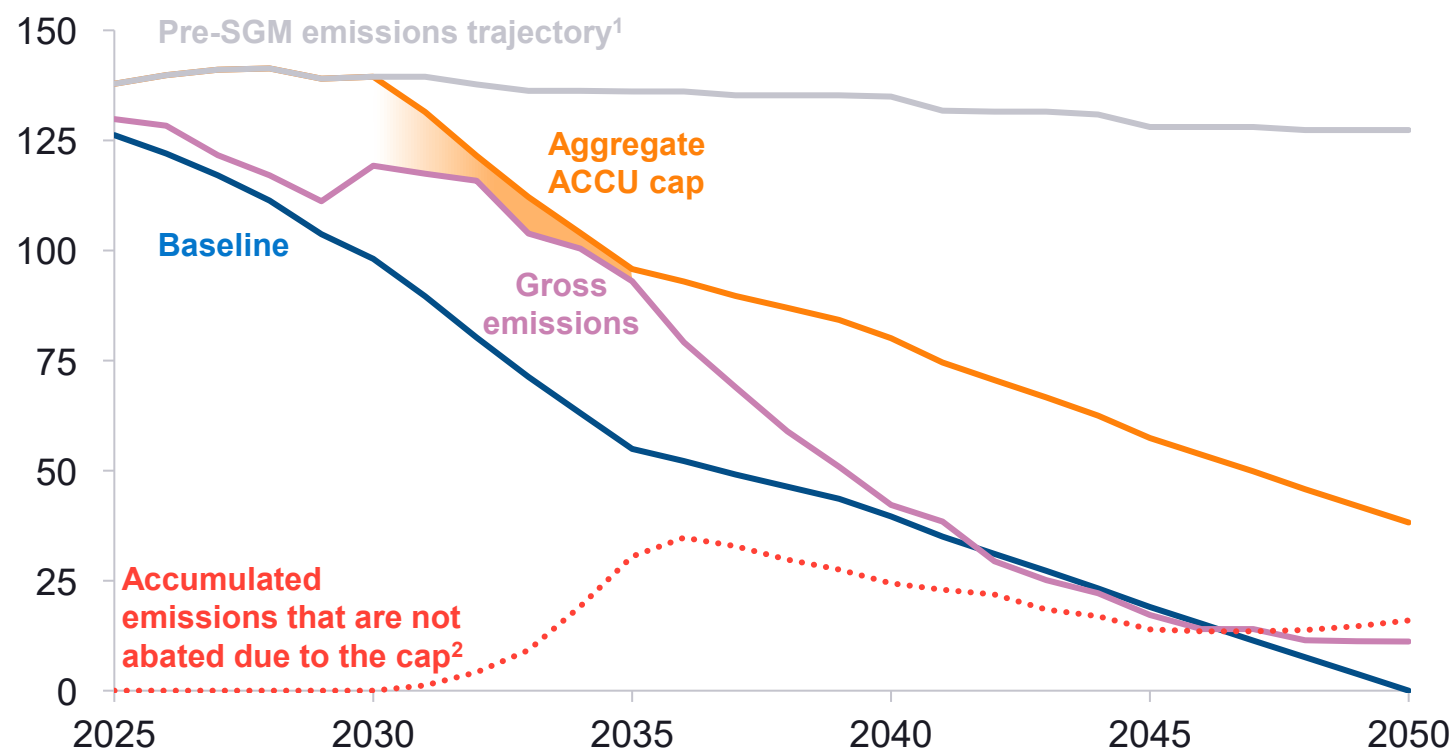
1. Non-compliance excludes new facilities. If new facilities enter above best practice emissions intensities, then they will likely breach caps immediately, and so may not enter without some form of exemption or transition arrangement. Government would need to take a view on whether this were a desirable outcome.

Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

Variations in facility context imply that any limits on ACCU use could be explored at the system level, rather than being imposed at facility level

4 ACCU caps | Potential impact of ACCU caps on compliance

Aggregate baselines, caps, and non-compliance (Mt CO₂e)



- **Discontinuous incentives created by a facility-level cap increase costs and system risks**, and can be difficult for market participants to respond to effectively
- Effects of a facility-level cap vary with context:
 - Facilities above their caps (incl. many non-TEBA facilities in higher decline scenarios) require SMCs to avoid non-compliance
 - Facilities between their baseline and their cap (incl. many TEBA facilities) do not generate SMCs because current settings do not allow facilities to 'generate' SMCs by purchasing ACCUs up to their cap
 - Facilities below their baselines can generate SMCs, but volume is typically low in the early 2030s, until SMC price signals flow through to incentivise more expensive on-site abatement
- **Material non-compliance is likely under a facility-level approach** when the aggregate ACCU cap comes too close to aggregate gross emissions
- This suggests any consideration of capping ACCU use could **explore imposing limits at the system-level**, to provide flexibility and support SMC generation

1. 'Pre-SGM emissions trajectory' is equivalent to 'pre-ERC' baselines (or Baseline / Emissions Reduction Contribution). 2. Excludes new facilities. If new facilities enter above best practice emissions intensities, then they will likely breach caps immediately, and so may not enter without some form of exemption or transition arrangement.

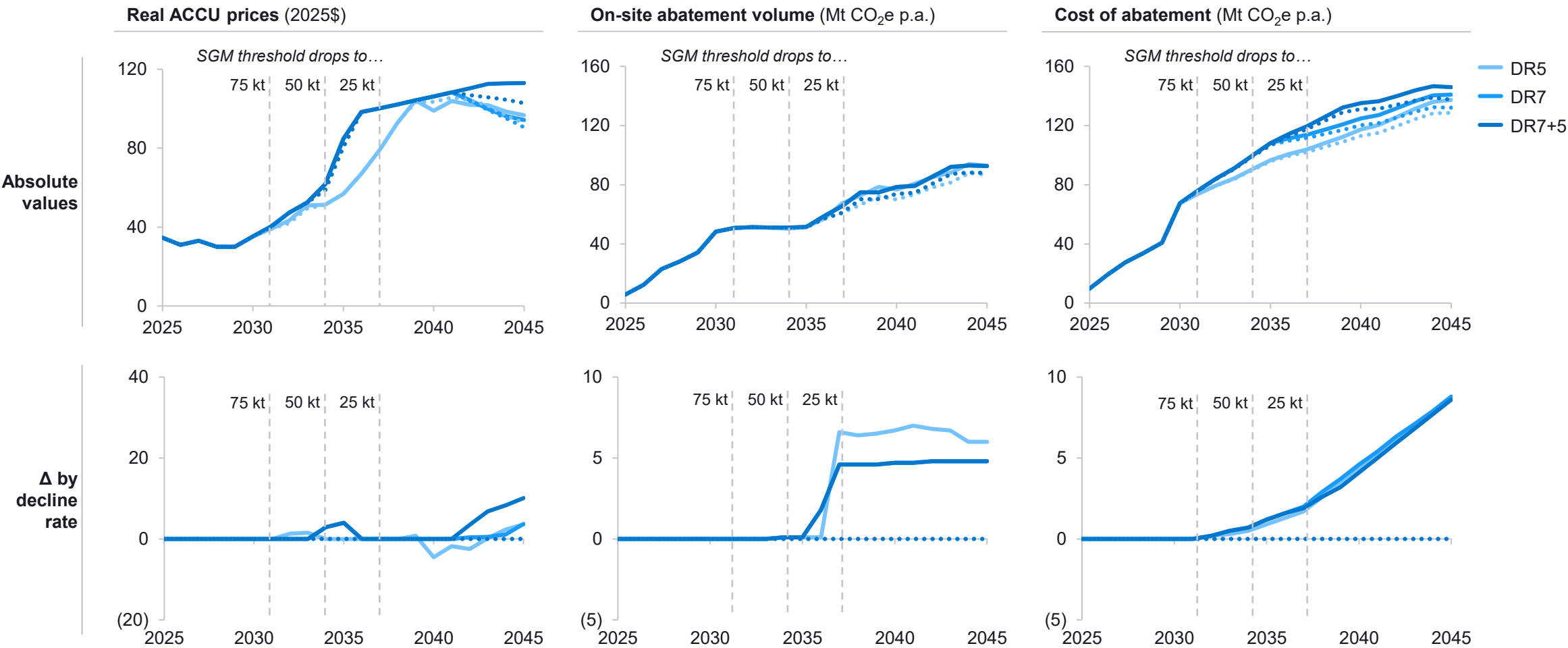
Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - Sector differentiated decline rates
 - Price visibility and investment risk
 - Context of on-site abatement, and financial support
 - Cost containment
 - Capping ACCU use
 - **Lower SGM facility threshold**
 - Combinations of measures
- More details on the modelling framework

Progressively lowering the facility threshold to 25kt p.a. increases on-site abatement by ~5 Mt p.a. before 2040, with relatively modest impacts on credit prices

Facility thresholds | Impact on ACCU prices, on-site abatement and gross costs

— With policy treatment
... Without policy treatment



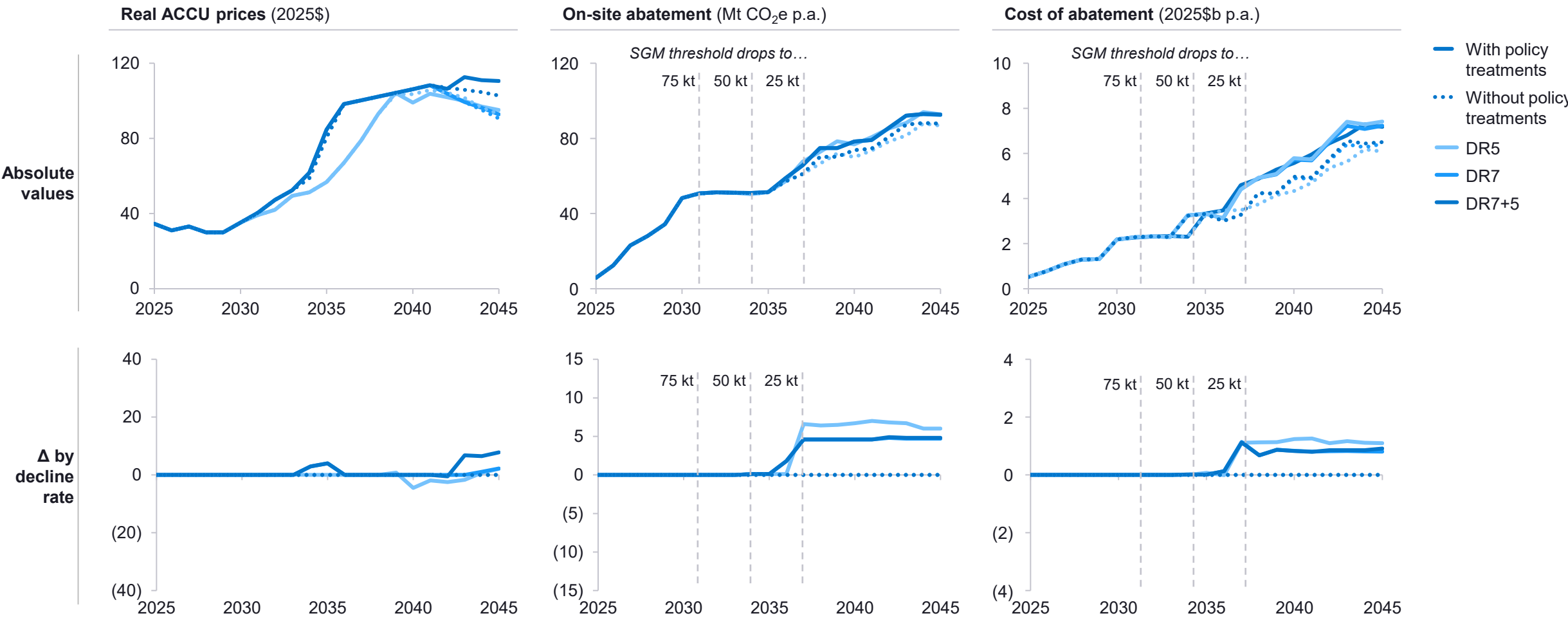
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- **Key results and insights**
 - Higher baseline decline rates
 - Sector differentiated decline rates
 - Price visibility and investment risk
 - Context of on-site abatement, and financial support
 - Cost containment
 - Capping ACCU use
 - Lower SGM facility threshold
 - **Combinations of measures**
- More details on the modelling framework

Combining differentiated decline and lower thresholds supports orderly increases in credit prices and incentives, with wider facility coverage driving higher total costs

Higher decline, differentiated rates and lower threshold | Impact on ACCU prices, abatement and costs



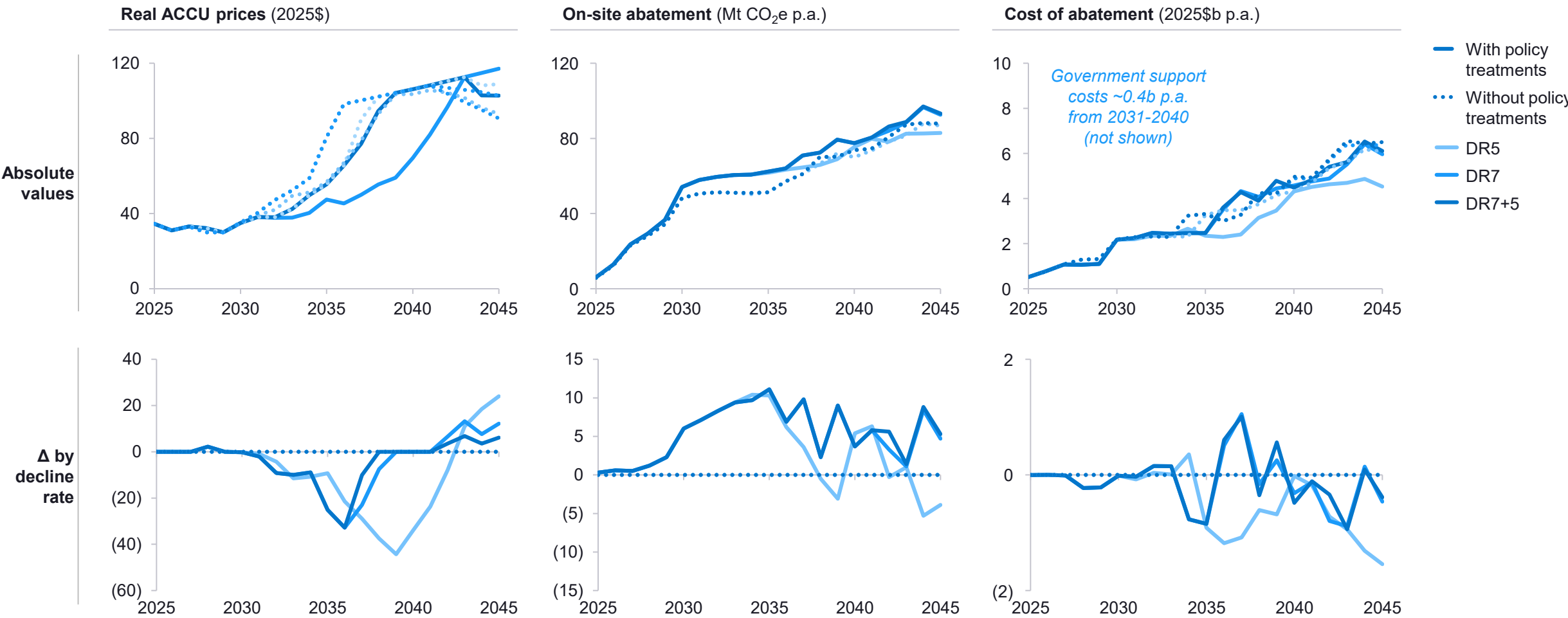
1. The package of measures includes differential decline rates, helping align sector level abatement task with low-cost abatement, which impacts the distribution of costs across sectors but has little or no impact on aggregate outcomes (such as credit prices, total and on-site abatement, and total compliance costs). Contracts of difference are not formally modelled.
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

EY Parthenon Strategy 42

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Adding financial support to the package of measures lifts and brings forward on-site abatement, and smooths the increase in credit prices and incentives

Core options¹ plus additional abatement support | Impact on ACCU prices, abatement and costs



1. The package of measures includes differential decline rates, helping align sector level abatement task with low-cost abatement, which impacts the distribution of costs across sectors but has little or no impact on aggregate outcomes (such as credit prices, total and on-site abatement, and total compliance costs). Contracts of difference are not formally modelled.
Source: EY-CARBON VIEW Model (July 2026). Results shown for medium-high price context.

