Queensland Government

Queensland Treasury

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Acting Scheme Manager Recommendations for the Post Transition Review of the Financial Provisioning Scheme

Summary Report

Contents

Executive Summary

The Financial Provisioning Scheme (FPS or the Scheme) commenced operation on 1 April 2019. The Scheme operates under the provisions of the Mineral and Energy Resources (Financial Provisioning) Act 2018 (MERFP or the Act). Development of the Act and the Scheme was undertaken within a broader set of financial assurance and rehabilitation reforms, which commenced in 2016.

The design principles that underpinned the reforms were that the changes should:

- Better protect the financial interests of the State;
- Reduce the financial burden for industry; and
- Promote good environmental outcomes.

While the Acting Scheme Manager believes that each of these principles are being met through the current design and operation of the Scheme, more can be done to optimise the extent to which they are being achieved. In the Scheme's fourth year of operation, there has been a significant increase in understanding and insight into the resources sector. Through analysis of the unique data that the Scheme collects, a series of recommended changes and further improvements have been identified.

As a result, the FPS Inter Departmental Committee (IDC) was re-established from the prior Financial Assurance Reform program and is comprised of the same membership: the Under Treasurer, Deputy Under Treasurer, Directors General from each of the Department of Environment and Science and Department of Resources, the Scheme Manager, the Rehabilitation Commissioner, and representatives of the Department of the Premier and Cabinet and Queensland Treasury Corporation. Reformation of the IDC was to seek input into, and oversight of, a post-transition review of the Scheme and more broadly assess risks that were identified during the 2016-17 Financial Assurance reforms and progress of mitigation strategies.

Following IDC endorsement to commence the Post Transition Review of the FPS, the Risk Advisor consortium, led by KPMG, was commissioned to undertake the review. Through ongoing engagement with the State Actuary, FPS was encouraged to seek actuarial considerations. EY was appointed as the successful proponent and have confirmed the original assumptions, demonstrating that the Scheme is operating in line with expectations and tested proposed changes to ensure the Scheme Fund will grow in line with expectations and remains sustainable.

As part of the Post Transition Review, consultation with industry was held from late June 2022 to early November 2022 across three phases, including two discussion papers and a series of virtual townhalls and focus groups. Generally, industry was appreciative with being consulted and being provided opportunity to provide feedback. Industry feedback is drawn upon throughout the recommendations.

Additional context on the proposed changes is outlined in the *Financial Provisioning Scheme Discussion Paper 1* (released July 2022) and *Financial Provisioning Scheme Discussion Paper 2* (released October 2022).

1.0 Endorsement of legislative changes

The proposed changes outlined in this section, would see the MERFP amended, thereby updating the Act and making it more nuanced to risk management based on evidence-based learnings from over three years of the Scheme's operation.

1.1 Prescribed Estimated Rehabilitation Cost

Current situation

The Scheme was designed to capture all Environmental Authorities (EAs) previously administered under the Financial Assurance Framework (FA) (the prior Scheme). To determine the subset of EAs to be assessed, a minimum prescribed estimated rehabilitation cost (ERC) of $100,000 was established.

Proposed change

It is proposed to increase the prescribed ERC for risk assessments from the existing $100,000 to $10 million. All EAs with an ERC of less than $10 million will be obliged to provide surety equal to 100% of the value of the ERC, in an approved form.

To support this change, transitional arrangements have been recommended and are detailed in Section 1.5 Transitional arrangements.

1.2 Risk Category Allocation

Current situation

When the Scheme was designed, four risk category allocations (RCAs) were introduced (Very Low, Low, Moderate, High) to segment the portfolio of EAs based on the individual risk assessments. This was required given the resources sector is not standardised in terms of the size of operators, type of resource, level of risk or financial strength. Therefore, the initial establishment of the FPS determined that providing one level of contribution to the Scheme Fund would not have covered the risk appropriately.

After three years of Scheme operation, it is evident that there is a strata of inter-category EA risk profiles. This is most evident in the Moderate category. Some Moderate outcomes present closer to the Low-risk category while others are closer to a High-risk outcome. This is complicated by the large increase in contribution rate at the lower end (i.e., from 1.0% to 2.75%) and the change of requirement for the provision of full surety at the High category allocation.

Proposed change

It is proposed to introduce a fifth risk category of Moderate/High, provisioned by increased contribution to Scheme fund (noting the various allocations would then incorporate the following five items: Very Low, Low, Moderate, Moderate/High, High).

Stakeholder feedback was supportive of an additional risk category, as well as 'transitional' provisioning category which eases the path between contribution and surety.

1.3 Pricing points

Current situation

The current pricing points were established during the design of the Scheme, using modelling from Queensland Treasury Corporation (QTC). Actuarial analysis performed by EY confirmed the Scheme Fund is growing approximately in line with the model proposed by QTC. The prescribed contribution rate for the current risk categories are presented in the following table.

Risk Category	Prescribed Contribution Rate
Very Low	0.50%
Low	1.00%
Moderate	2.75%
High	Surety

Table 1 Prescribed contribution rate percentage

Proposed change

Based on conclusions reached from the actuarial modelling, it is proposed to change the prescribed contribution rate of risk categories appropriately given the additional risk category of Moderate/High as follows:

Risk Category	Proposed Contribution Rate
Very Low	0.50%
Low	1.00%
Moderate	2.25%
Moderate/High	6.50%
High	Surety

Table 2 Proposed prescribed percentage of risk categories

1.4 Fund Threshold Level

Current situation

The current Fund Threshold of $450 million was established having regard to single point risk exposure limits. At the time, 5% of the aggregate ERC exposure was recommended as being appropriate given overall State appetite for risk.

