

# MacGregor Advisory Group

## Safeguard Mechanism after two years

Compliance, inventory and the question of what comes next

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Compliance, inventory and the question of what comes next

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## Key highlights

- **The safeguard mechanism is currently heavily reliant, in these early days, on the carbon markets to deliver its targets.** The impact of investments made in the last two years, and the coming years, will help determine how sustainable the mechanism's impact is on reducing emissions.
- **The compliance environment is tightening as designed.** Aggregate surplus headroom (the gap between a facility's baseline and its net emissions after all compliance actions) narrowed from 8.55 million to 6.72 million tCO<sub>2</sub>e, consistent with the ERC's (Energy Reduction Coefficient) amplifying baseline decline.
- **The mechanism is still working as the environment tightens.** Despite the fact that overall baseline emissions target declined by 6.4% in 2024–25 compliance year, 217 of 227 facilities remained at or below their baseline in that year. This suggests that the mechanism is driving broad-based compliance while continuing to raise the bar over time. However, four new facilities have entered MAG's emissions exposed category for the first time in 2024–25.
- **Carbon credit markets are playing a central role.** ACCU demand from covered facilities rose 41% to 10.58 million units in 2024–25 from 7.46 million units in 2023–24, absorbing approximately 45% of total ACCU issuance.
- **The internal safeguard mechanism credit market is compressing.** Annual net SMC generation fell from 6.92 million (2023–24) to 4.14 million units (2024–25).
- **Credit surrender is the dominant compliance strategy.** 127 of 131 balanced facilities used ACCU or SMC surrenders to meet their baseline. In 2024–25, 56 facilities sat on the supply side of the SMC market.
- **Forward planning creates optionality.** On-site abatement projects typically require one to three years to deliver. Facilities that begin scoping their medium-term compliance pathway now will have more options as baselines continue to tighten.

## Executive summary

When the reformed Safeguard Mechanism took effect in July 2023, the central question was whether Australia's largest emitting facilities would respond. Two years later, the answer is more nuanced than either critics or supporters might have expected.

The mechanism is working, with carbon markets playing an important role in supporting compliance during these early years. Its long-term emissions impact will be shaped by how investment made over the first two years, and in the coming two years, translates into operational abatement.

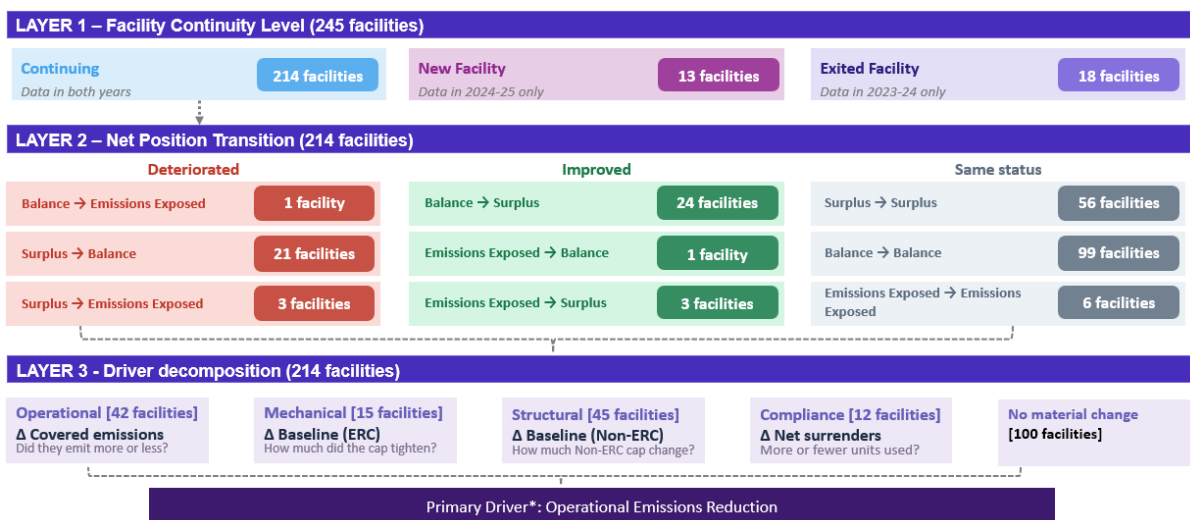
The compliance environment is tightening rapidly. Overall baseline emissions targets declined by ~8.65 million tCO<sub>2</sub>e, or 6.4%, compared with 2023–24, reflecting the combined effect of the Emissions Reduction Coefficient (ERC) and non-ERC adjustments. This was well ahead of the 4.9% annual ERC rate alone, showing that baseline tightening is already material at the system level.

Facilities are responding to this tighter environment. In 2024–25, 217 of 227 facilities remained at or below their baseline. This suggests that the mechanism is driving broad-based compliance while continuing to raise the bar over time. However, four new facilities entered MAG’s emissions exposed category for the first time, indicating that pressure is beginning to emerge for a subset of covered facilities.

Compliance is being achieved through multiple abatement strategies working together. Covered emissions fell by ~3.09 million tCO<sub>2</sub>e, but this was not sufficient on its own to offset the full effect of baseline tightening. The remaining gap was bridged through Australian Carbon Credit Unit (ACCU) and Safeguard Mechanism Credit (SMC) surrenders, confirming that carbon credits are now central to safeguard compliance. Total ACCUs surrendered rose by 42%, from 7.46 million units in 2023–24 to 10.58 million units in 2024–25, while the SMC surplus compressed by 40%, from 6.92 million units to 4.14 million units. The carbon market’s capacity to support growing demand is therefore becoming an increasingly important question for the years ahead.

This article explores these dynamics through three layers of facility-level analysis, followed by a new inventory positioning framework developed by MacGregor Advisory Group (MAG) that examines how facilities are currently managing their emissions exposure as the baseline tightens to 2030.