EY Parthenon Strategy 43

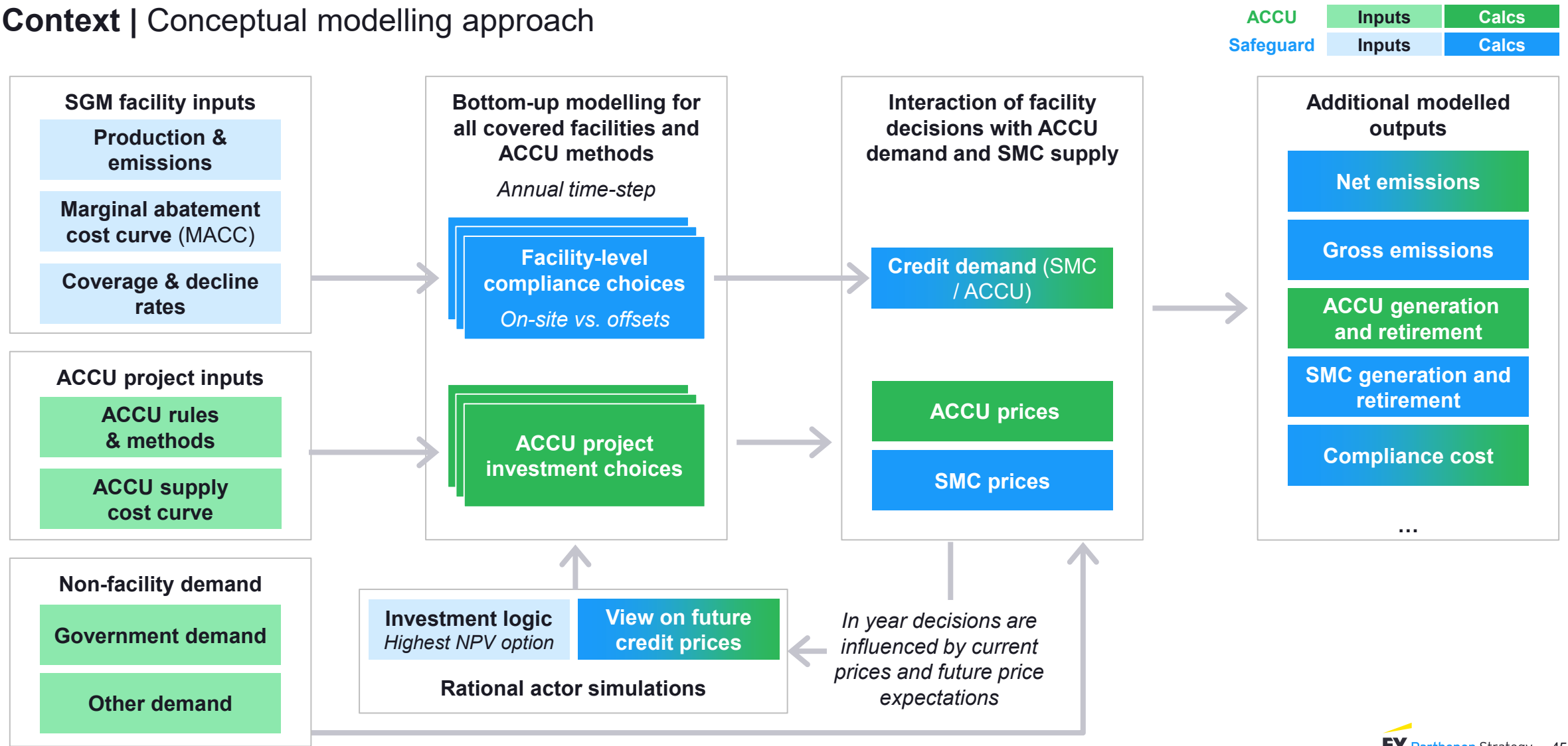
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Contents

- Introduction and summary of key findings
- Context of the analysis
- Overview of modelled policy options
- Key results and insights
- **More details on the modelling framework**

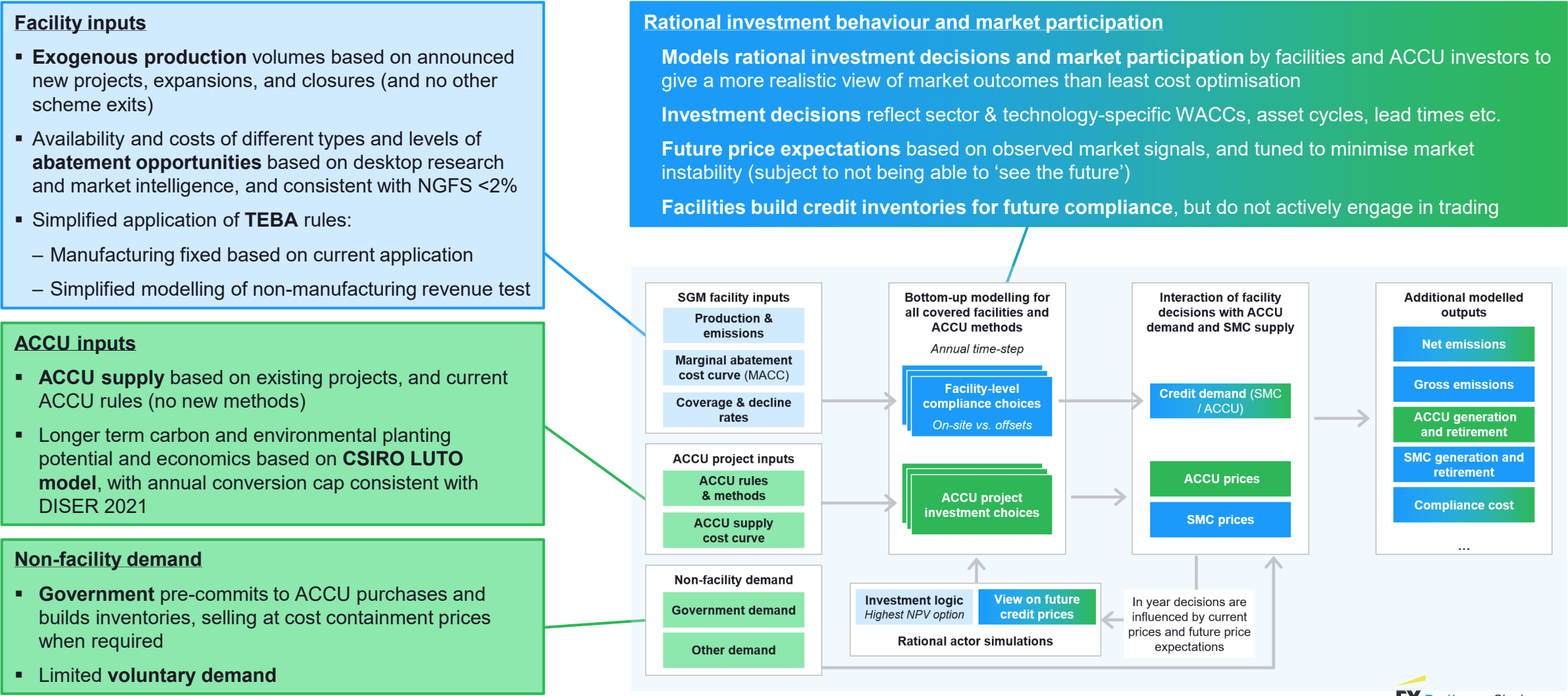
The EY-CARBON-VIEW model analyses facility-level compliance choices and their interactions with credit supply and markets to project system outcomes

Context | Conceptual modelling approach



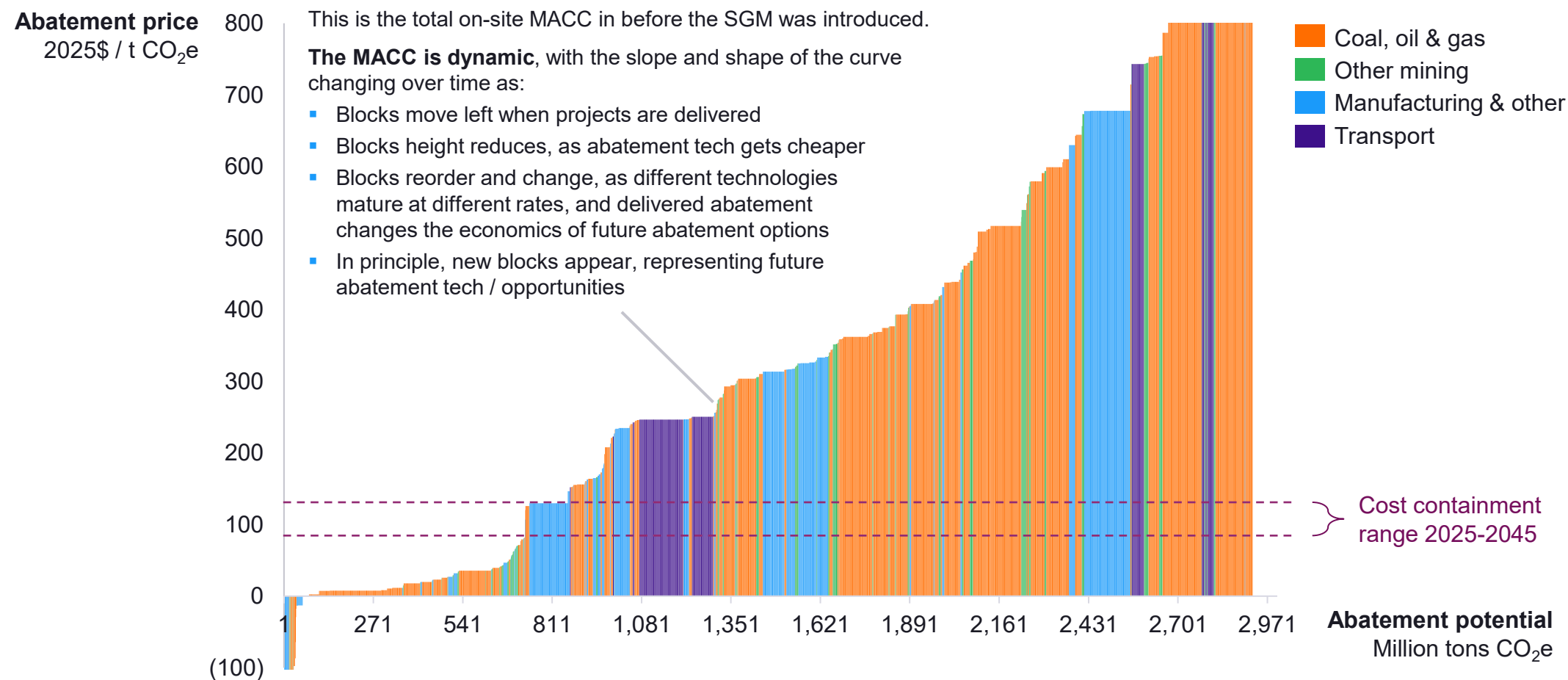
EY-CARBON-VIEW simulates rational investment and market participation decisions based on bottom-up modelling of facility and ACCU project inputs

Core modelling assumptions | Overview of key assumptions



A whole-of SGM marginal abatement cost curve (MACC) is estimated based on the cost and volume of abatement options for all emissions sources at each facility

Core modelling assumptions | Facility marginal abatement cost curve (pre-SGM reforms)

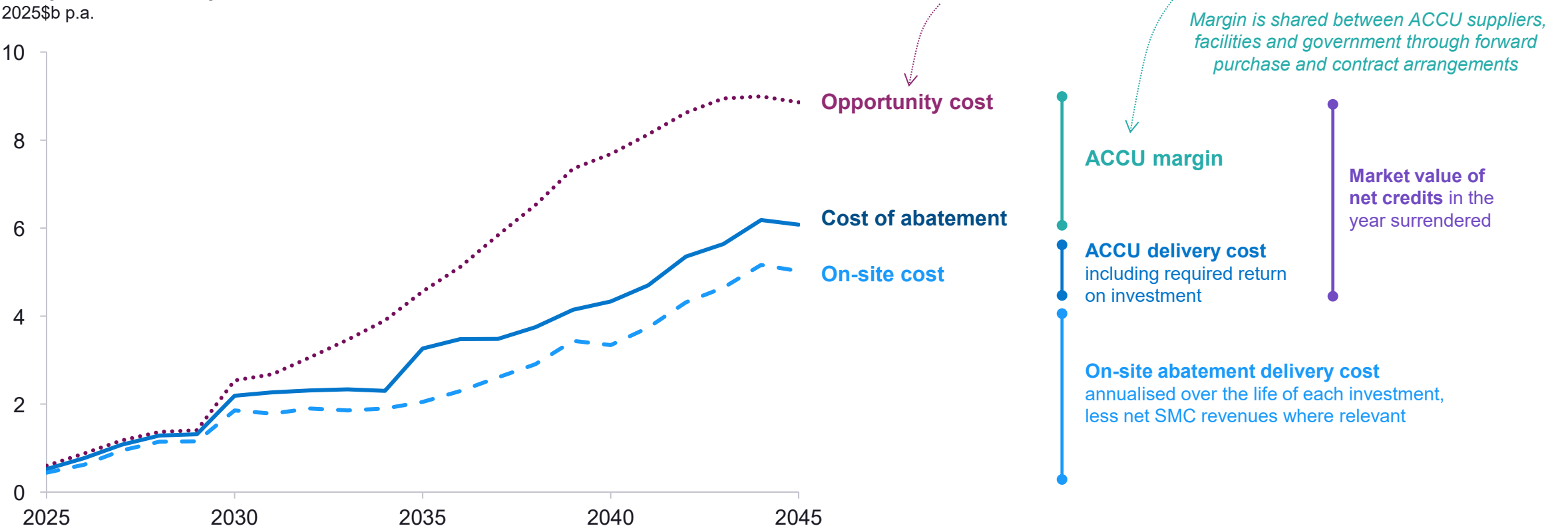


Note: Abatement options and costs are generally based on international estimates, while actual costs will be influenced by local factors including scale, supply chain factors, local regulations and learning by doing.
Source: EY-CARBON-VIEW model (July 2026)

