CLIMATE CHANGE AND SUSTAINABILITY

Australia's Safeguard Mechanism Is Heating Up

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ARTICLE JANUARY 28, 2026 8 MIN READ

Australia's Safeguard Mechanism is the primary tool to incentivise Australia's largest industrial facilities to reduce their greenhouse gas emissions. Each facility must reduce emissions to meet a declining baseline or purchase and surrender carbon credits. This has given rise to a dynamic market for Australian Carbon Credit Units (ACCU). In our previous article on the ACCU market we encouraged readers to be mindful of the supply and demand dynamics of the ACCU market when forming views on price. Based on the dramatic oversupply of ACCUs at the time we suggested "Prices may eventually rise to the cap, but it might take a while."

The last three years have seen an ACCU market with a fair degree of volatility and very little price appreciation, with average prices rising from A$35 to just A$37. They held their value, but fell behind an investment in a low-risk term deposit and dramatically lagged the expectations of bullish market commentators. It was also a bumpy ride, with prices ranging from A$26 to A$43.

Three years on the market is showing signs of improvement. This view is based on BCG's observations on typical trends from other markets as well as the specific movements in Australia's domestic supply and demand environment.

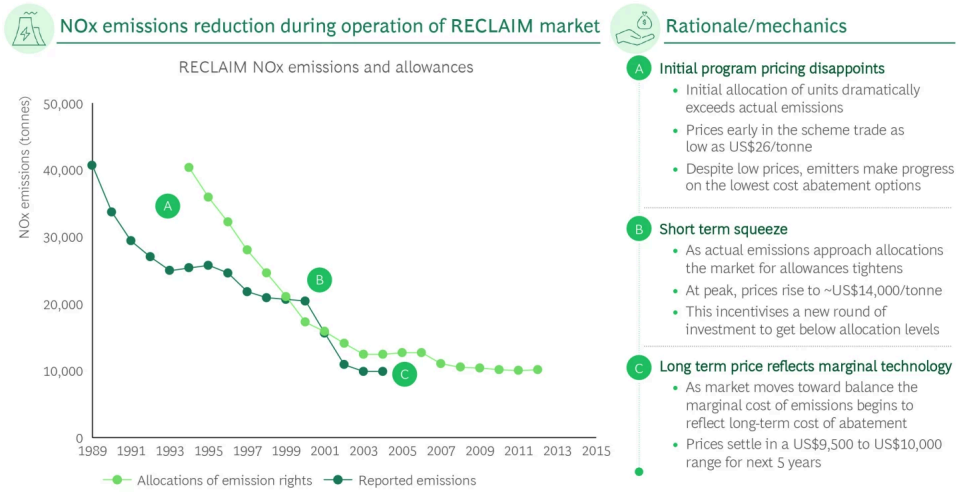
A Well-Constructed Emission Market Will Work

Left to its own devices, an Emissions Market will work. The rules of the market mean that facility emissions baselines will decline at a steady rate. In early years, facilities will typically meet their obligations with the lowest cost abatement opportunities. Then, over time, baselines will continue to tighten requiring even more action. The easy abatement options will be exhausted early and the price of emissions will rise to a level where they incentivise more difficult activities.

California's RECLAIM market (Regional Clean Air Incentives Market) is a great case study in the mechanics of emissions market dynamics. RECLAIM was designed to deal with a dangerous smog problem by reducing NOx and SOx pollution in Southern California. Early on, prices were low as facilities found easy ways to keep their emissions below baselines. Baselines then tightened and caused a ~50x increase in price, which in turn drove a new round of abatement. NOx emissions dropped ~75% over 15 years, and the air in Southern California is dramatically cleaner today than it was in the late 1980s.

EXHIBIT 1

Case Study | Regional Clean Air Incentives Market (RECLAIM) reduced California's NOx emissions by greater than 75%



Source: Annual RECLAIM Audit Report for the 2004 Compliance Year. South Coast Air Quality Management District, March 2006. (Jensbn); Pollution.com; Federal Reserve Bank of Chicago

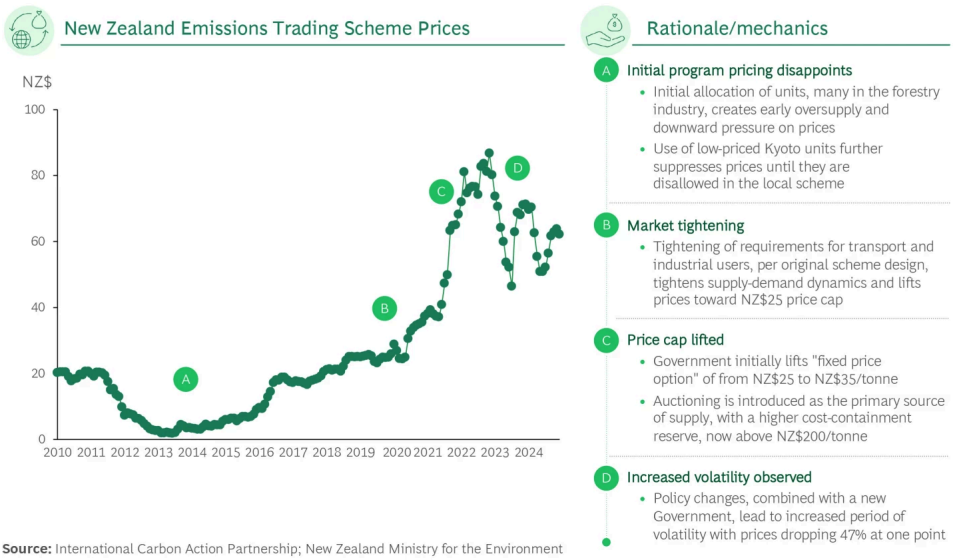
A Typical Emissions Market Pattern Starts Low, and Then Tightens Fast – with a Lot of Volatility