Exhibit 1. Layered analysis framework overview



# Chapter 1: What happened in 2024–25

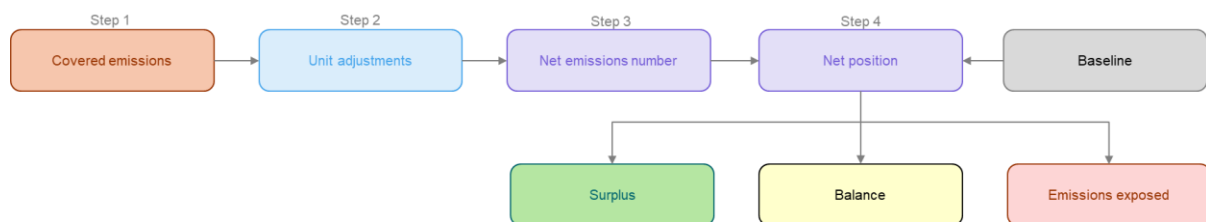
## How we define compliance status

Before examining what changed, it is worth establishing what we are measuring. The Safeguard Mechanism assigns each covered facility a baseline emissions number. We classify each facility into one of three net position statuses based on the relationship between covered emissions, baseline, and any carbon credits surrendered.

- **Surplus** facilities sit below their baseline with headroom to spare and may earn SMCs on the difference.
- **Balance** facilities have used the precise volume of units needed to meet their baseline, with no headroom remaining.
- **Emissions Exposed** facilities carry unresolved excess emissions above baseline.

This classification captures headroom after all compliance actions but does not distinguish between facilities that achieved their position through operational performance versus unit surrenders. That distinction is addressed separately through the inventory positioning framework in Chapter 3.

*Exhibit 2. Infographic showing Surplus / Balance / Emissions Exposed classification*

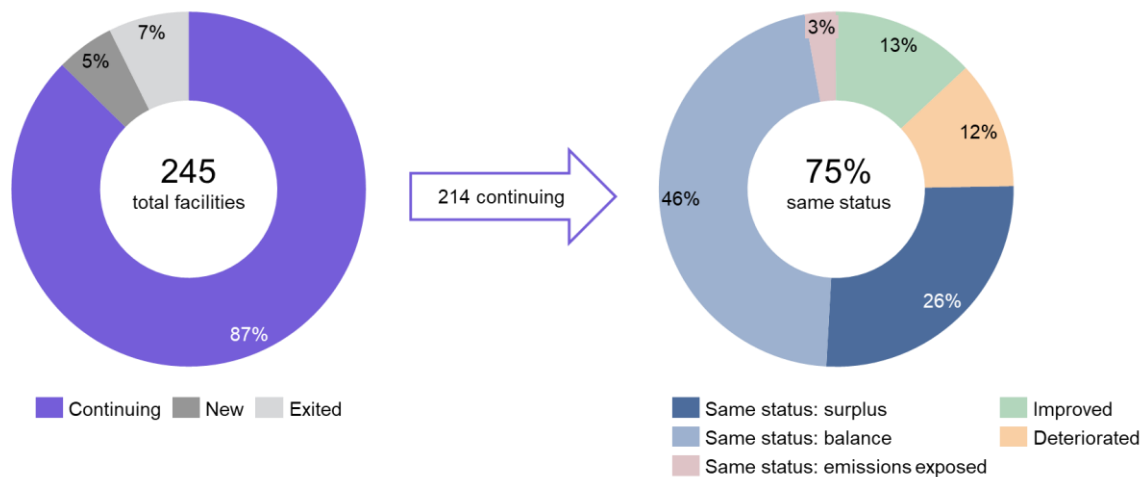


*MAG Safeguard Assessment Toolkit*

## Most facilities held their position, and the mechanism is tightening as designed

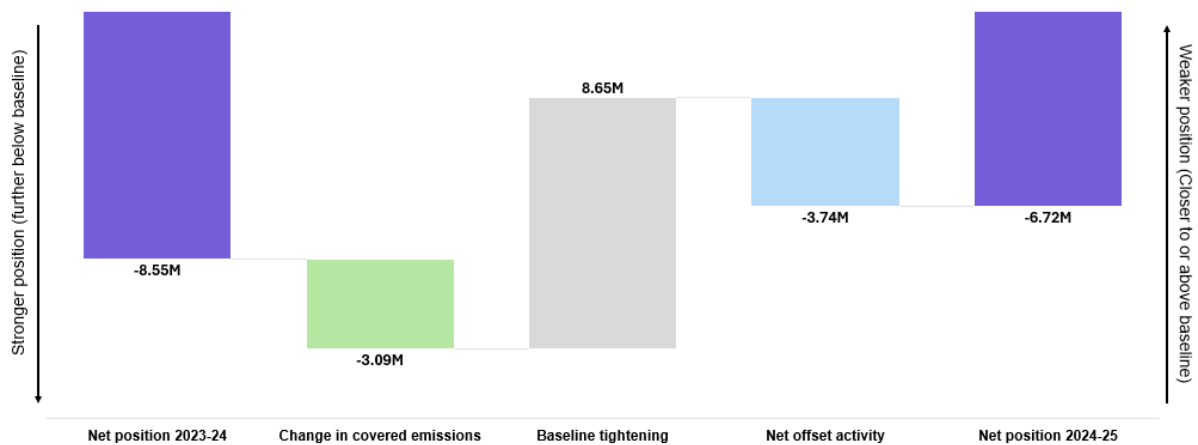
Of the 245 facilities analysed, 214 (87%) reported data in both compliance years. As shown in Exhibit 3, 75% of continuing facilities held the same compliance status year on year. This degree of stability is an early positive sign for a mechanism in only its second year of operation.