We model several measures of compliance costs

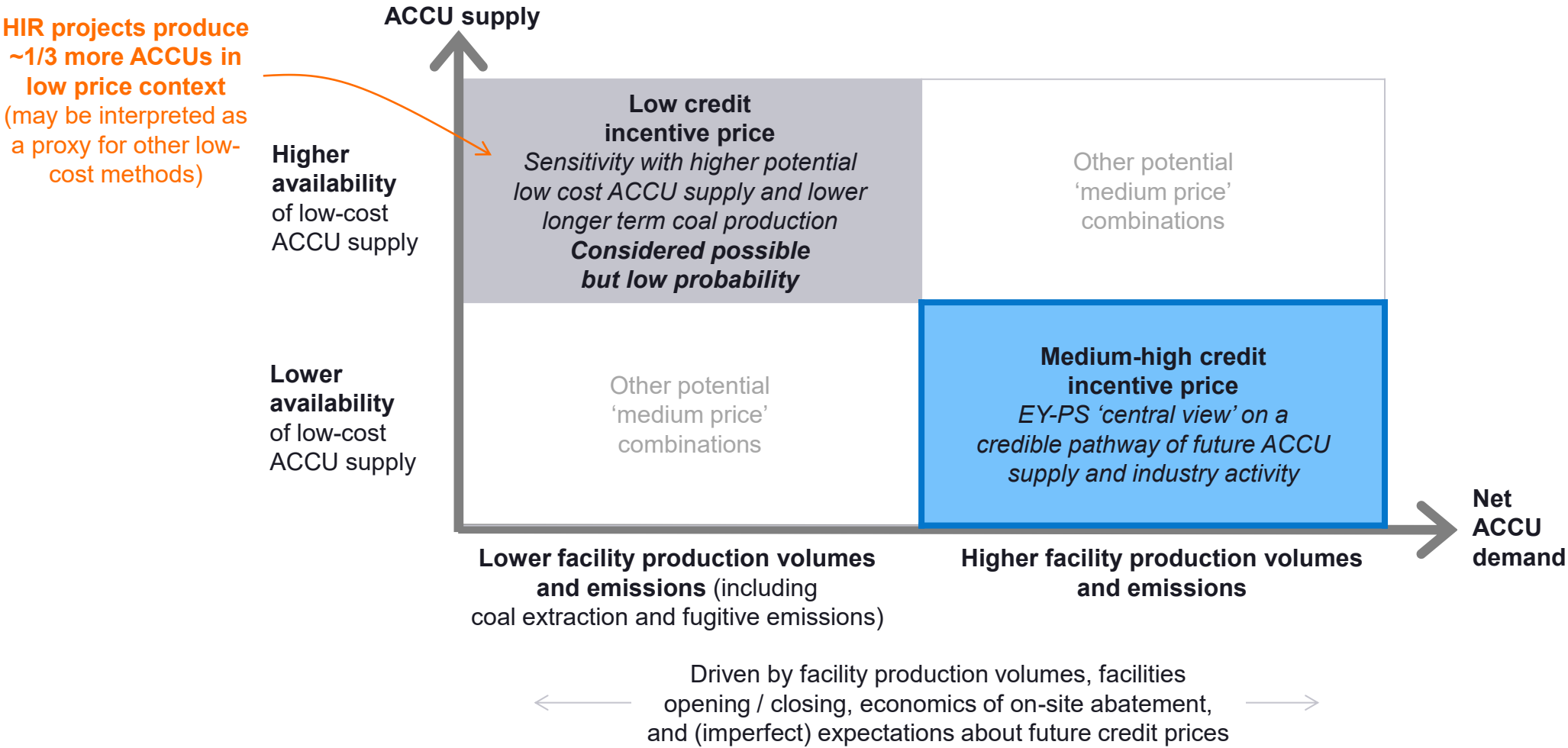
Costs | Components of compliance costs

Components of compliance costs



We distinguish *low* and *high* ACCU supply scenarios based on physical supply potential from new HIR projects

Context | Central and alternative reference contexts for modelled scenarios



We distinguish *low* and *high* net ACCU demand scenarios by varying the volume of industry output

Contexts | Facility volume assumptions for net ACCU demand scenarios

	<i>Medium-High Credit Price scenarios</i> Higher facility volumes	<i>Low Credit Price scenarios</i> Lower facility volumes
Overview	▪ EY-PS ‘house view’ on a credible pathway of industry activity in the future	▪ Varies from the EY-PS’s ‘house view’: External conditions mean fossil fuel sectors do not implement planned new projects
Existing facility treatment	▪ Facilities produce at capacity until the end of their technical lives	▪ Facilities produce at capacity until the end of their technical lives
New capacity	▪ Announced expansions and other projects are delivered for all sectors	▪ Announced expansions delivered for all sectors ▪ New projects are: – Not delivered for fossil fuel – Delivered for other sectors

Glossary

Definitions of key variables

Abatement cost	Cost of on-site abatement less net SMC revenues plus cost of ACCU delivery, plus non-compliance fees where relevant. On-site costs are average annual costs over the investment life.
Abatement cost per tonne	Abatement cost divided by the total tonnes of abatement achieved in that year
ACCU margin	Market clearing ACCU price less the weighted average delivery cost ACCUs supplied in that year, multiplied by the volume of ACCU retirements
Opportunity cost	Abatement cost plus ACCU margin in the year surrendered
Opportunity cost per tonne	Opportunity cost divided by the total tonnes of abatement achieved in that year
Gross emissions	Facility emissions (after abatement actions)
Net emissions	Gross emissions less net credit (ACCU and SMC) surrenders
Non-compliant emissions	Above-baseline emissions that are not able to be offset through ACCU or SMC surrenders in scenarios involving facility level ACCU cap

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Assessment of Safeguard Mechanism options to motivate on-site abatement and support the transition to a competitive and sustainable low-carbon Australian economy

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Abstract: Australia's Safeguard Mechanism, which requires the country's large industrial and resource facilities to reduce their greenhouse gas emissions over time, is under review. Current policy settings drive net abatement while keeping compliance costs low through allowing the use of ACCU credits, but do little to support investment in industry and resource sector decarbonisation and the transition to a resilient and competitive low-carbon economy. The Safeguard Mechanism Review has the opportunity to consider options that continue to use ACCUs to reduce average abatement costs, while providing greater incentives for on-site abatement and moving to a future where the incremental ACCU supply cost does not set the system-wide marginal abatement incentive, given that the supply price of ACCUs is likely to be lower than the efficient incentive required to drive the SGM and economy-wide abatement required for Australia's net zero transition. This paper outlines and assesses several options to sharpen the incentive for on-site abatement and smooth the transition to a competitive and prosperous low emissions economy. We find there are a range of options that could meet the goals, among them price-based (or royalty) approaches that increase the cost to facilities of acquiring or using ACCUs through a fee on ACCU surrender or an in-kind percentage of ACCU generation; a volume-based ACCU discount (or exchange rate) that requires surrender of more than one ACCUs per tonne of SGM abatement shortfall; and a system level ACCU cap, implemented with full flexibility across facilities. We assess the effects of different options quantitatively, and find they have different impacts on system incentives, average abatement costs, emissions reductions in industry and in the ACCU credit generating activities, and public benefits outcomes.

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Contents

INTRODUCTION AND SUMMARY 3

ASSESSMENT OF SAFEGUARD MECHANISM OPTIONS TO MOTIVATE ON-SITE ABATEMENT AND SUPPORT THE TRANSITION TO COMPETITIVE, RESILIENT AND SUSTAINABLE LOW-CARBON ECONOMY 5

 The SGM drives net abatement, but not the larger transition to net zero emissions 5

 Assessing options to motivate more on-site abatement by lifting the cost or constraining the use of ACCUs..... 6

 Analytical approach and limitations 12

 Conclusions 13

 References 14

 About the authors 15

 Acknowledgements and disclaimer 15

SUPPORTING INFORMATION 15

 Explanatory charts

 Data tables

INTRODUCTION AND SUMMARY

Assessment of Safeguard Mechanism options to motivate on-site abatement and support the transition to competitive, resilient and sustainable low-carbon economy

While current Safeguard Mechanism (SGM) settings drive net abatement while keeping compliance costs low, they do little to support investment in industry and resource sector decarbonisation and the transition to a resilient and competitive low-carbon economy.

The SGM review has the opportunity to consider options that continue to use ACCUs to reduce average abatement costs to industry, while providing greater incentives for on-site abatement, and moving to a future where the incremental ACCU supply cost does not set the system-wide marginal abatement incentive. This is relevant because the supply price of ACCUs is likely to be lower than the efficient incentive required to drive the SGM and economy-wide abatement required for Australia's net zero transition.

This paper outlines and assesses through quantitative analysis some of the broad options available to address a key challenge for Australia's Safeguard Mechanism: how to sharpen the incentive for on-site abatement and smooth the transition to a competitive and prosperous low emissions economy.

We find there are a range of options that could lift on-site abatement incentives while limiting costs through ACCU use and support deeper long-term decarbonisation, while limiting costs through ACCU use, with different options having different impacts on average abatement costs and other outcomes including for other public benefits.

We assess first order effects of five options in the context of an average annual abatement task of 90Mt and ~120Mt, consistent with the total SGM abatement required in 2033-34 and 2039-42 across different decline rates aligned to the 2035 and 2050 national emissions targets.

We find all the options assessed would lift the level of on-site abatement compared to current settings, with estimated impacts ranging from 5-24Mt (17-71%) when calibrated to raise the marginal incentive for on-site abatement by at least 40%, but with quite different impacts on total industry costs and risks, the ACCU market, and wider benefits.

Our exploration and analysis suggest there are three broad approaches to adjusting current SGM settings to lift the incentive for on-site abatement: increase the price or cost of purchasing and/or using ACCUs to meet compliance obligations; increase the volume of ACCUs needed to meet a given compliance obligation; constrain the use of ACCUs that may be used to meet compliance obligations. High level findings on these options include:

- **Price-based (or royalty) approaches** increase the cost to facilities of acquiring or using ACCUs through a fee on ACCU surrender or an in-kind percentage of ACCU generation or a combination of both. This is calibrated to increase costs by x1.4, which we find lifts on-site abatement 18-56% while increasing industry costs up to 31%, and raising 1.8-4.2 billion in annual revenues.
 - We assess three price-based options, two of which reinvest the revenue in ways that lower industry abatement costs (relative to no reinvestment), while delivering additional benefits through nature repair or support for on-site abatement. In one case, under assumptions chosen here, this results in lower industry costs than current policies (providing net savings) as the benefits of reinvestment accrue.

- **Volume-based ACCU discount (or exchange rate) approaches** require surrender of >1 ACCUs per tonne of SGM abatement shortfall. This is calibrated as a x1.4 discount, which we find lifts on site abatement 6-17% (5-8Mt) and motivates ~25-45Mt additional abatement outside the SGM, but as a consequence involves a significantly larger increase (~72-87%) in industry costs than other options. Commensurately, this option also drives higher overall revenues from ACCU sales.
- **System level ACCU cap** of total abatement, implemented with full flexibility across facilities. Calibrated as a cap set at 50% for illustration, it lifts on-site abatement by 50-70% while increasing industry costs 17-34%. The cap would be set on the basis of expectations about abatement costs. To limit credit price uncertainty, the ACCU cap could be overridden if a chosen price level in the SGM is reached, resulting in a stable price cap.

Different options also have different types and degrees of administrative flexibility, which could be used manage transitional impacts and perhaps fine tune implementation. In principle, options applied to use or surrender of ACCUs allow differentiation across facilities or sectors while options applied to generation or issuance of ACCUs allow differentiation across projects (including existing versus new projects) or methods.

The analysis is based on static marginal average annual abatement supply curves for on-site abatement and ACCU supply derived from the EY CARBON VIEW model, rather than fully modelling the options. Key limitations include that the analysis is does not account for transition dynamics, evolution of abatement options, or potential accumulation and use of ACCU and SMC holdings. The modelling assumes the cost containment settings do not bind.

Results should thus be treated as illustrative, and can be interpreted as the long run 'equilibrium effects' of different policy options, once they are fully implemented and transitional effects have washed through.

The analysis and evidence presented supports three key conclusions:

- There are grounds to be concerned that a system abatement incentive that is tightly linked to the supply price of ACCUs is likely to be lower than the efficient incentive required to drive the SGM and economy-wide abatement required for Australia's net zero transition.

- To support policy clarity and investment confidence the SGM Review should consider options for sharpening incentives for on-site abatement, set out the circumstances when the government would consider this, and the principles or broad approach the government would use to pursue greater on-site abatement. Our analysis suggests that differentiating SMC market prices from ACCU market prices has merit.
- On the available evidence a royalty and reinvestment approach appears to have potential to achieve a material increase in on site abatement, at lower costs to industry than many other approaches, and warrants further examination.

Overall, the analysis suggests that there is room to build on the foundation provided by the SGM through a well-designed mechanism to sharpen the incentive for on-site abatement, while continuing to use ACCUs to lower average industry costs, potentially while generating revenues to reinvest in delivering public benefit outcomes.

ASSESSMENT OF SAFEGUARD MECHANISM OPTIONS TO MOTIVATE ON-SITE ABATEMENT AND SUPPORT THE TRANSITION TO COMPETITIVE, RESILIENT AND SUSTAINABLE LOW-CARBON ECONOMY

The SGM drives net abatement, but not the larger transition to net zero emissions

Current Safeguard Mechanism (SGM) settings provide a policy foundation to drive net abatement while keeping compliance costs low. Existing scheme settings also minimise near-term risks to competitiveness and carbon leakage, though border carbon adjustments should be considered to address future carbon leakage risks in some specific sectors.[1] Policy settings to enable supply and use of ACCUs to offset residual emissions are central to this outcome.[2]

But this strength in moderating industry costs is also a weakness, as the central role of ACCUs in motivating cost-effective abatement (including off-site abatement using ACCUs) also moderates incentives for on-site abatement.

As a result, current SGM policy settings are expected to fall short of what is required to support deep decarbonisation – which we interpret as involving 80-100% reductions in gross emissions, based on national and global economic modelling – and the long-term transition to a resilient and competitive low-carbon economy. To date, only a limited extent of investment to reduce onsite emissions at Safeguard facilities is evident; the majority of reductions in covered emissions is due to facilities dropping below the coverage threshold or reducing output. While modelling of SGM and ACCU outcomes is useful, the mix of longer-term outcomes remains uncertain. [2-4].

This suggests policy makers can be confident that current SGM settings will drive real abatement, including some extent of on-site emissions reductions, but that sharper incentives, possibly along with more support for innovation and adoption of zero- and low-emissions production technologies, will be required to drive greater on-site abatement towards deep decarbonisation over coming decades.

Cost-advantaged ACCU supply will result in SGM abatement incentives that are well below the efficient economy-wide incentive pathway, under the current settings

It is well established in economics that policy should avoid requiring or motivating higher cost abatement in one area, while ignoring lower cost abatement elsewhere (from other activities, or sectors, or emissions sources).

This is why the single system-wide abatement incentive provided by SGM settings to all covered facilities is important and valuable for motivating the least cost suite of abatement across SGM facilities. However it has little traction over the emissions outside the SGM. Only a small fraction of emissions reductions options outside the SGM are covered by ACCU methods.[2]

The logic of a single scheme-wide abatement incentive does not imply that the ACCU supply price under current policies is the correct or efficient incentive price for SGM facilities or the wider Australian economy.

There are several reasons why ACCU prices under the current policy approach are and will remain below the efficient level for the system-wide emissions incentive price, and why a harmonised price (across the ACCU market on the one hand and the SGM and potentially other sectors on the other) would not be required for a dynamically efficient economy wide outcome:

1. Current policies limit compliance demand for ACCUs to activities that account for around 26% of gross emissions in Australia (~135Mt), dramatically reducing ACCU prices relative to the level that would result from abatement demand with coverage of all energy and industrial emissions (~430Mt) under an efficient economy-wide approach.
2. The ACCU scheme is not a carbon price for the land sector; rather it is legislated opt-in credit scheme that provides incentives for specific abatement opportunities that are eligible under specific ACCU methodologies which are subject to regulatory decision making, while not applying a carbon price to other sources of agricultural, forestry or land sector emissions.