This 'start low, tighten fast' pattern has played out numerous times in multiple markets. The New Zealand Emission Trading Scheme (ETS) is another example, this time in the market for greenhouse gas emissions. Large scale allocation of permits kept prices subdued in the early years of the scheme. However, planned tightening of facility obligations eventually tightened the market and pushed the price of New Zealand Emissions Units (NZUs) to the cap of NZ$25/tonne. Once the cap was reached, the Government initially raised the cap to NZ$35/tonne and then restructured the auction mechanism entirely. Prices continued to climb, eventually reaching NZ$86/tonne – more than 3x the previous cap. An investment in NZUs in 2015 returned a staggering 10x return over 8 years.

The NZ example also illustrates price volatility in an Emissions Market, with a 47% drop in prices in the nine months following their peak in 2022. These markets are not for the faint of heart. Market participants, both investors and corporates, need to have clear plans for managing the risks of their current positions and future obligations.

EXHIBIT 2

Case Study | The New Zealand ETS illustrates the increase in value and volatility of carbon units as a market tightens



Source: International Carbon Action Partnership; New Zealand Ministry for the Environment

Demand for ACCUs Is Skyrocketing

A closer look at Australia suggests that the ACCU market may be about to experience a similar phenomenon. The market is still oversupplied. In the 12 months to September 2025 supply of ACCUs was ~21 million tonnes, far exceeding demand of 8.5 million tonnes. But demand is rapidly catching up with supply. Between 2021 and 2024 demand for ACCUs grew at 38% per annum, as compared to supply growth of ~3%. In 2025, ACCU demand growth accelerated to ~6 million tonnes. If this trend continues the market will become undersupplied in less than 3 years.

As commodities go this mismatch between supply and demand is exceptional. Over the same periods, copper demand grew 2.3% and supply grew 2.6%.Lithium, the market favourite among critical minerals, grew at a staggering 29%, but this was met with a faster growth in supply of 33%. By comparison, ACCUs are experiencing a very rapid tightening of supply-demand dynamics and price appreciation should follow.

Potential Changes to the Safeguard Mechanism Would Tighten the Market Even More

Potential changes to the scheme will add fuel to the fire. Over the next 18 months, the Government will review the Safeguard Mechanism and propose changes. Given the Government's recently announced ambitious target to reduce national emissions by 62 to 70% by 2035, the balance of recommendations could be biased toward tightening. One option could be to bring more facilities into the scheme by reducing the Safeguard Mechanism facility threshold from 100kt per year to 25kt per year. Other changes could include expanding the scheme to other industries or tightening baselines further. Regardless, there is a very real potential for material changes to the market.

Market Participants Need to Get Ready

In this context, the owners of facilities affected by the Safeguard Mechanism need to have a plan to deal with their growing liability. We recommend companies take the following steps:

- **Form a house view on price trajectory**. As with any commodity that affects the P&L, have a base ACCU forecast and develop a range of scenarios to pressure test business cases.
- **Understand the options to meet Safeguard Mechanism obligations**. The decision to retire ACCUs need to be weighed against the many options a facility has to directly reduce emissions through on-site decarbonisation, which is the ultimate goal of the scheme. If purchasing ACCUs, emitters could simply choose to be price-taker or could adopt a more sophisticated hedging or pre-purchasing strategy. Some facilities will choose to meet their obligations by investing directly in ACCU scheme projects to originate their own credits.
- **Develop a plan and monitor signposts in the market regularly**. Given the regulatory and market risk, a disciplined approach that is signed off by the key finance and operating executives is vital. But, given the dynamism of the market, that plan needs the flexibility to change if circumstances shift.
- **Explore new avenues of revenue growth**. Companies with particular assets or capabilities, like large tracts of land needing nature-based remediation, may choose to expand their efforts beyond their own needs, creating a whole new revenue stream in this growing industry.

Serious Value Opportunities and Risks Are Emerging

Investors and bankers should also take note. ACCUs are a new government-backed financial instrument with genuine value to companies that need to meet their regulatory obligations. ACCUs are a volatile commodity that could increase dramatically in value over time, and a potential new asset class for investors who are willing to wear the risk.

We already have multiple examples of companies that have realised gains in excess of $100 million by being proactive in the ACCU market. As it heats up, these opportunities are set to multiply.

Do You Have a Plan?

Market participants, including facilities owners and investors, are now faced with a choice. Do they see the ACCU market as an opportunity for significant growth in value? Or as a risk that needs to be hedged so their company can focus on their core competencies? Either way, every market participant should have a plan to address the financial and physical aspects of the Safeguard Mechanism and a process to monitor the changing environment and adjust strategy accordingly.

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