Exhibit 3. Compliance status continuity across reporting years 2023–24 and 2024–25



At the system level, the aggregate net emissions position remained in surplus, although headroom narrowed from 8.55 million tCO<sub>2</sub>e in 2023–24 to 6.72 million in 2024–25. As Exhibit 4 shows, the primary driver of reducing headroom was 8.65M tCO<sub>2</sub>e of baseline tightening, which will increase in aggregate absolute terms as the 4.9% annual decline compounds. Facilities are responding - covered emissions fell by 3.09 million tCO<sub>2</sub>e through operational improvements, while net carbon credit adjustments of 3.74 million helped maintain the aggregate surplus. Emissions reduction and carbon credit activity are working together to ensure the mechanism delivers. As baselines decline, facilities will need to continue investing to maintain and ideally improve their position.

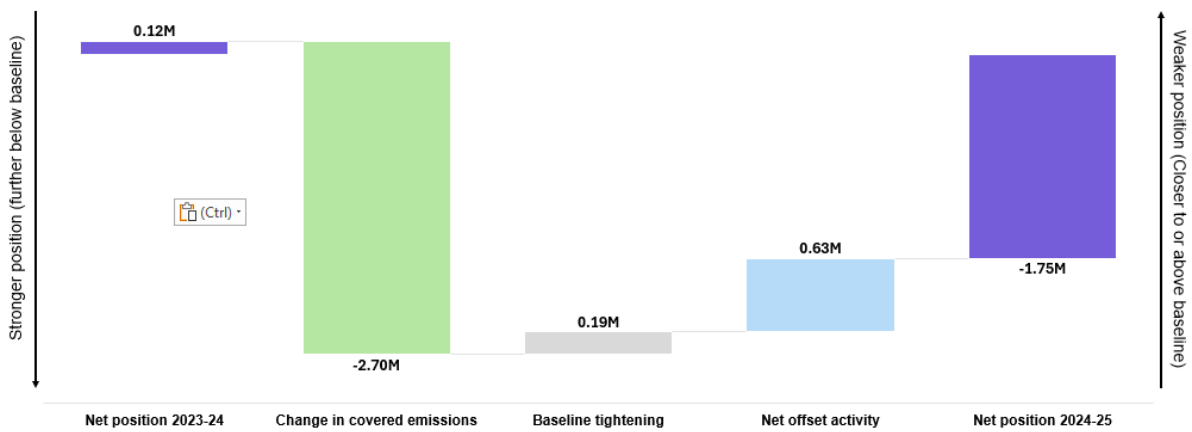
Exhibit 4. Net position bridge waterfall (all 214 continuing facilities, 2023–24 to 2024–25)



Three distinct patterns emerge when we separate facilities by the direction of their year-on-year movement:

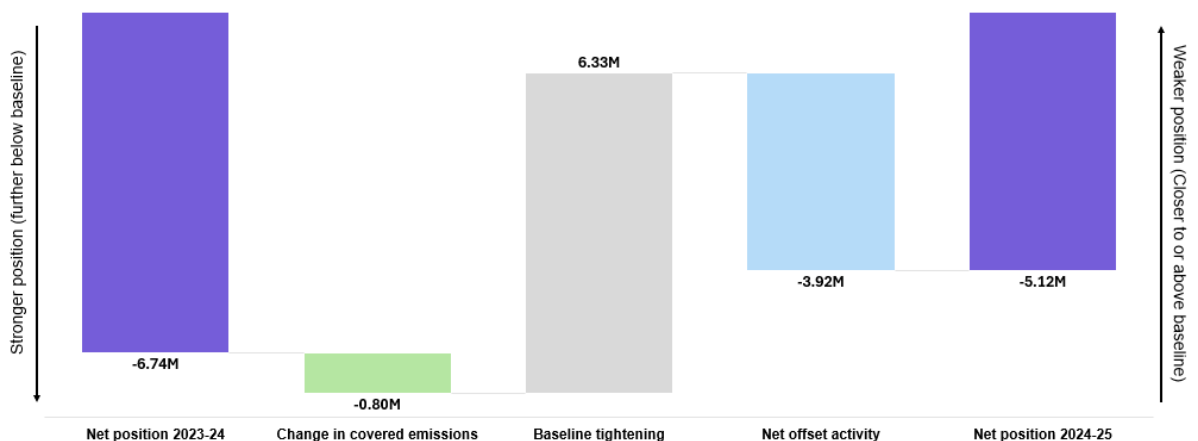
- Facilities that improved their position did so primarily through operational emissions reduction.** These included facilities moving from balance to surplus, emissions exposure to balance, or emissions exposure to surplus. Their year-on-year gains reflect investment decisions made ahead of the tightening baseline and provide an early indication of what sustained decarbonisation effort can deliver within the mechanism’s architecture. These facilities appear to be building a more durable compliance position over time.