3. Current and projected ACCU prices under the current policy approach are well below the incentive pathways that national modelling suggests would be necessary to achieve a net zero trajectory and the national emissions targets for 2035 or 2050. [3-8]
4. Global climate modelling consistently finds land sector removals have a valuable and perhaps essential role in meeting Paris consistent global net emissions pathways. This modelling also finds the global incentive price is set by incremental (or marginal) industrial decarbonisation costs, rather than land sector supply and opportunity costs, implying that high integrity credits will be extremely valuable as the world transitions to net zero emission– and likely well above current and projected ACCU prices. This is reinforced by the latest IPCC scenarios and synthesis, which emphasise the essential role of removals for overshoot pathways.[9-10]
5. In addition, land-sector removals are a scarce non-renewable policy-created entitlement. Creating ACCUs thus creates value-in-use that is allocated via policy settings. Policy settings that encourage ACCUs to be used well below their long-term value would be inefficient and could result in substantial opportunity costs for Australia. This also suggests a case to collect royalty on the generation or use of ACCUs.[11-12]

Policy should lean in to support clarity and investment certainty

The consultation paper for the SGM review notes that the Government is seeking to ensure industrial decarbonisation is aligned with Australia's medium- and long-term emissions goals.

The pace and extent of desirable abatement outcomes over time will vary across sectors and facilities, and will be influenced by multiple factors including the availability and cost of abatement technologies and options, competitive pressures, shifts in demand for different products and for products with different embodied emissions and sustainability characteristics, investor preferences and expectations, and the evolution of domestic and international climate, energy and trade policies. All of these are uncertain, and many are strongly influenced by global technology, policy and economic trends in addition to domestic trends.

Notwithstanding these multiple uncertainties, it seems likely that at some point Australian SGM policy will need to consider the merit of motivating faster

or deeper on-site abatement in specific sectors or across the SGM as whole – as well as how it might seek to do this, if it is needed.

This suggests the outcome from the current SGM Review should provide greater clarity regarding the circumstances under which additional incentives or policy mechanisms may be considered to accelerate on-site abatement, and preferred approaches to achieving this. Doing this would provide greater clarity for investors, even if the Review concludes no additional action is required in the current cycle, which is focused on policy settings to 2035.

Assessing options to motivate more on-site abatement by lifting the cost or constraining the use of ACCUs

We consider these considerations imply the current SGM review should consider options to sharpen abatement incentives.

We suggest the importance of ACCUs in reducing compliance costs and supporting jobs and competitiveness implies the following guiding principle:

SGM policy should continue to use ACCUs to reduce average abatement and industry costs, while moving to a future where the incremental ACCU supply cost does not set the system-wide marginal abatement incentive.

Our exploration and analysis of this issue suggest there are three broad approaches to adjusting current SGM settings to lift the incentive for on-site abatement:

- Increase the price or cost of purchasing and/or using ACCUs to meet compliance obligations
- Increase the volume of ACCUs needed to meet a given compliance obligation
- Constrain the use of ACCUs that may be used to meet compliance obligations

Going deeper, our assessment identifies five options including three variants of the price based approach, each with distinctive incentive effects.

Table 1 below outlines the detail of each option and summarises their main effects, with key impacts also shown in Exhibit 1.

Table 1. Summary of incentive effects and first order impacts of Safeguard Mechanism reform options

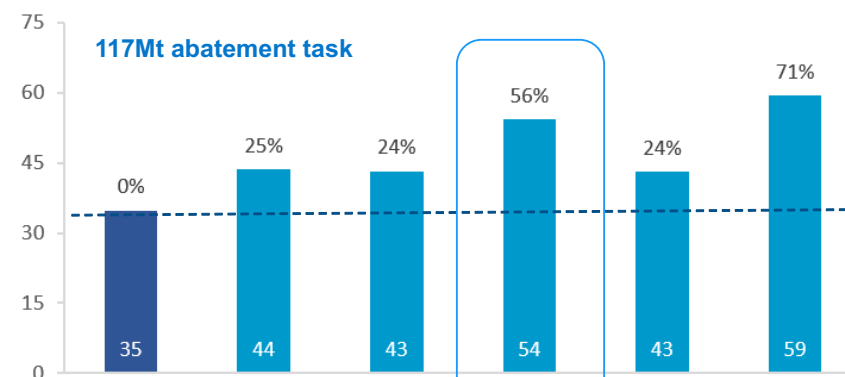
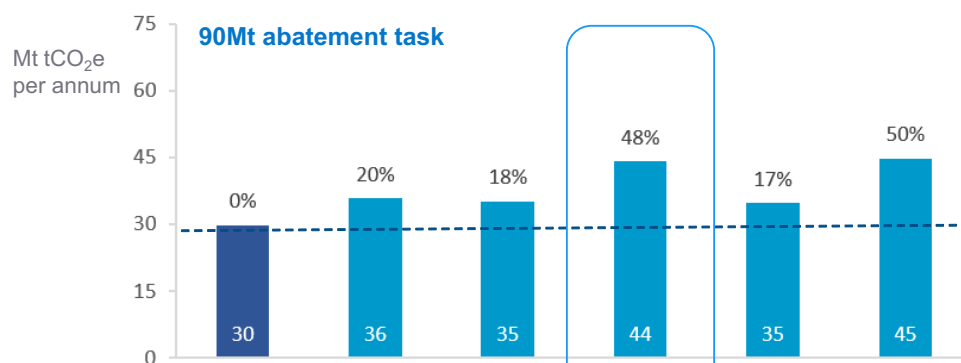
OPTION	INCENTIVE EFFECTS AND OTHER OUTCOMES	On-site abatement	Industry cost	Other outcomes
Results for total SGM abatement task of 90-117Mt:				
Current policy approach	System wide abatement incentive set by incremental ACCU supply price.	\$119-137/t	44-64/t	n.a.
ACCU Royalty or surrender fee No reinvestment Royalty via dollar fee on ACCU surrender or collecting a share of credits generated and selling them on market.	This increases the royalty inclusive ACCU price required by project proponents above the cost of ACCU supply (as proponents need to recover total costs from a smaller number of ACCUs), decreases demand for ACCUs, and lifts the system-wide abatement incentive and SMC price above the ACCU supply price. Imposing an equivalent dollar fee on the use of ACCUs, or a combination of the percentage royalty and a dollar fee, has identical static incentive effects. The no reinvestment option assumes revenues are used in ways that do not lower facility abatement costs, such as supporting fiscal repair or other policy goals.	20-25% (6.0-8.7Mt) increase \$147-187/t incentive price	31% increase \$58-84/t average cost	\$2.3-4.1 billion annual revenue
• Nature royalty fund: 100% of revenue is used to provide top-up payments for nature repair, lifting ACCU supply through co-benefit projects.	In addition to royalty effects above, this expands the ACCU supply curve by bringing in land that provides nature benefits that would otherwise not be competitive for carbon plantings, reducing ACCU prices relative to the royalty with no nature fund. The analysis assumes top-up payments increase ACCU supply volumes 8-15% for supply prices of \$80-130/t.	18-24% (5.3-8.4Mt) increase \$139-175/t price	20-23% increase \$55-77/t average cost	\$2.3-4.0 billion annual revenue to support nature benefits
• Royalty with support for abatement and nature: Share of revenue reinvested to reduce on-site abatement cost to facilities by ~35% and balance used for nature benefits.	In addition to royalty effects above, this increases the volume of on-site abatement motivated by a given system-wide abatement incentive, reducing ACCU demand relative to the royalty with no financial support for abatement. The analysis assumes incremental on-site costs can be reduced ~35%, lifting on site abatement ~10Mt pa (relative to the nature royalty) at a resource cost of ~\$975-1,950 million pa. The option assumes remaining revenues support nature repair.	48-56% (14-20Mt) increase \$132-175/t incentive price	13% increase 7% decrease \$50-60/t average cost	\$1.8-3.2 billion annual revenue to support on-site abatement and nature benefits
ACCU discount (or exchange rate). SGM facilities must surrender >1 ACCU per tonne of compliance obligation.	This increases near term demand for ACCUs and lifts the incentive for on-site abatement above the ACCU price, making the Safeguard Mechanism Credit (SMC) price the system-wide marginal abatement signal. This also ‘overdelivers’ net abatement achieved by ACCUs, which is recognised in the national emissions accounts but not recognised within the SGM.	17-24% increase \$134-155/t incentive price	72-81% increase \$76-117/t average cost	25-26Mt additional abatement (outside SGM)
System-level ACCU cap: Policy establishes some form of constraint or tradable quota for ACCU use and allocates this without charge to facilities.	This limits aggregate use of (and demand for) ACCUs and increases demand for SMCs, lifting the SMC price above the ACCU price and making the SMC price the system-wide marginal abatement incentive. The analysis assumes a cap set at 50% of the total abatement task (relative to pre-SGM emissions), and does not assess distribution of costs across sectors.	50-71% increase \$237-376/t incentive price	17-34% increase \$52-87/t average cost	Does not raise revenue or drive additional abatement (outside SGM).

Exhibit 1. We find price-based approaches that re-invest in nature support and on-site abatement can achieve significant additional on-site abatement with lower long-term cost to industry impacts than other options

On-site abatement outcomes and compliance costs vs current approach, 90Mt/a and 117Mt/a

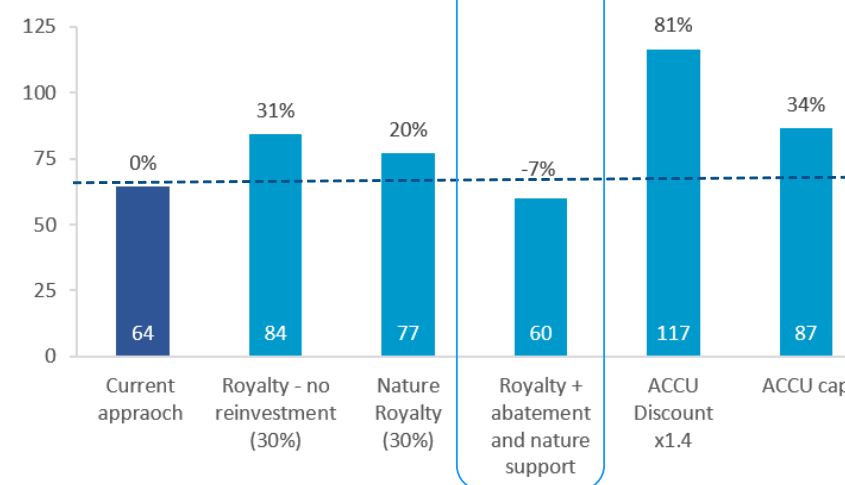
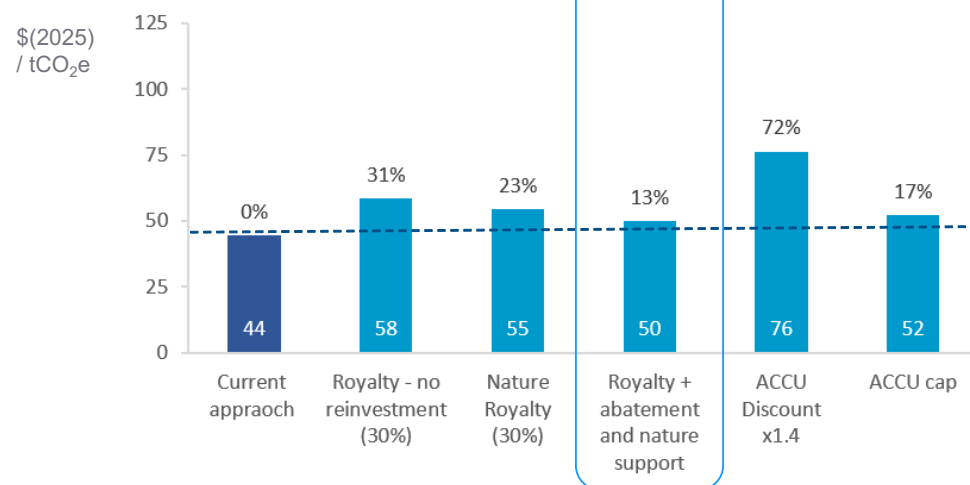
On-site abatement

(and deviation from current approach)



Industry costs

(and deviation from current approach)



Notes: See text and Table 1 for definitions of options, and Table 3 in the technical Appendix for more details.

Source: Calculations by authors using on-site MACC and off-site ACCU supply data from the EY CARBON VIEW model [13]

Overview of abatement outcomes and cost impacts

We find that, in principle, each of the five options could lift on-site abatement incentives and support deeper long-term decarbonisation, with each having different impacts on average abatement costs and other outcomes.

We assess first order effects of these options using static marginal supply curves for incremental costs and volumes of on- and off-site abatement, derived from the EY CARBON VIEW model.[12]

In essence, this assessment estimates the incentive effect of changing or constraining ways that ACCUs are able to be used to meet SGM compliance obligations, and how this flows through to change the balance of on-site abatement vs off-site abatement (achieved through ACCU use), and total costs to industry of meeting their SGM obligations.

We undertake this assessment for several levels of annual total abatement task, to illustrate how impacts and incentive effects vary with context. We focus the assessment on 90Mt per year and ~120Mt per year of total on- and off-site abatement, consistent with the total annual abatement required in either 2033 or 2034 (~90Mt/a) or at some point between 2039 and 2042 (~120Mt/a), with the precise timing of when this abatement is required being determined by SGM decline rates to 2035 and beyond.[2-3]

We find all five options would lift the level of on-site abatement, with estimated impacts ranging from 5-24Mt/a (17-71%), but with quite different impacts on total industry costs and risks, and wider benefits. (For simplicity the text generally reports the range of results for on-site abatement, industry costs and other outcomes based on the 90Mt/a and 117Mt/a abatement task.)

High level findings include:

- **Price-based (or royalty) approaches** increase the cost to facilities of acquiring or using ACCUs through a fee on ACCU surrender or an in-kind percentage of ACCU generation or a combination of both. This is calibrated to increase costs by x1.4, which we find lifts on-site abatement 18-56% while increasing industry costs up to 31%, and raising 1.8-4.2 billion in annual revenues. Collecting ACCUs on generation and selling them into the market can also be used to support a price corridor via the ACCU sales policy adopted. We assess three price-based options:
 - **Royalty equivalent incentive fee without revenue reinvestment** lifts onsite abatement 20-25% and increases industry costs 28-31%, while delivering \$2.4-4.2 billion in annual revenue (around x2 the increase in industry costs), under the chosen assumptions.
 - **Royalty-funded nature repair** delivers similar on-site abatement outcomes at lower costs to industry, as biodiversity payments bring in land that would otherwise not be attractive for carbon plantings, while annual payments of \$2.3-4.0 billion drive significant nature repair.
 - **Royalty-funded support for on-site abatement and nature repair** has the smallest estimated impact on total industry costs (up to 13%) while delivering a significant increase in on-site abatement (48-56%) and still making available significant payments for nature repair. The impact on industry costs moderates as the benefits of reinvestment accrue, and is estimated to be lower than the current policy approach (providing net savings) for the 117Mt/a abatement task.
- **Volume-based ACCU discount (or exchange rate) approaches** require surrender of >1 ACCUs per tonne of SGM abatement shortfall. This is calibrated as a x1.4 discount, which we find lifts on-site abatement 6-17% (5-8Mt/a) and motivates ~25-45Mt per year additional abatement outside the SGM, but involves a significantly larger increase (~72-87%) in industry costs than other options. Commensurately, this option also drives higher overall revenues from ACCU sales.
- **System level ACCU cap at 50%** of total abatement, implemented with full flexibility across facilities, could, in principle, lift on-site abatement by 50-70% while increasing industry costs 17-34%. Given resulting greater price uncertainty in the SMC market, an ACCU cap would best be accompanied by a price corridor for SMCs.

A system-wide cap could be implemented with tradeable allocations for the use of ACCUs, ensuring least-cost outcome through flexibility across facilities. Government would allocate tradeable ACCU-use permits to facilities for free (assumed in the analysis here), or could auction them. Setting the cap would occur under uncertainty about the cost schedule for on-site abatement and thus credit prices, and prices for credits in the SGM would be

sensitive to this. This suggests the use of a predetermined ceiling price for SMCs, at which additional ACCU-use permits are made available.

The technical appendix provides charts that show the main static incentive effects of each option, along with a Table 2 providing results for key variables.

