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Submission First Sentier Investors to DCCEEW Reform of Safeguard Mechanism.

First Sentier Investors (FSI) is an investment management business and the home of investment teams FSSA Investment Managers, Igneo Infrastructure Partners, Realindex Investments and Stewart Investors.

Our vision is to be a provider of world-leading investment expertise and client solutions, led by our responsible investment principles. We are stewards of assets under management of AU$215.5 billion (as at 31/12/2022) across listed equities, fixed income and direct infrastructure on behalf of institutional investors, pension funds, wholesale distributors and platforms, financial advisers and their clients.

As allocators of capital, stewards of our clients' assets and active shareholders in companies, we have a responsibility to contribute to a sustainable economy and society through our investment activities and business operations. We aim to align our investments with the goals of the Paris Agreement towards net zero; understand and manage climate-related financial risks and opportunities; and influence companies and the flow of capital to accelerate climate transition.

FSI welcomes the opportunity to provide feedback on the Department of Climate Change, Energy, Environment and Water's (DCCEEW) consultation the proposed reforms of the Safeguard Mechanisms (SM) to assist large emitting entities to reduce their emissions in line with Australia's climate targets. If our largest emitters do not play their role in the transition to a low carbon economy, everyone else will have to do more to fill the gap.

1. Overall comments

Overall, we support the proposed changes to the Safeguard Mechanism. We do not believe Australia will be able to meet its National Determined Contribution of its 2030 emission reduction target to 43 per cent below 2005 levels by 2030 and achieve its net zero target by 2050, if it does not ensure an effective, equitable, efficient and simple Safeguard Mechanism.

We support the vision of a mandated reduction of GHG emissions, in the most cost-efficient way, whilst ensuring that Australian businesses remain competitive during their decarbonisation journey and allowing for flexibility to meet those baseline reductions by introducing safeguard crediting and trading.

2. Baselines

We support the proposal to remove the headroom. The previous headroom levels were often surplus to a facilities' actual emissions, giving them scope to do little or nothing on emissions reduction. Removing the headroom will force facilities to decarbonise from day one of the proposed reforms starting.

We also support the production-adjusted intensity baseline and the decline rate of 4.9% (which is in line with the additional reduction needed to achieve 43% of 2005 baseline by 2030). The suggested hybrid model seems a reasonable approach to the baseline setting, as it allows for a phased approach towards an industry average by 2030. It also allows the concerned facilities time to adjust and create a level playing field, whilst allowing the early movers that have invested in abatement measures and technologies to retain their facility-specific advantage.

Predictable and credible safeguard mechanism baselines can become an effective tool for helping to reduce GHG emissions in a manageable way, spur better capital allocation to investments in clean solutions and make Australian industry more competitive in a global markets, which are moving rapidly towards net zero.

We would also like to comment on the notion that new entrants or new in-scope facilities will be held to a higher international standard. We support the higher standards that will be applied to new investments as they can be designed to use the latest technologies. However, we would also like to explore options to include additional expectations to ensure an orderly and just transition, especially for transitioning fuels that may be phased out over time.

3. Flexibility Mechanisms

We support the flexibility mechanisms but are cognisant of some inherent risks. Safeguard Mechanism Credits that will only be of application within the Safeguard Mechanism framework are welcome, as we see them as a useful incentive for facilities to reduce their GHG emissions beyond the baseline, and to drive reduction faster where it can occur at a lower cost.

We also support the continued use of Australian Carbon Credit Units (ACCU). However, to the extent it is possible, companies exceeding the baseline should prioritise acquiring SMCs before ACCUs. We would recommend considering the option of limiting ACCUs in order to ensure that companies are reducing their emissions and not buying their way out of taking responsibility.

A cap of AUD 75 seems plausible, but is already lagging behind the EU carbon price which currently exceeds EUR 100[1] (approx. AUD 150). The decision to introduce a capped pricing model can lead to situations where it could be more economical to buy ACCUs than actually investing in solutions that will reduce GHG emissions.

4. Tailored Treatment for Emissions-Intensive Trade Exposed facilities (EITE)

The allocation of AUD 600 million Safeguard Transformation Stream, within the *Powering of the Regions Fund*, seems fair as long as it meets its purpose of delivering a genuine reduction in GHG emissions, backed up with solid transition plans.

FSI welcomes the idea of further discussions on a carbon border adjustment mechanism (CBAM) as an alternative way to deal with carbon leakage.

[1] https://www.reuters.com/markets/carbon/eu-carbon-price-hits-record-high-nearing-100-eurostonne-2023-02-20/