Exhibit 4a. Facilities that improved their net status



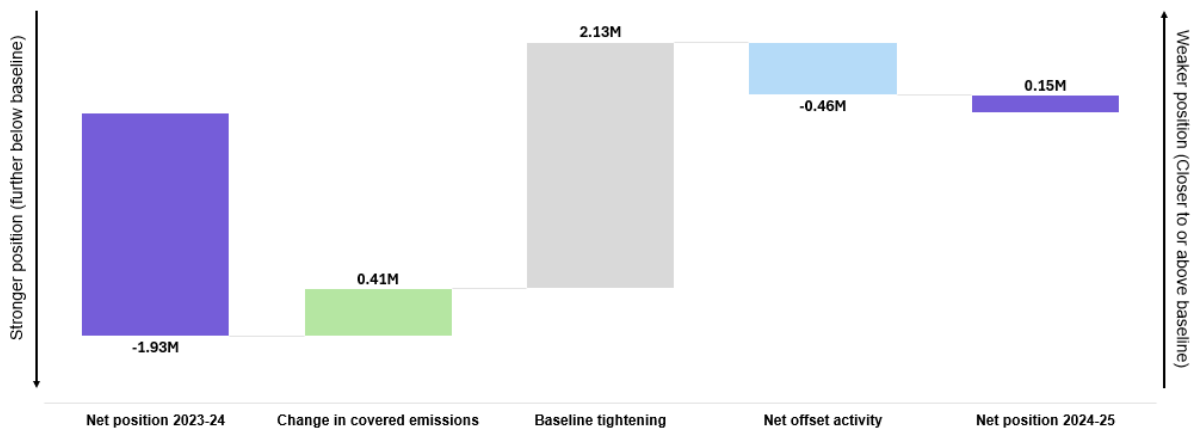
- Facilities that maintained their position still achieved a meaningful outcome in a tightening mechanism.** With baselines declining annually and limited investment in facilities, holding steady required significant reliance on Carbon credits. Carbon credit activity is the balancing force for this group. Looking forward, it remains to be seen whether operational improvements will gradually reduce the volume of units required, or whether credit dependency becomes more entrenched as baselines continue to tighten.

Exhibit 4b. Facilities that maintained their net status



- Facilities whose position deteriorated generally faced an increasingly difficult emissions challenge with covered emissions increasing and limited ability to use the carbon credits market.** While some may be managing compliance over a longer time horizon (MYMP), the data suggests that without operational emissions reduction or as a minimum additional carbon credit, maintaining even their current position becomes progressively harder as annual baseline declines.

Exhibit 4c. Facilities whose net status deteriorated

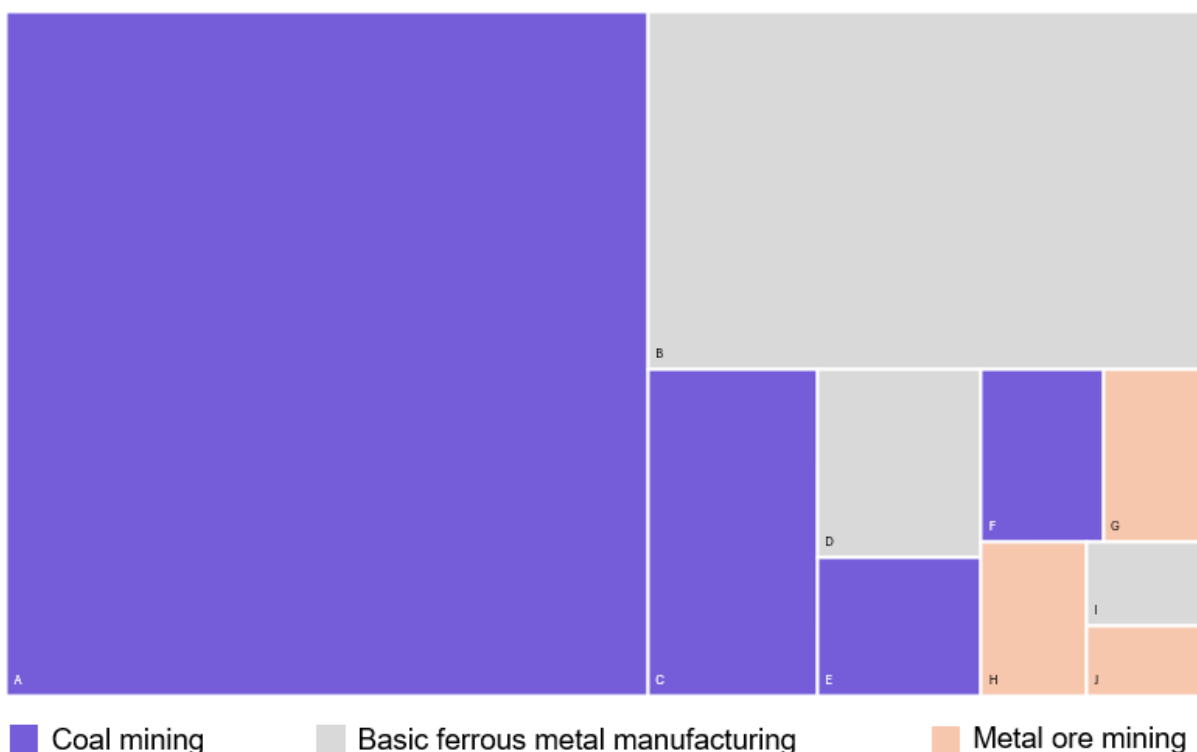


Across the mechanism, ten facilities carried an emissions exposure in 2024–25, and four new facilities entered an exposed emissions position for the first time.

By sector, certain facilities in coal mining operations represented the largest share of aggregate emissions exposure, followed by basic ferrous metal manufacturing, and metal ore mining. Exhibit 5 maps how the aggregate emissions exposure quantum distributes across these sectors and the individual emissions-exposed facilities.

It is worth noting that an emissions exposed position does not necessarily mean a facility is in breach. The mechanism’s multi-year monitoring period (MYMP) framework allows facilities to manage their net emissions position across multiple compliance cycles. With two years of data now available, the practical question is whether these facilities are on a trajectory toward resolution or whether the gap is widening.

Exhibit 5. Emissions exposure concentration chart



## Chapter 2: The carbon markets

This section examines how carbon credits are used and whether supply of those instruments can keep pace with demand. In this article, we use the term “carbon credits” to refer to both ACCUs and SMCs, recognising that both instruments can be used as levers for Safeguard Mechanism compliance.