Distributional effects on ACCU market participants

The static method used for this analysis does not account for distributional effects related to pre-existing holdings or offtake agreements for ACCUs or SMCs. In practice we would expect the following high level distributional effects from the introduction of each of these options, relative to the existing policy approach:

A fee on the use of ACCUs and a discount on ACCU recognition:

- increases the value (or internal return) for past on-site mitigation actions and investments
- decreases the value-in-use of ACCUs already purchased or contracted (including their re-sale value were a facility switches strategy from using ACCUs to implementing on-site abatement)
- impacts future sale-price and revenues from uncommitted ACCUs generated from established projects differently – with a fee decreasing prices and revenues, while an ACCU discount increases them.

A royalty collected on the generation or issue of ACCUs:

- increases the value (or internal return) for past on-site mitigation actions and investments
- increases the market value of ACCUs already purchased or contracted
- reduces the future sale-price and revenues from uncommitted ACCUs generated from established projects.

A well designed and implemented ACCU cap:

- increases the value (or internal return) on past on-site mitigation actions and investments

- decreases the market value and value-in-use of ACCUs already purchased or contracted
- reduces the future sale-price and revenues from uncommitted ACCUs generated from established projects.

It is important to note these effects are defined relative to a ‘business as usual’ current policies scenario. In many cases underlying policy-driven increases in ACCU prices relative to today, for example through more rapid SGM baseline decline rates, will outweigh the marginal effects of these policy changes.

These effects are summarised in Table 2.

Table 2. Overview of effects on existing investments and administrative flexibility

OPTION	Value of past on-site abatement	Value of ACCUs already purchased or contracted	Value of uncontracted ACCUs from established projects	Flexible across facilities	Flexible across ACCU projects
Fee on ACCU use	↑	↓	↓	✓	✗
Royalty on ACCU generation	↑	↑	↓	✗	✓
Combined fee and royalty*	↑	~*	↓	✓	✓
ACCU discount (on use)	↑	↓	↑	✓	?
ACCU cap	↑	↓	↓	✓	✗

Note: * Under ‘combined fee and royalty’, impact on value of ACCUs already purchased or committed will be less than for other options, with the extent of the net increase or decrease determined by the mix of fee vs royalty, along with transitional arrangements.

Other benefits and outcomes within and outside the SGM

Several of the options can also be designed to drive non-abatement outcomes of value to different constituencies and stakeholders:

- ACCU collecting options, such as a royalty on generation and potential variants of the ACCU discount, could be used to support an ACCU price corridor through policy settings for how ACCUs collected are sold into the market, such by establishing pathway for reserve prices (for the lower end of a price corridor) [1,10]
- Revenue generating options provide resources as a byproduct of the lift in abatement incentives, and can direct these to achieving public benefits or fiscal repair
- The ACCU discount can motivate additional abatement outside the SGM – here delivering ~25-45 Mt by around 2040 (as calibrated for this analysis), which could be used to overperform or set a more stringent 2040 national emissions target, or to moderate the impacts of weaker abatement outcomes in other sectors
- Reinvesting revenues in nature repair could enable substantial regeneration of priority ecosystems, with previous research finding a similar royalty arrangement could achieve 2.7-3.6 Mha of high-priority habitat plantings by 2050 while lifting farm sector incomes by ~10%, reducing the extent of land use change ~25% (relative to no royalty), and supporting regional tourism [11-12]

Harnessing synergies to deliver a wider range of benefits – such as nature outcomes, stronger regional economies, or improved resilience to climate and other volatility – can also establish a stronger coalition of support across different constituencies, including stakeholders for whom decarbonisation and climate action are not high priorities.

Administrative flexibility and managing transitional effects

The different options also have different types and degrees of administrative flexibility, and different information requirements for policy design. For example:

- A royalty or other measure imposed on ACCU generation could be applied differently to different types of projects, including new vs current ACCU projects.
- A royalty fee or ACCU discount imposed on surrender could be applied differently to different sectors or facilities.
- A system-wide cap, implemented through tradeable permits for the use of ACCUs, allows differentiation between types of facilities in allocation of free ACCU-use permits, and could provide a revenue source as some or all of the permits.

These differences could be used to support transition arrangements and mitigate the effects of policy changes on investors.

A royalty on ACCU generation, for example, might be applied at the full rate to projects registered after an announced date, while the royalty rate could be phased in over time for projects that are already registered or have issued ACCUs by a certain date. In principle, in the context of policy-driven increase in ACCU prices, a phased approach could be managed so the returns to existing projects are not reduced relative to a base year (calculated relative to an assumed cost, such as \$25 per unit).

A royalty or fee on ACCU surrender, by contrast, could be applied in different ways to facilities facing different contexts or opportunities (such as sectors where it is clear there little or no abatement opportunities at costs well above the system incentive price). Transition arrangements for a surrender fee should be careful to avoid ‘punishing good decisions’, such as early purchase of ACCUs at lower prices.

While appearing more complex, one approach to implementing and managing the impacts of introducing a price-based approach would be to collect royalty both through a set fee on surrender and through a percentage share of units generated and issued. This would provide both a predictable administratively defined abatement incentive (with a known escalation factor), and a market-determined royalty-inclusive ACCU cost. It would also spread the transition effects of the policy change across actors in different parts of the ACCU supply chain – including ACCU developers and suppliers, those who have committed to advance purchases or offtake agreements, and facilities who have chosen to rely on the spot market to meet future compliance needs.

Illustrative implementation of a royalty and incentive payment to support abatement and nature repair

This section steps through what might be involved in introduction of a combined royalty on ACCU generation and surrender fee on ACCU use, with the revenues reinvested in on-site abatement and priority nature repair, and provides an overview of the outcomes that might be achieved. The illustration assumes a total incentive effect equal to a 30% royalty, with one third of the incentive is provided through the set dollar fee and two thirds through the percentage royalty.

Calibrating this to the results of the static analysis for this paper, this implies setting the abatement reinvestment fee at around \$10 per unit in 2031 (in 2026 real dollars), rising at CPI + 6% per annum. This is broadly consistent with:

- A fee of \$14 for each ACCU surrendered (real current dollars) combined with a 20% royalty on generation around 2033 – 2034
- A fee of \$18 for each ACCU surrendered (real current dollars) combined with a 20% royalty on generation around 2039 – 2042

(This calibrates the starting level and escalation rate to achieve the longer-term incentive level required for the ~120Mt target around 2040, starting a little higher than implied by the 70Mt and results in a unit fee a little lower than the 90Mt task as shown in Table 3.)

The results presented in Table 3 assume available revenues each year are allocated to cover the average annual resource costs of abatement support, with the remainder going to nature repair. This approach avoids levels of on-site abatement support that might be considered inconsistent with the polluter pays principle, while providing a defensible increase in on-site abatement achieved. The actual resource cost to government of providing abatement support consistent with the project outcomes could well be substantially lower than reported in Table 3, particularly if support is provided through concessional finance.

On this basis, the results suggest that government could pre-commit, if desired, to dedicating at least one third of revenues raised to support for SGM abatement and at least half the revenues to support priority nature repair and benefits, while achieving the outcomes estimated here.

Taken together, this suggests an incentive and reinvestment package announced in 2027 with a date of effect in 2031 would be projected to achieve the following outcomes:

- Increase onsite abatement by around 45% before 2035 and up to 55% after 2035
- Increase overall industry costs by around 16% on introduction, with these incremental costs declining as the benefits of revenue reinvestment flow through – potentially resulting in net cost reductions over time, with lower total costs to industry before 2040 relative to current policies
- Raising over \$1.8 billion per year in revenues for investment from 2031, rising to over 3.0 billion after 2035 – implying abatement support worth over 0.6-1.0 billion per year and nature support worth 0.9-1.5 billion per year, without any cost to government budgets or general taxpayers – while noting actual revenues each year would depend on the volume of ACCUs carried over from prior years, and transitional arrangements for how the royalty is applied to projects established before the policy change

We consider this mix of benefits might also help secure broader and stronger stakeholder support for the SGM and the generation and use of ACCUs, reducing the risk of more arbitrary and disruptive policy changes over the political cycle, and improving industry and investor confidence.

Analytical approach and limitations

The analysis is based on static marginal average annual abatement supply curves for on-site abatement and ACCU supply derived from the EY CARBON VIEW model, rather than fully modelling the options.

Our professional judgement is that the high-level results, ranking, and broad ratios of impacts are likely to be robust across different timeframes and different modelling estimates of relevant MACC, noting this is already seen in differences in impacts and outcomes for different levels of abatement task. But it is well beyond the scope of this paper to fully model illustrative examples of these options, or to arrange a multi-model comparison of static MACC or dynamic scenarios.

In practice, we know the on-site abatement MACC and ACCU supply curve will not be static.

- The cost of, and access to, on-site abatement will be shaped by two high level trends. First, the SGM is intended to drive incremental on-site abatement each year, which reduces the volume of options for future abatement and makes the cost-curve steeper (while also delivering a stream of annual abatement from past actions). Second, innovation and learning-by-doing is expected to reduce the costs of existing options and perhaps create new options, although the timing and extent of these changes are uncertain.
- The volume and cost of off-site abatement will be strongly influenced by agricultural profits and land values, as various types of reforestation make up the bulk of incremental ACCU supply. Here the CSIRO LUTO estimates of land sector sequestration incorporated into the EY CARBON VIEW model may underestimate trend growth in land values (despite assumptions of strong agricultural productivity growth), and so actual future supply volumes may be lower (or costs higher) than suggested by the ACCU supply curve used here.

More general limitations of the analysis include that it does not account for transition dynamics, evolution of abatement options (included in the MACC), changes in SGM coverage, changes in the range of eligible ACCU methods, or potential accumulation and use of ACCU and SMC holdings. The analysis also assumes the existing SGM cost containment settings do not bind.

Results should thus be treated as illustrative, and can be interpreted as the long run 'equilibrium effects' of different policy options, once they are fully implemented and transitional effects have washed through.

Conclusions

This paper outlines and assesses some of the broad options available to address a key challenge for Australia's Safeguard Mechanism: how to sharpen the incentive for on-site abatement and smooth the transition to a competitive and prosperous low emissions economy.

We have used the best available data and analysis to undertake a 'first pass' static analysis of relative merits of different options. Substantive policy changes should be supported by and tested against deeper and more extensive analysis than we have been able to provide in this paper.

The analysis and evidence presented support three key conclusions:

- There are grounds to be concerned that a system abatement incentive that is tightly linked to the supply price of ACCUs is likely to be lower than the efficient incentive required to drive the SGM and economy-wide abatement required for Australia's net zero transition.
- To support policy clarity and investment confidence the SGM Review should consider options for sharpening incentives for on-site abatement, set out the circumstances when the government would consider this, and the broad approach the government would use. Differentiating SMC from ACCU market prices has merit.
- On the available evidence a royalty and reinvestment approach] appears to have potential to achieve a material increase in on site abatement, at lower costs to industry than many other approaches, and warrants further examination

Overall, the analysis suggests that there is room to build on the foundation provided by the SGM through a well-designed mechanism to sharpen the marginal incentive for on-site abatement by decoupling it from the ACCU supply price, while continuing to use ACCUs to lower average industry costs, potentially while generating revenues to reinvest in delivering public benefit outcomes.

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- [12] EY Net Zero Centre (2023) Creating a nature-positive advantage: Assessing the outlook for Australia in a net zero world.
- [13] EY CARBON VIEW model (2026) unpublished data and calculations for annualised on-site marginal abatement and ACCU supply cost curves, reflecting pre-2025 abatement potential, used with permission

About the authors

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Steve Hatfield-Dodds notes the use of outputs from previous EYPS work for IGCC (see references 3 and 4) and ACBF (see reference 11), with the ACBF work expanding on ideas presented in references 6, 7 and 12.

All opinions and judgements in this report reflect the personal and professional views of the authors, and should not be interpreted as the views of our employers or other associated institutions.

The analysis aims to capture complex interactions between investment and operational decisions made by SGM facilities and ACCU project proponents. As with any analysis, this involves a number of simplifying assumptions and limitations. Readers are advised that the scenarios analysed represent a range of possible future options, and it must be acknowledged that many alternative futures exist. No reliance may be placed on this report or any of its contents, findings or results, and this report does not constitute financial advice.

SUPPORTING INFORMATION

Explanatory charts

(below)

Data tables

(below)

Assessment of Safeguard Mechanism reform options to motivate on-site abatement and support the transition to competitive, resilient and sustainable low-carbon economy

EXPLANATORY CHARTS

Steve Hatfield-Dodds
Frank Jotzo

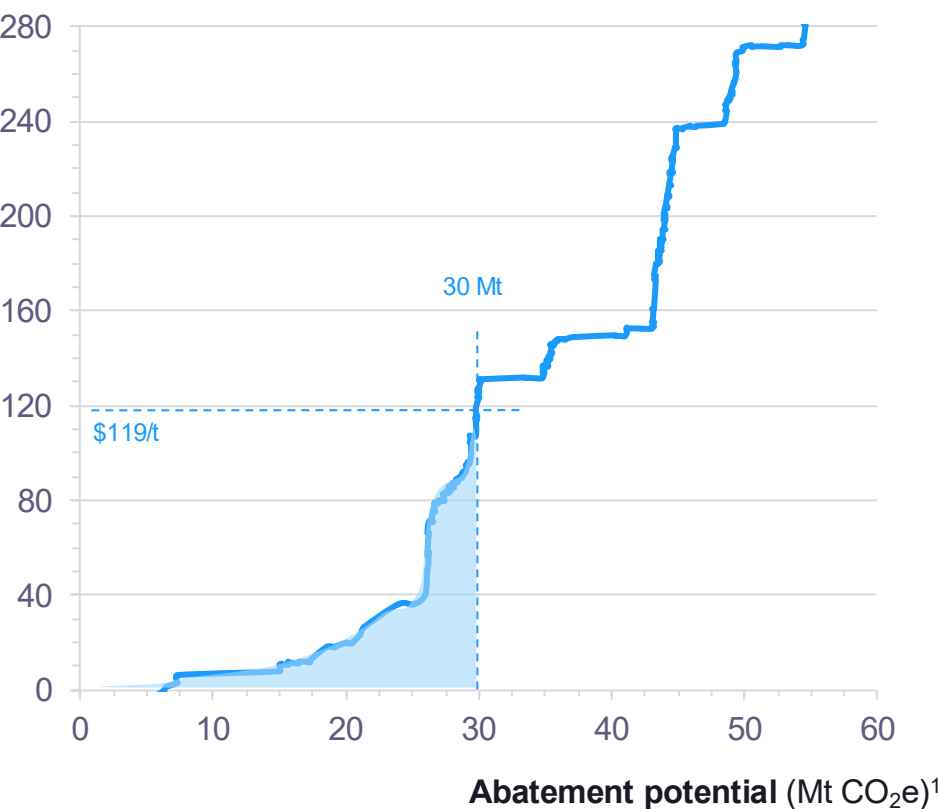
September 2026

Current settings result in the marginal ACCU supply cost setting the system-wide SGM abatement incentive, delivering an estimated 90Mt abatement at ~\$120/tCO₂e

On-site MACC and off-site ACCU abatement potential

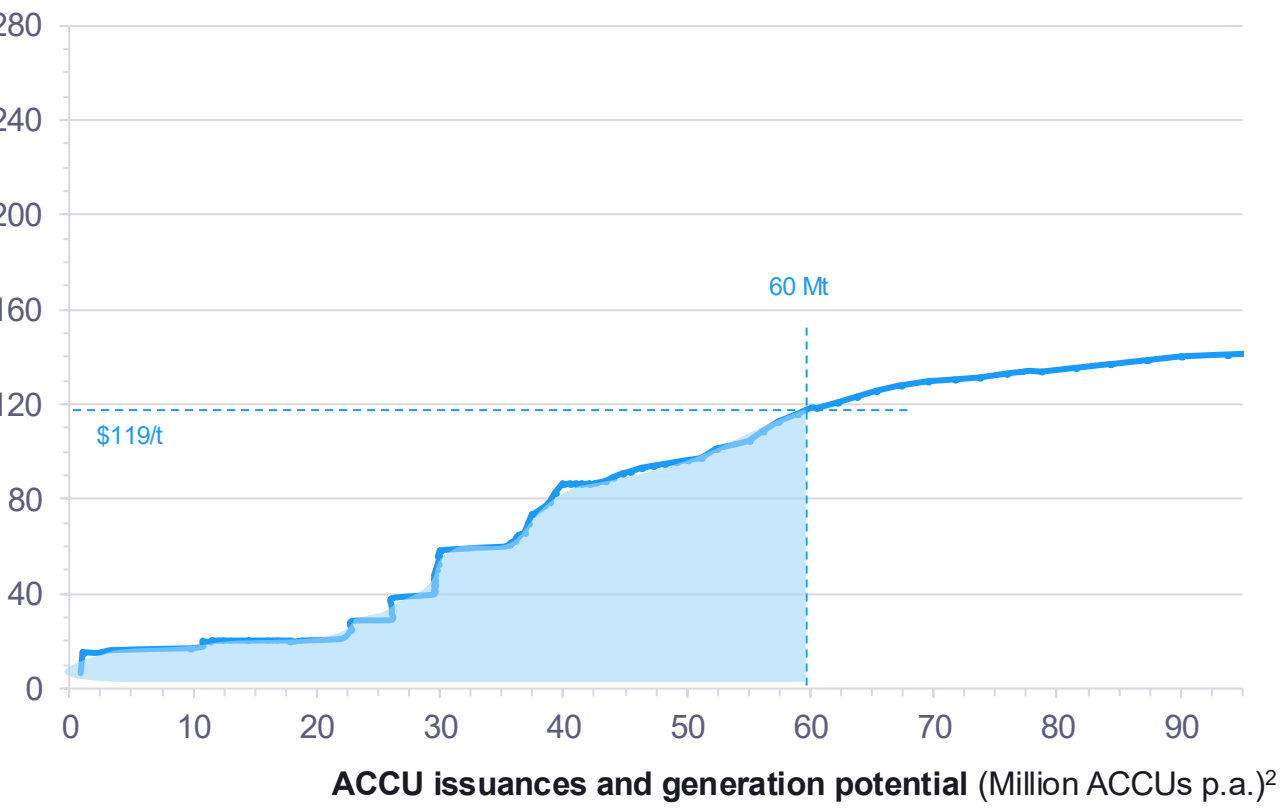
Current onsite abatement cost curve

On-site abatement price (2025\$ / t CO₂e)



Current potential ACCU supply curve

'Off-site' abatement price (2025\$ / t CO₂e)



1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

ACCU discount of x1.4 raises the volume of ACCUs required, moving up the ACCU supply curve and raising ACCU price, lifting the incentive for on-site abatement

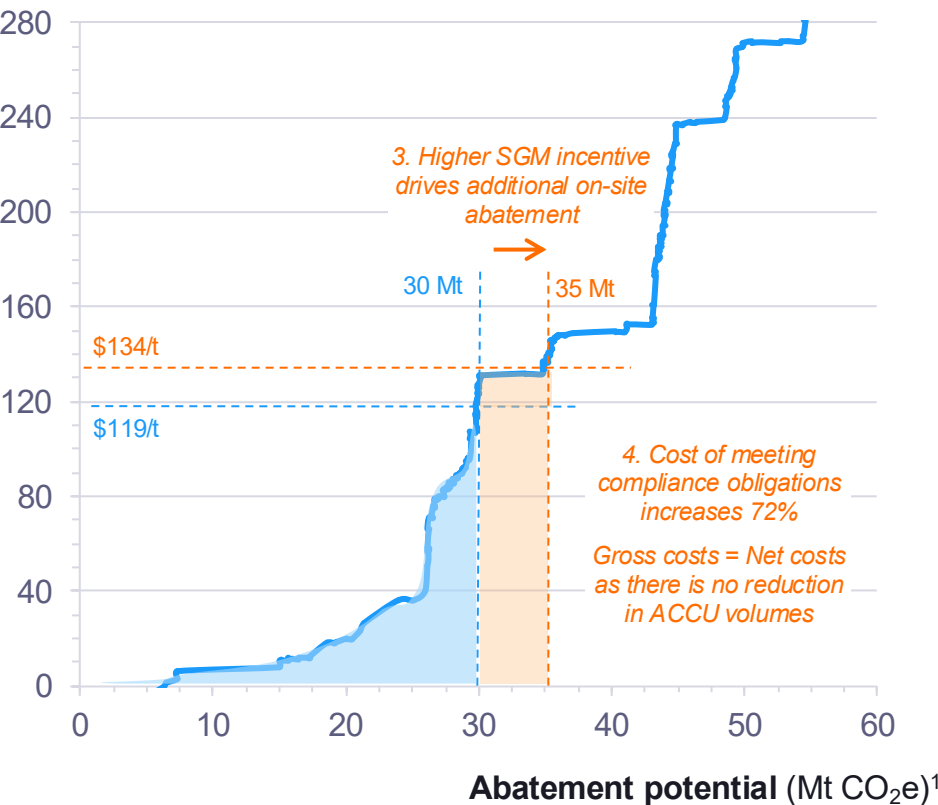
Impact on on-site and off-site ACCU abatement, for 90Mt SGM task

Abatement costs to facilities:

- Costs under current policies
- Increased costs

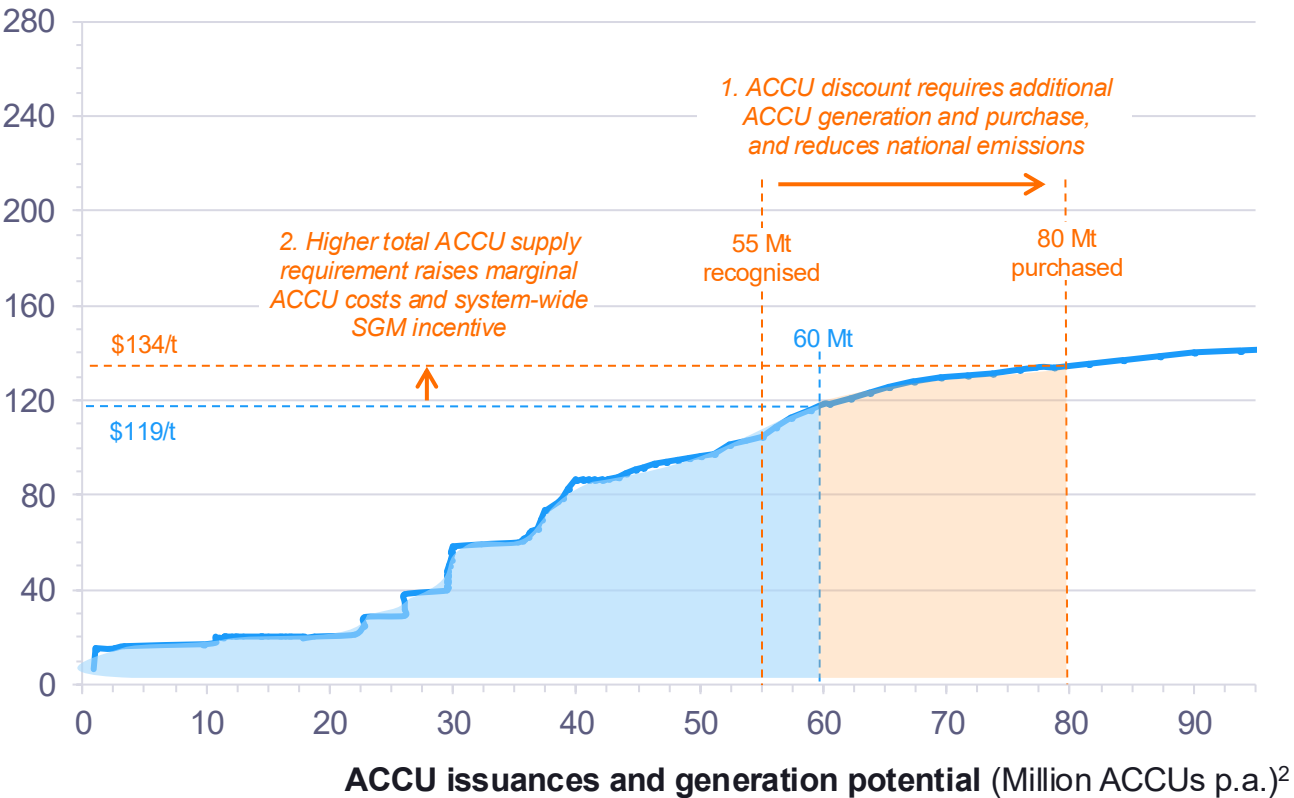
Current onsite abatement cost curve

On-site abatement price (2025\$ / t CO₂e)



Current potential ACCU supply curve

'Off-site' abatement price (2025\$ / t CO₂e)

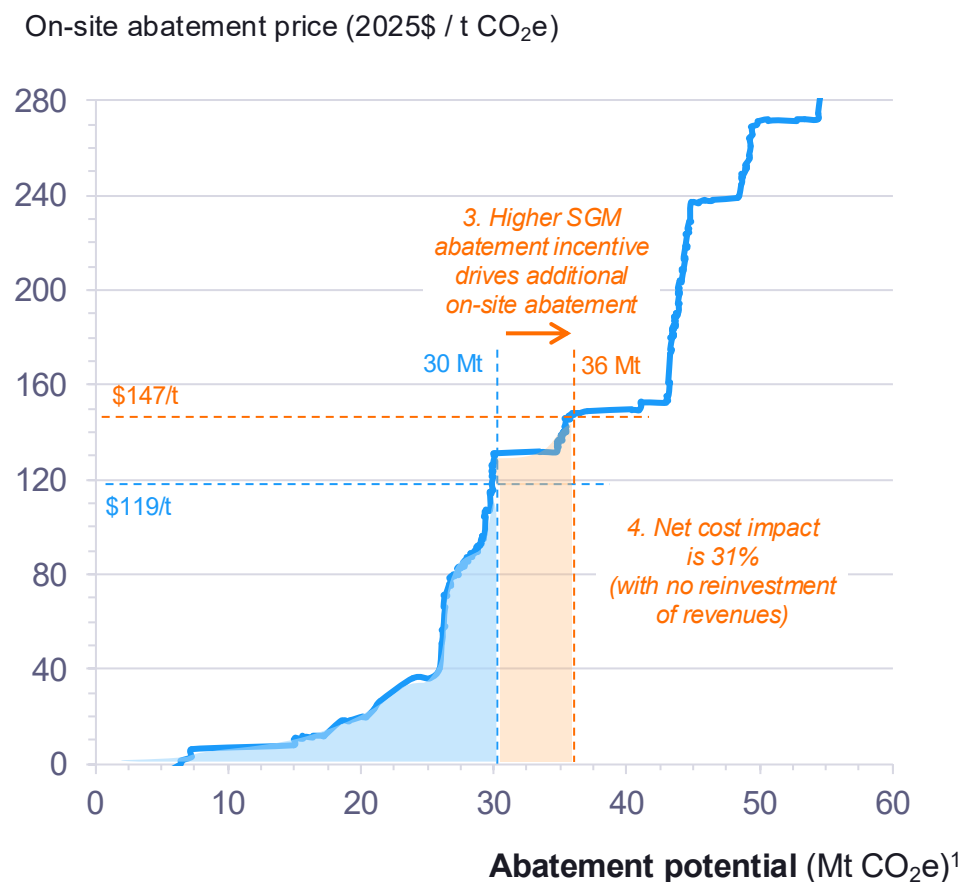


1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

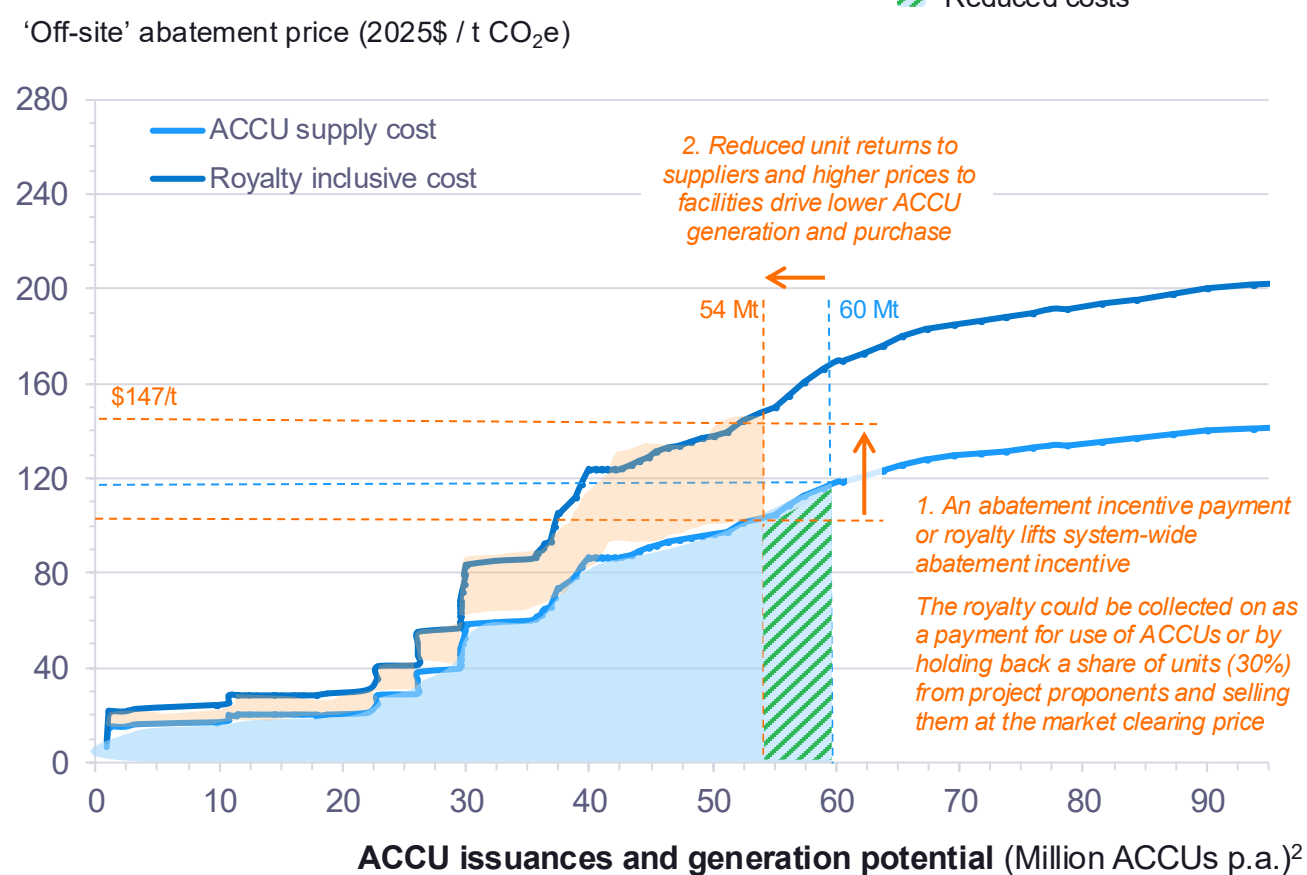
A royalty or abatement incentive payment increases the total ACCU cost to facilities, *reducing* ACCU demand and *increasing* on-site abatement incentives and volumes

Impact on on-site and off-site ACCU abatement, for 90Mt SGM task

Current onsite abatement cost curve



Current potential ACCU supply curve



Abatement costs to facilities:

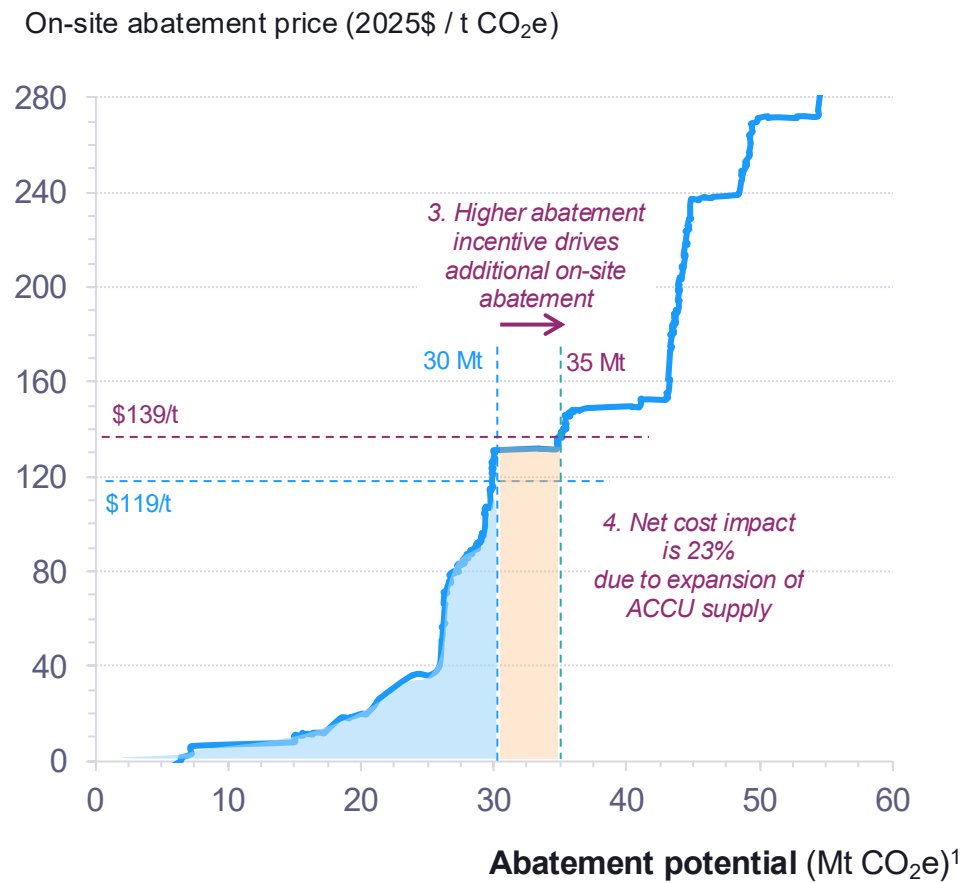
- Costs under current policies
- Increased costs
- Reduced costs

1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

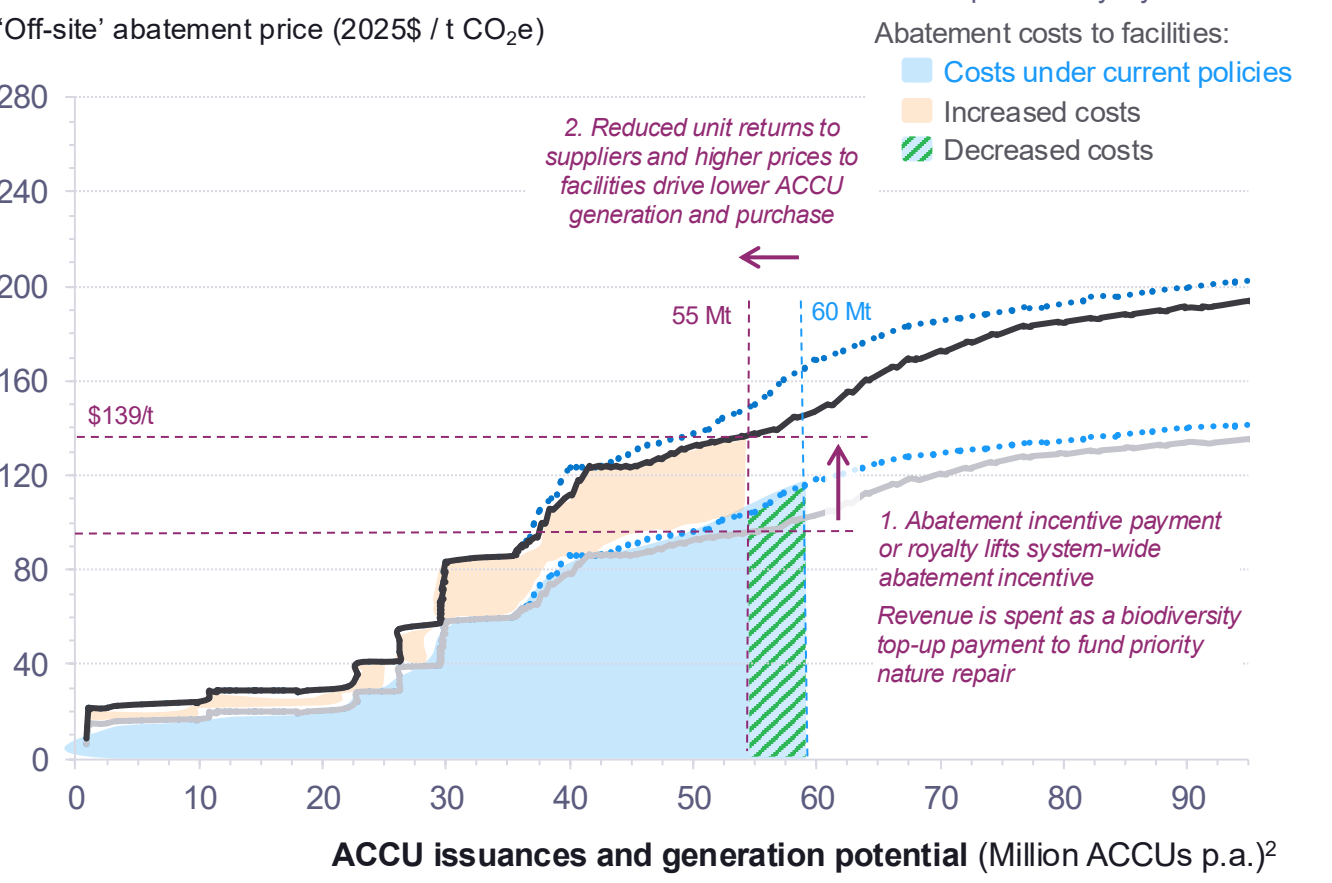
A nature royalty reinvests revenues to support projects with priority nature benefits, expanding ACCU supply and moderating cost impacts through lower ACCU prices

Impact on on-site and off-site ACCU abatement, for 90Mt SGM task

Current onsite abatement cost curve



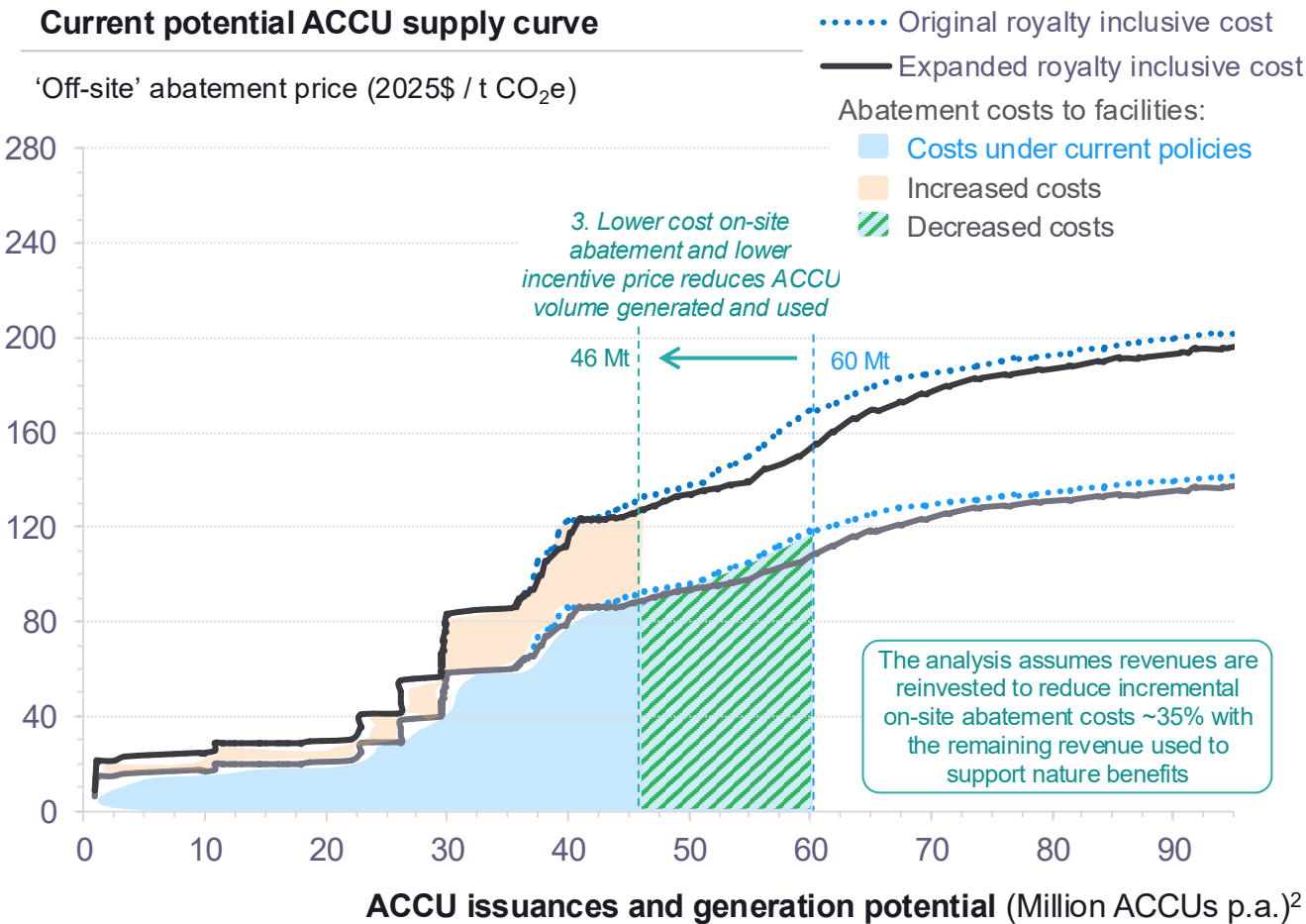
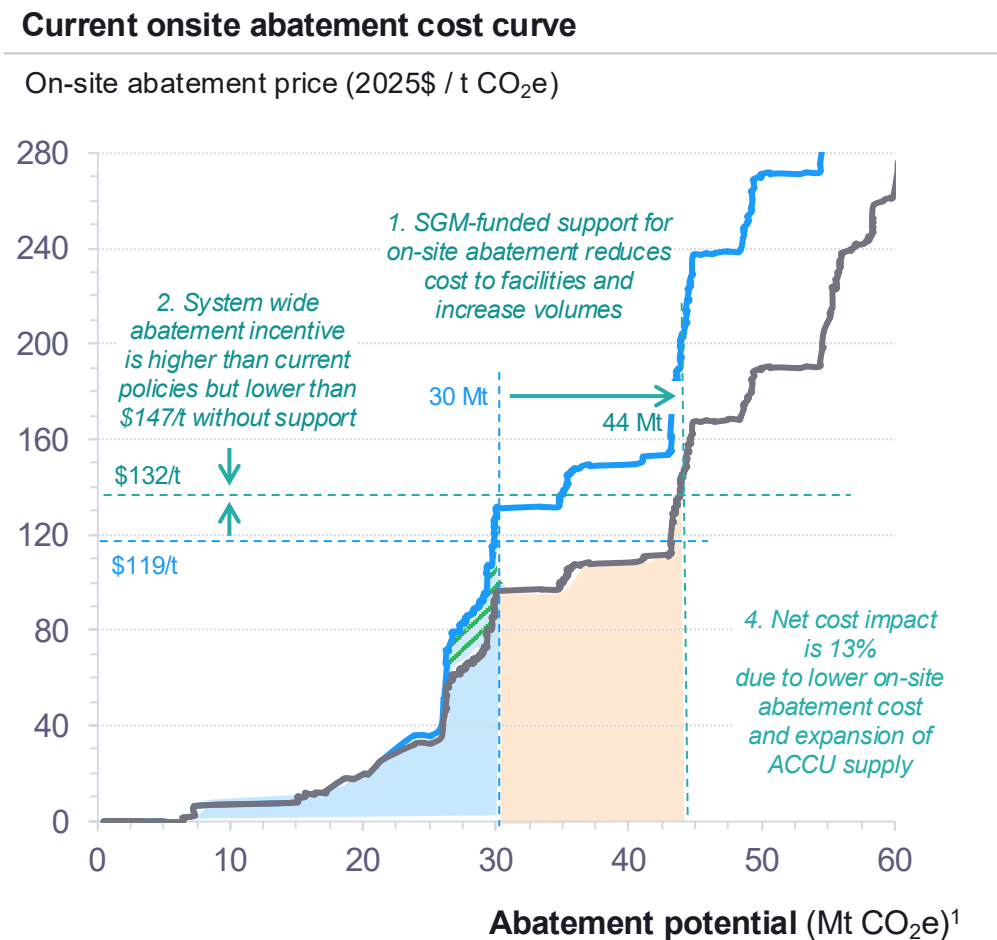
Current potential ACCU supply curve



1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

A royalty or surrender fee revenues could also be used to support on-site abatement, *reducing* facility abatement costs and *increasing* on-site abatement volumes, and *reducing* the system-wide abatement incentive vs no abatement support

Impact on on-site and off-site ACCU abatement, for 90Mt SGM task



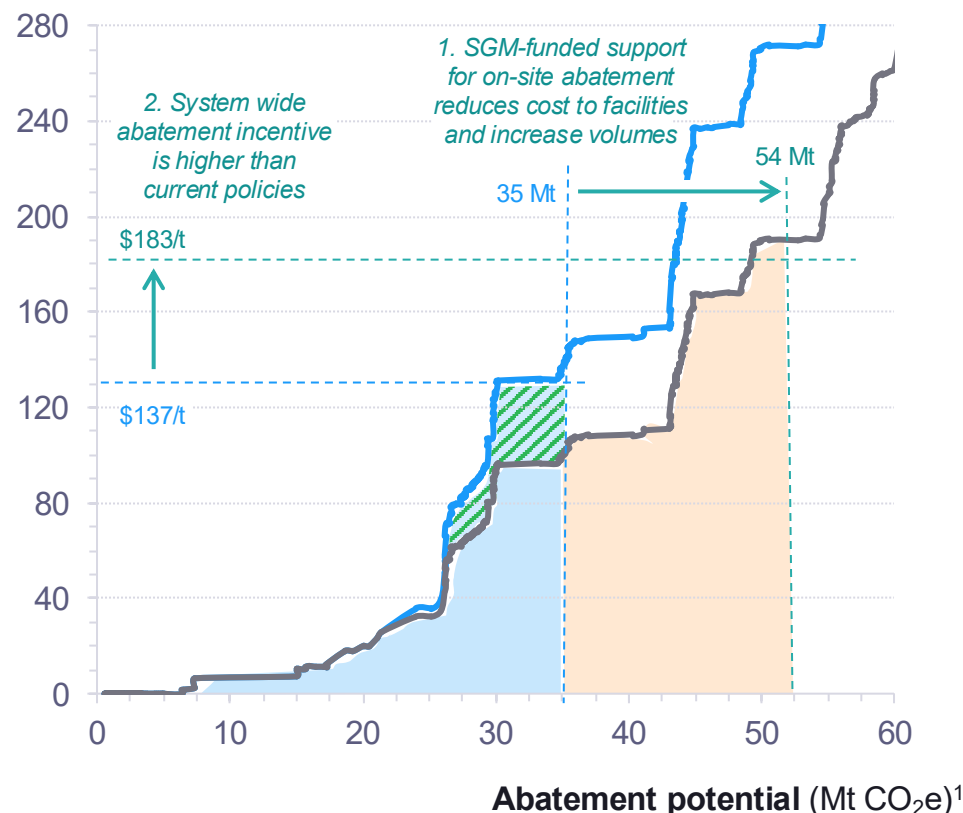
1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