### The ACCU market: growing demand, limited supply

The mechanism’s reliance on ACCUs increased in 2024–25, with net market procurement rising to 9.70 million units from 7.13 million the prior year, and total ACCU surrendered increasing 42% to 10.58 million. Of that total, open-market surrenders rose 38.8% to 10.30 million, while deemed surrenders, which satisfy compliance obligations through contractual delivery arrangements that do not appear in public market transaction data, grew from 42,000 to 283,000 units (~573% rise). On the supply side, facility-level ACCU issuance grew 169% to 0.88 million units, reflecting investment in ACCU-generating projects. While the growth trajectory supports establishment of an efficient carbon credits market, on-site generation still represents less than 9% of what the mechanism consumes annually, and the gap between credit demand and available supply has widened.

Exhibit 6. ACCU generation versus consumption by covered facilities

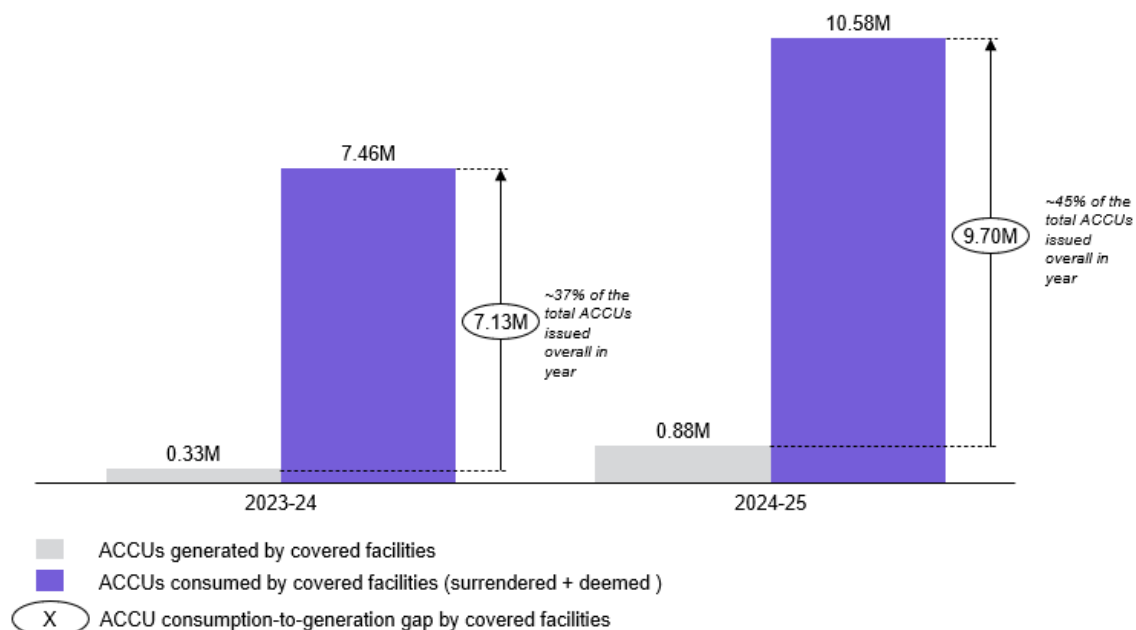


Exhibit 6 illustrates this dynamic. In 2023–24, net ACCUs consumed by covered facilities represented approximately 37% of total national ACCU issuance for the year. By 2024–25, that share had risen to approximately 45%. The mechanism is absorbing an ever-larger proportion of ACCUs generated, and the trajectory is likely to reward facilities that invest in projects generating ACCUs. As demand rises and baselines tighten, sources of additional ACCU supply at scale are yet to become clear. The answer will likely involve some combination of new Emissions Reduction Fund (ERF) project approvals and potentially including the long-anticipated Integrated Farm and Land Management (IFLM) method, and a broader shift in facility-level abatement investment to reduce demand. The ACCU offset market is

only half the picture. The mechanism also relies on the internal carbon credit instrument, and the dynamics there tell a similar story.

## The SMC market: tightening supply, shrinking surplus

The mechanism’s internal credit market, the SMC market, is tightening because the surplus between SMC issuance and SMC surrender is narrowing. As shown in Exhibit 7, SMCs issued fell 19% from 8.31 million to 6.70 million, while SMC surrenders nearly doubled from 1.39 million to 2.56 million. The result was a reduction in net SMC surplus, which fell by 2.78 million units in a single compliance year, from 6.92 million to 4.14 million.

Exhibit 7. SMC inventory

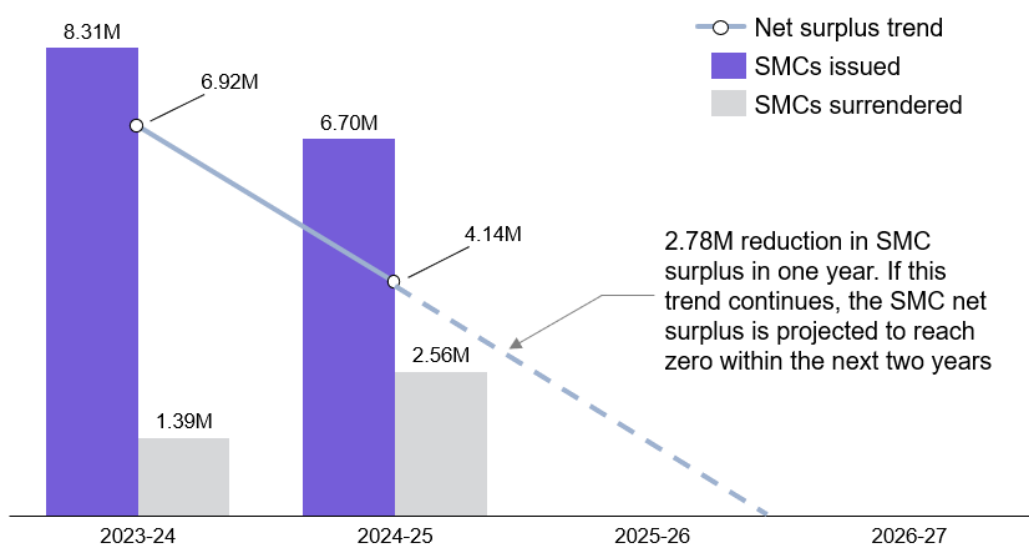


Exhibit 7 shows that if the past year’s rate of surplus compression continues, the pool of available SMCs could approach exhaustion within two compliance cycles. As that pool shrinks, facilities that have relied on SMCs as a compliance lever may increasingly compete for a smaller supply or turn to the external ACCU market as an alternative. That shift would add further demand pressure to an ACCU pipeline that, as Exhibit 6 shows, is already absorbing a growing share of annual supply.

To understand why the SMC surplus is shrinking, it is worth looking at where the supply sits and how it is moving. Supply is highly concentrated: the top 20 SMC holders account for ~82% of outstanding cumulative SMC surplus. As baselines tighten and facilities migrate from surplus toward balance, even a small number of exits from this category would have an outsized impact on available supply.

Exhibits 6 and 7 together tell a consistent story. Both credit instruments are tightening. The question is not whether tightening will create pressure, but when it materially affects compliance costs and strategy. That leads to the next layer of analysis: if most facilities rely on credit markets to comply, how are they doing it, and how resilient are those strategies as credit demand grows and available credit pools become more contested?

## Chapter 3: How are facilities using the carbon market?

### An inventory lens on the Safeguard Mechanism

The analysis in Chapters 1 and 2 captures where facilities stand and what is driving change. There is also a more fundamental question: how are facilities managing their carbon credit exposure? A compliant facility may only be compliant because it purchased enough ACCUs and SMCs to close the gap. These are structurally different positions, with different risk profiles, cost trajectories, and implications for the mechanism’s long-term viability.

To explore how facilities use the carbon market as part of their abatement strategy, we developed an inventory positioning framework that classifies each covered facility by its observable relationship with carbon credits. Rather than asking only where a facility stands, it asks whether the facility is building carbon credits, consuming them, or sitting outside the market entirely.

### The framework

Each facility is assigned to one of eight mutually exclusive categories per compliance year based on its carbon market participation, structured around three groups: generators (supply side), consumers (demand side), and facilities with no market participation. Exhibit 8 sets out the categories, market role, and what each signals.

*Exhibit 8. Inventory positioning classification framework*

| Classification                  | Role   | Description                                                                                                                                       |
|---------------------------------|--------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Generators (Supply Side)</b> |        |                                                                                                                                                   |
| ACCU + SMC generator            | Supply | Generates ACCUs from on-site ERF projects and earns SMCs through operational outperformance, with no surrender activity.                          |
| ACCU generator                  | Supply | Generates ACCUs from on-site ERF projects with no SMC issuance and no surrender activity. Signals active capital investment in on-site abatement. |
| SMC generator                   | Supply | Earns SMCs from operational performance below baseline with no ACCU activity and no surrenders. The mechanism’s internal credit supplier.         |
| <b>Consumers (Demand Side)</b>  |        |                                                                                                                                                   |
| ACCU consumer                   | Demand | Surrenders ACCUs only, with no on-site generation and no SMC activity. Most exposed to external offset market price risk.                         |
| SMC consumer                    | Demand | Surrenders SMCs only, with no ACCU activity. Relies on mechanism-internal credits and exposed to SMC supply compression.                          |
| ACCU + SMC consumer             | Demand | Surrenders both ACCUs and SMCs with no on-site generation. Signals a gap neither instrument alone can close.                                      |
| ACCU gen. + consumer            | Mixed  | Generates and surrenders ACCUs. A transitional position reflecting active abatement investment alongside continued market participation.          |
| <b>No Market Participation</b>  |        |                                                                                                                                                   |
| No carbon credit activity       | None   | No carbon credit activity of any kind. May be naturally below baseline, on a MYMP, or carrying unresolved excess emissions.                       |

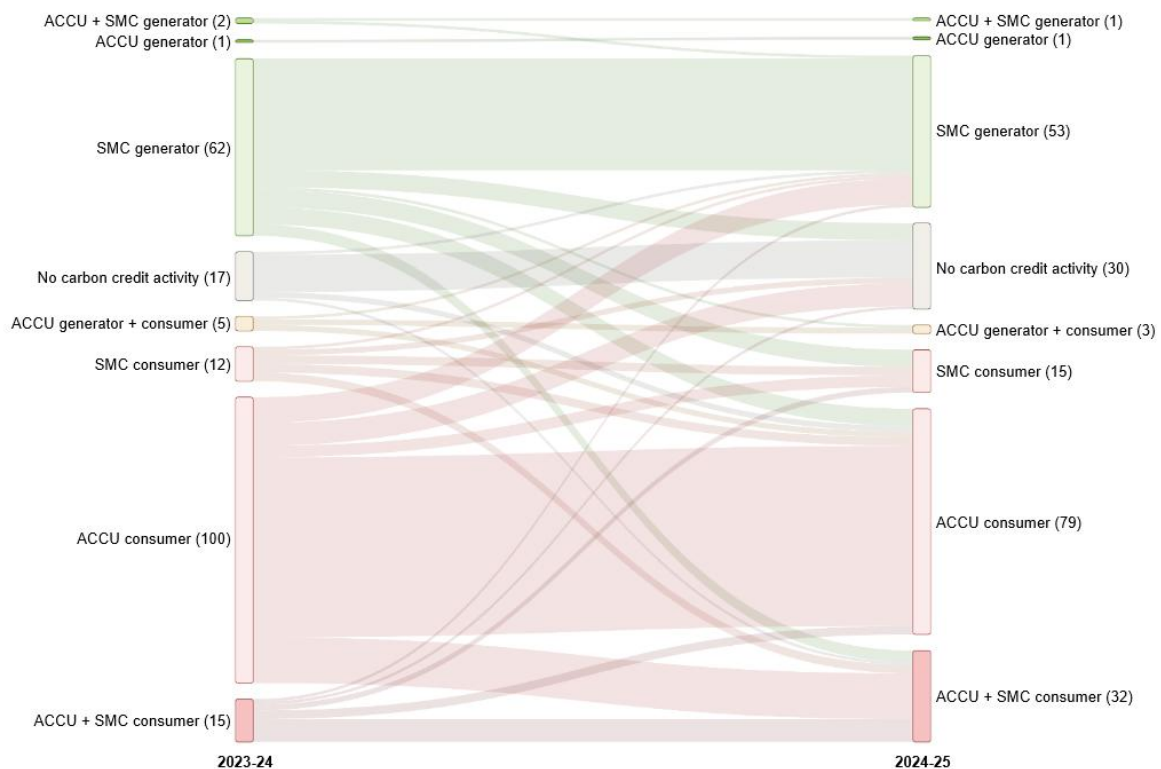
For a detailed discussion of the classification logic, or to explore how a specific facility maps to the framework, please reach out to the MacGregor Advisory Group team.