For higher abatement tasks:
 Royalty-funded abatement support could *decrease* industry compliance costs relative to current policies while *increasing* on-site abatement and nature benefits achieved

Impact on on-site and off-site ACCU abatement, for 1170Mt SGM task

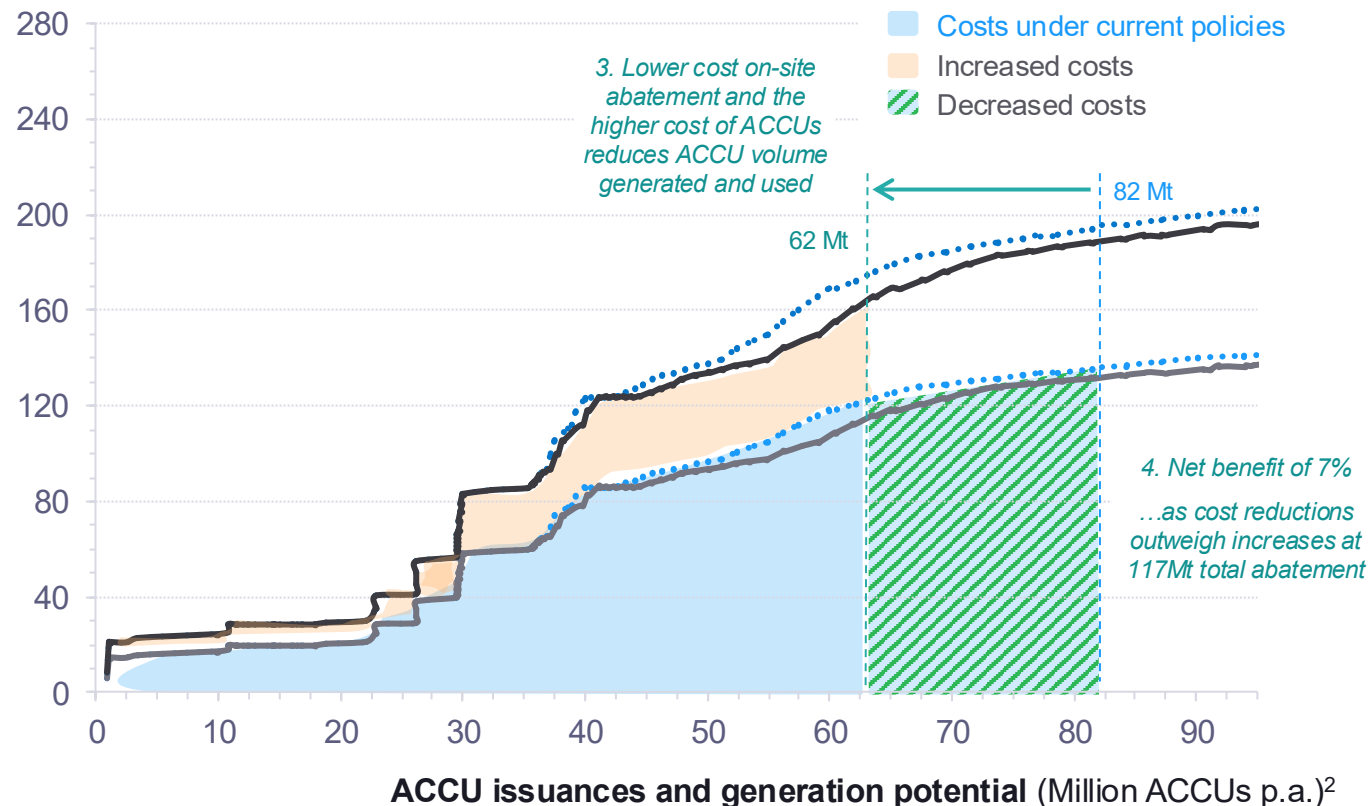
Current onsite abatement cost curve

On-site abatement price (2025\$ / t CO₂e)



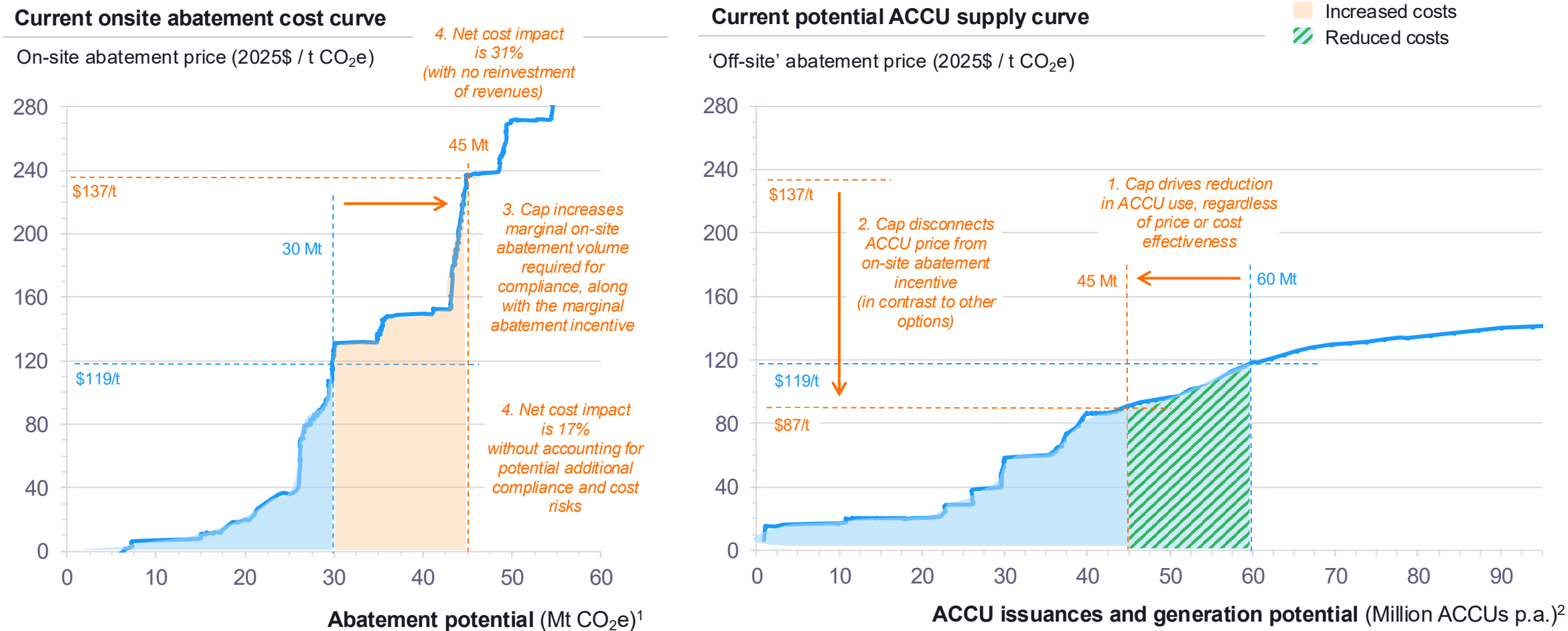
Current potential ACCU supply curve

'Off-site' abatement price (2025\$ / t CO₂e)



A system-level ACCU cap might be designed to drive additional on-site abatement, raising on-site costs and risks while reducing ACCU prices and costs

On-site MACC and off-site ACCU abatement potential



1. Reflects pre-SGM reform (2023) abatement potential. 2. ACCU issuance potential p.a. is shown as an average over the life of the relevant ACCU projects.
Source: EY-CARBON-VIEW model (July 2026). Results shown for medium-high price context.

70 Mt TOTAL SGM ABATEMENT (~FY30-31)

		Current policies	Royalty &/or surender fee			Discount x1.4	System level ACCU cap 50%
			No reinvestment	Nature repair	Abatement + nature		
Total SGM abatement	MtCO ₂ e	70	70	70	70	70	70
ABATEMENT INCENTIVES AND OUTCOMES							
SGM abatement incentive	A\$/tCO ₂ e (2025 real)	87	124	107	89	109	137
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0	37	20	3	22	50
Deviation from current policies (%)	percent	0%	42%	24%	3%	25%	58%
On-site abatement	MtCO ₂ e	28	30	30	33	30	35
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0.0	1.8	1.7	5.4	1.7	6.8
Deviation from current policies (%)	percent	0%	6%	6%	19%	6%	24%
ACCU use	MtCO ₂ e	42	40	40	37	40	35
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0.0	-2.1	-2.1	-5.3	-1.9	-6.7
Deviation from current policies (%)		0%	-5%	-5%	-13%	-5%	-16%
ACCU supply cost (weighted average)	A\$/tCO ₂ e (2025 real)	36	33	32	112	51	28
ACCU value at market price	A\$ million (2025 real)	3,650	4,941	4,287	3,293	4,360	2,121
Average cost per tonne to facilities	A\$/tCO ₂ e (2025 real)	29	37	36	33	54	33
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0	8	7	4	25	4
Total cost to facilites	A\$ million (2025 real)	2,014	2,581	2,489	2,330	3,774	2,327
Deviation from current policies (\$/t)	A\$ million (2025 real)	-	567	475	316	1,760	313
Deviation from current policies (%)	percent	0%	28%	24%	16%	87%	16%
OTHER OUTCOMES							
Outside abatement	MtCO ₂ e	-	-	-		16	-
Royalty or ACCU surender fee revenue	A\$ million (2025 real)	-	1,484	1,342	1,033	-	-
inc. resource cose of SGM abatement support		-	-	-	~ 375	-	
inc. support for nature repair and community resilience		-	-	1,342	~ 650	-	
Total national abatement	MtCO ₂ e	70	70	70	70	86	70
Deviation from current policies (%)		0%	0%	-1%	0%	23%	0%
Average national abatement supply cost	A\$/tCO ₂ e (2025 real)	29	37	36		39	33
Deviation from current policies (%)	percent	0%	29%	24%		36%	15%
ACCU market clearing price		87	124	107	89	109	60
ACCU supply price		87	103	97	66	109	60

90 Mt TOTAL SGM ABATEMENT (~FY33-34)

90 Mt TOTAL SGM ABATEMENT (~FY33-34)							
		Current policies	Royalty &/or surender fee			Discount x1.4	System level ACCU cap 50%
			No reinvestment	Nature repair	Abatement + nature		
Total SGM abatement	MtCO ₂ e	90	90	90	90	90	90
ABATEMENT INCENTIVES AND OUTCOMES							
SGM abatement incentive	A\$/tCO ₂ e (2025 real)	119	147	139	132	134	237
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0	29	21	14	16	118
Deviation from current policies (%)	percent	0%	24%	17%	12%	13%	100%
On-site abatement	MtCO ₂ e	30	36	35	44	35	45
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0.0	6.0	5.3	14.2	4.9	15.0
Deviation from current policies (%)	percent	0%	20%	18%	48%	17%	50%
ACCU use	MtCO ₂ e	60	54	55	46	55	45
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0.0	-6.2	-5.0	-13.6	-4.8	-15.3
Deviation from current policies (%)		0%	-10%	-8%	-23%	-8%	-25%
ACCU supply cost (weighted average)	A\$/tCO ₂ e (2025 real)	44	46	43	0	59	39
ACCU value at market price	A\$ million (2025 real)	7,108	7,918	7,663	6,136	7,401	4,045
Average cost per tonne to facilities	A\$/tCO ₂ e (2025 real)	44	58	55	50	76	52
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0	14	10	5	32	8
Total cost to facilities	A\$ million (2025 real)	3,994	5,235	4,914	4,507	6,863	4,671
Deviation from current policies (\$/t)	A\$ million (2025 real)	-	1,240	920	512	2,869	676
Deviation from current policies (%)	percent	0%	31%	23%	13%	72%	17%
OTHER OUTCOMES							
Outside abatement	MtCO ₂ e	-	-	-	-	25	-
Royalty or ACCU surender fee revenue	A\$ million (2025 real)	-	2,376	2,276	1,847	-	-
inc. resource cose of SGM abatement support		-	-	-	~ 975	-	-
inc. support for nature repair and community resilience		-	-	2,276	~ 875	-	-
Total national abatement	MtCO ₂ e	90	90	90	90	115	90
Deviation from current policies (%)		0%	0%	0%	1%	28%	0%
Average national abatement supply cost	A\$/tCO ₂ e (2025 real)	44	46	43	41	59	52
Deviation from current policies (%)	percent	0%	3%	-4%	-9%	32%	17%
ACCU market clearing price		119	147	139	132	134	90
ACCU supply price		119	103	97	93	134	90

117 Mt TOTAL SGM ABATEMENT (~FY39-42)

Current policies

Royalty &/or surrender fee

Discount x1.4

System level ACCU cap 50%

No
reinvestment

Nature repair
Abatement +
nature

Total SGM abatement	MtCO ₂ e	117	117	117	117	117	117
ABATEMENT INCENTIVES AND OUTCOMES							
SGM abatement incentive	A\$/tCO ₂ e (2025 real)	137	187	175	175	155	376
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0	50	38	38	18	239
Deviation from current policies (%)	percent	0%	36%	28%	28%	13%	174%
On-site abatement	MtCO ₂ e	35	44	43	54	43	59
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0.0	8.7	8.4	19.6	8.2	24.6
Deviation from current policies (%)	percent	0%	25%	24%	56%	24%	71%
ACCU use	MtCO ₂ e	82	74	74	62	74	57
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0.0	-8.5	-8.1	-20.1	-8.3	-24.8
Deviation from current policies (%)		0%	-10%	-10%	-24%	-10%	-30%
ACCU supply cost (weighted average)	A\$/tCO ₂ e (2025 real)	55	49	45	138	72	39
ACCU value at market price	A\$ million (2025 real)	11,270	13,778	12,967	10,878	11,465	6,450
Average cost per tonne to facilities	A\$/tCO ₂ e (2025 real)	64	84	77	60	117	87
Deviation from current policies (\$/t)	A\$/tCO ₂ e (2025 real)	0	20	13	-4	52	22
Total cost to facilities	A\$ million (2025 real)	7,547	9,898	9,048	7,015	13,634	10,103
Deviation from current policies (\$/t)	A\$ million (2025 real)	-	2,351	1,501	532	6,088	2,556
Deviation from current policies (%)	percent	0%	31%	20%	-7%	81%	34%
OTHER OUTCOMES							
Outside abatement	MtCO ₂ e	-	-	-	-	46	-
Royalty or ACCU surrender fee revenue	A\$ million (2025 real)	-	4,162	3,996	3,220	-	-
inc. resource cose of SGM abatement support		-	-	-	~ 1,950	-	-
inc. support for nature repair and community resilience		-	-	3,996	~1,275	-	-
Total national abatement	MtCO ₂ e	117	117	117	117	163	117
Deviation from current policies (%)		0%	0%	0%	0%	39%	0%
Average national abatement supply cost	A\$/tCO ₂ e (2025 real)	64	66	61	73	89	87
Deviation from current policies (%)	percent	0%	2%	-6%	14%	39%	34%
ACCU market clearing price		137	187	175	175	155	112
ACCU supply price		137	132	126	121	155	112