With the framework established, the next step is to apply it across both compliance years and examine category movement.

## What the transition data suggests

Applied to the 214 continuing facilities, the framework reveals how compliance strategies shifted between 2023–24 and 2024–25. Of these facilities, 130 (61%) retained their inventory classification and 84 (39%) changed category.

*Exhibit 9. Inventory positioning transitions for 214 continuing facilities, 2023–24 to 2024–25*



Three patterns are worth examining:

- **The supply side of the credit market is thinning as expected due to SMC issuance without significant investment in abatement being less likely as baselines tighten.** SMC generators fell from 62 to 53, with around 40% of the previous generator group either becoming market-independent or moving to consumer status. New entrants partially offset the decline, but the net effect is a tighter internal credit supply and likely higher ACCU procurement.
- **Most facilities kept the same credit market status year on year.** The main exception was previous SMC consumers, who fragmented across several categories, suggesting they are actively navigating a broader range of compliance options as their position evolves.
- **Participation is slightly lower; however, the usage is significantly higher with increased reliance on third-party credits.** This is a natural position in the early years of a major policy transition: capital investment takes time, while credit purchasing is available and rational in

the near term. What remains less clear is what signals would need to strengthen for more facilities to invest in on-site abatement at scale.

For the 79 facilities that ended 2024–25 as ACCU consumers, one key question is whether that position reflects a deliberate near-term strategy while longer-lead time investments are developed, or a facility strategy that has chosen to offset. For the former, the credit market is a valuable tool to bridge the time required to bring the development into operations. For the latter, the current market dynamics create an increasing risk, as the window for addressing covered emissions directly narrows.

## Bringing it together

Exhibit 10 brings together the compliance position and inventory classification data for all 245 facilities in a single view.

*Exhibit 10. Summary matrix based on net position after offset activity in 2024–25 data*

|                  | Generator | Consumer   | Gen. + Con. | No Activity | Total      |
|------------------|-----------|------------|-------------|-------------|------------|
| <b>Balance</b>   | 0         | 127        | 2           | 2           | <b>131</b> |
| <b>Liability</b> | 0         | 1          | 0           | 9           | <b>10</b>  |
| <b>Surplus</b>   | 56        | 7          | 1           | 22          | <b>86</b>  |
| <b>Total</b>     | <b>56</b> | <b>135</b> | <b>3</b>    | <b>33</b>   | <b>227</b> |

*Note: Covers 227 facilities reporting in 2024–25. Excludes 18 facilities that exited the mechanism after 2023–24. In addition, the 227 facilities include the continuing facilities as well as new facilities.*

Three structural observations emerge from this matrix.

First, every facility classified as a generator (ACCU, SMC, or both) by nature holds a surplus position.

Second, the 131 facilities at balance are, almost without exception, active in the carbon credit market. Of these, 127 recorded ACCU or SMC surrender activity in 2024–25. Balance is rarely achieved via investments alone. It is a managed position, and carbon credits are the mechanism through which most covered facilities are balancing their baseline.

Third, the ten facilities with an unresolved compliance position recorded limited ACCU or SMC activity relative to their emission exposure quantum. This raises a question about how they are planning to resolve their position: through multi-year monitoring, abatement investment already underway, or a pathway not yet fully visible in the available data.

Taken together, the matrix reinforces Chapter 2’s central finding: the mechanism’s compliance architecture is currently sustained by credit markets, and the net surplus within those markets is thinning. The facilities best positioned in three to five years are those making capital allocation decisions today based on that trajectory, not just the current snapshot. Credit purchasing is an important near-term tool, and for facilities already investing in longer-lead abatement infrastructure, it is buying the time that investment needs. For facilities still mapping their medium-term compliance path, the data suggests that work should start soon, before the market tightens further and costs increase.

# Chapter 4: Looking forward

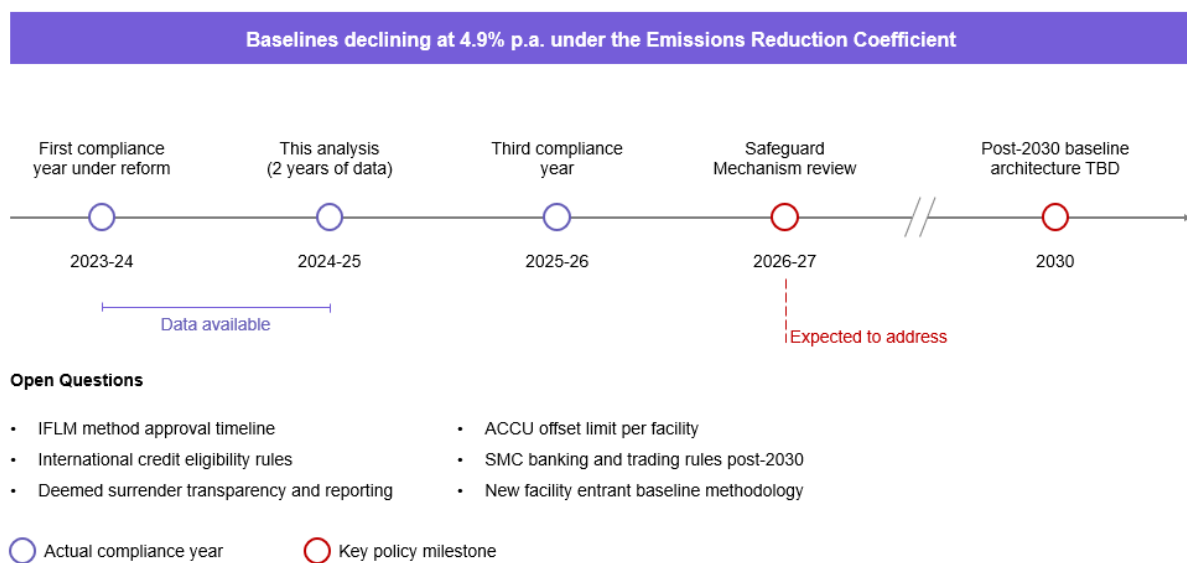
## The continuing compliance path

The mechanism is working. The question now is what each facility’s trajectory will look like from here.

The forces shaping these trajectories are catalysing the challenge. Tighter baselines push more facilities from surplus into balance, reducing SMC supply, increasing ACCU demand, and tightening the external market further. Adding to this pressure, the IFLM method, potentially the largest source of new ACCU supply, remains unapproved.

None of these pressures are unmanageable in isolation. The challenge is the longer facilities take to address their emissions, the less effective and more expensive the solutions become. Exhibit 11 maps the forward path from the current data window through to 2030, with the key policy milestones and open questions that will shape how that path unfolds.

Exhibit 11. Forward-looking timeline: ERC trajectory, policy milestones, and open questions to 2030



## What this means in practice

The implications land differently depending on how the reader is participating in the safeguard mechanism and the carbon markets.

### FOR COVERED FACILITIES

The challenge to remain compliant will continue to increase as the mechanism becomes less flexible. The covered facilities consumed 10.58 million ACCUs in 2024–25 alone. Facilities without forward contracts may face price and availability risk as the 2026–27 compliance year approaches. On-site abatement projects typically require one to three years to deliver, which means facilities beginning their investments now will be better positioned than those deferring it. Credit purchasing remains a valuable tool and works best when paired with a medium-term view of where the facility's compliance position is heading.

### FOR THE CREDIT MARKET

The SMC inventory trajectory suggests limited surplus by 2027–28 without new surplus entrants. The growth in deemed surrenders (from 42,000 to 283,000 units) is not visible in public market data, meaning market observers may be systematically undercounting compliance demand. Approval of additional new methodologies and associated projects will be the most important variable for supply from 2027 onwards.

### FOR THE POLICY ENVIRONMENT

The upcoming 2026–27 Safeguard review provides a natural opportunity to consider several open questions:

- How should ACCU offset limits per facility be calibrated to balance compliance flexibility with the scheme's decarbonisation objectives?
- Under what conditions should international carbon credits become eligible for safeguard compliance, and at what volume?
- What banking and trading rules should apply to SMCs beyond 2030?
- Should deemed surrender volumes be disclosed in public market reporting to give market participants a complete picture of compliance demand?
- How should baselines be set for new facility entrants to avoid systematically adding demand to the credit market without corresponding supply?

On this last point, all 13 new facility entrants in 2024–25 arrived at balance status with 255,000 units of combined ACCU demand and no SMC surplus, suggesting that each new entrant is likely to add demand on an aggregate basis.

## Where this leaves us

Two scenarios sit beneath the data. In the first, the current trajectory continues: facilities rely increasingly on credit purchasing, the ACCU and SMC pools tighten further, and compliance costs rise as supply constraints materialise.

In the second, capital investment decisions already made, or being made now, begin to deliver real emissions reductions over the next two to three years, reducing underlying credit demand and rebuilding the surplus pool from the operational side.

The reality is likely some combination of both, and the balance between them will be shaped by decisions being made today at the facility level, in the credit market, and in the policy environment. What the data makes clear with the current assumptions is that the window for those decisions is narrowing, and that the facilities and market participants who engage with the trajectory early will have more options than those who wait.

As always, MacGregor Advisory Group would welcome the opportunity to discuss how these findings might apply to your facilities, portfolio, or policy considerations.

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## Methodology and data sources

All analysis is based on facility-level data published by the Clean Energy Regulator for the 2023–24 and 2024–25 compliance years.

The net position status classification (Surplus, Balance, Liability) is derived directly from the CER’s published net emissions number and baseline emissions number for each facility.

The transition analysis covers 214 continuing facilities (those reporting in both years). Thirty-one non-continuing facilities (18 exited, 13 new) are analysed separately. Driver decomposition identifies the primary factor behind each facility’s year-on-year change by isolating the largest absolute movement among four components: covered emissions change, ERC mechanical tightening, non-ERC baseline change, and net surrender change.

The inventory positioning framework classifies facilities into eight mutually exclusive categories based on observable carbon credit activity across five CER-published columns (ACCUs issued, ACCUs deemed surrendered, ACCUs surrendered, SMCs surrendered, SMCs issued). All assignments are reproducible from the published data. For a detailed discussion of the classification methodology, please contact the MacGregor Advisory team.

# The Authors

For further information or to discuss how these insights may apply to your organisation, please feel free to contact our team or visit us at [www.macgregoradvisory.com](http://www.macgregoradvisory.com)



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