Proposed change

As 5% of today's aggregate ERC equates to circa $600 million, there is an intent to increase the Fund Threshold. Not increasing the Fund Threshold would increasingly see the Scheme operated more conservatively than intended and it would elongate timeframes for the Fund to mature to long term sustainability. Therefore, it is proposed to increase the fund threshold for BBB+ or better credit rated entities to $600 million, and to retain a $450 million threshold for all other entities.

It is proposed to amend Section 57 of the Act to add a sub-section for when an EA Holder must give increased surety due to a change in the Fund Threshold limits. Following this change, the current mechanisms within Section 57 for the Scheme Manager to extend the period to provide increased surety, if it is not reasonably practicable for the holder to obtain it within the period, apply. A review of the Fund Threshold is legislated to occur every three years and will be led by the Actuary.

1.5 Transitional arrangements

Current situation

It will be necessary to incorporate transitional arrangements to implement changes recommended by the Post Transition Review of the Scheme.

Proposed change

Transition from contribution to surety due to change in risk category allocation

Change is required to one transitional arrangement currently in the Act namely, Section 46(b)(i) where the Scheme Manager makes an annual review decision for an authority that allocates the authority to the risk category of High when they were previously either Moderate, Low or Very Low. This allows the Scheme Manager to decide for the EA Holder to continue providing contribution if the EA Holder is not reasonably able to give surety within 12 months of the decision. Currently it is only permitted when the EA Holder has received that same outcome for the previous four years. The Scheme is entering its fourth year and some EA Holders have received their first risk category allocation in the last year alone. The requirement to have the same risk category allocation for the previous four years is intended to be removed.

In addition, it is proposed to include a subsection s46(c): *the Scheme Manager is satisfied that allowing the EA Holder to contribute to the Scheme Fund is unlikely to result on a claim on the Scheme Fund*.

Transition from contribution to surety due to ERC being less than $10 million

A new transitional arrangement will also be required where an EA Holder is required to provide surety due to their ERC being less than $10 million and they are no longer eligible to be assessed. EA Holders will have the option to provide 50% surety in the first year, with the other 50% to be covered by contributing to the Scheme Fund at the Moderate/High contribution rate. The surety requirement would then increase to the full 100% in the second year, allowing a two-year transition period from contribution to surety.

1.6 Annual review

Current situation

The Initial Allocation Day (also known as the Statutory Date) is set when the Scheme Manager decides the first or Initial Risk Category Allocation. The Annual Review Allocation Date is 12 months after the Initial Allocation Day. EAs are assessed individually with many EA Holders (and/or Assessed Entities) having multiple EAs assessed at different points throughout the year.

Proposed change

It is proposed to align EA assessments by grouping them by Assessed Entity and to realign annual review dates so grouped assessments can be reviewed at the same time.

1.7 Fees

Current situation

The decision to implement an annual assessment fee for all risk assessed EAs was grounded in the intent to partially recover some of the costs of administering the Scheme. The current assessment fees are as follows:

ERC	Assessment Fee (per annum)
$100,000 - <$1m	$250
$1m - <$10m	$1,250
$10m - <50m	$5,000
$50m - <$100m	$22,500
$100m +	$45,000

Table 3 Current Assessment Fees

Proposed change

The characterisation of the fee as an ‘assessment’ fee has brought unintended misunderstanding. It was not an attempt to recover the specific and individual costs of any single assessment, but to recoup Scheme administration expenses across all assessed companies regardless of their requirement to provide surety or contribution.

During industry consultation, some stakeholders stated they consider the fees to be high. In recognition of introducing ‘Assessment Pathways’, a ‘Streamlined’ assessment (outlined in Section 2.1 Administration of the Scheme) will see EAs with an ERC of $50 million or more will incur a fee that is 50% less than what they would otherwise pay.

It is also proposed that any entity, regardless of RCA, may request the opportunity to engage in a ‘Comprehensive’ Assessment Pathway (outlined in Section 2.1 Administration of the Scheme). This more thorough considered assessment requires more time and effort by FPS and the Risk Advisor and is therefore priced accordingly in the revised assessment fee schedule is as follows:

Streamlined Assessment Fees

ERC	Initial and every third year Assessment Fee	Other Yearly Assessment Fees
$10m - <50m	$5,000	$5,000
$50m - <$100m	$22,500	$11,250
$100m +	$45,000	$22,500

Table 4 Proposed Streamlined Assessment fees

Comprehensive Assessment Fees

ERC	Yearly Assessment Fee
$10m - <50m	$5,000
$50m - <$100m	$22,500
$100m +	$45,000

ERC	Assessment Fee
EA Holder Request for Comprehensive Assessment	$45,000

Table 5 Proposed Comprehensive Assessment Fees

2.0 Endorsement of guideline changes

The proposed changes outlined in this section would see the Scheme Manager Guidelines amended and shift the Scheme from a one size fits all approach to determining provisioning outcomes into a more active instrument of risk management and opportunity enablement.

As a result, it is proposed to begin a period of beta-testing the changes with industry, to gather more feedback and improve the processes as needed. It is proposed to host beta-testing for a period of up to three months (March to May 2023). After this time, final updates to the Scheme Manager Guidelines would be completed for IDC endorsement and any changes to the Scheme implemented by a target date of 1 April 2024 (aligning with the fifth anniversary of commencement of the Scheme).

2.1 Administration of the Scheme

Current situation

Under the current Scheme construct, an Initial Assessment is conducted for each assessable EA to derive the initial RCA. Following the Initial Assessment, each EA must complete Annual Assessments to review their RCA. Given the initial transition of all EAs was completed in March 2022, only minimal Initial Assessments are expected going forward (e.g., for new EAs or changed holders).

Proposed change

Stakeholders provided consistent feedback that the Scheme should move away from its current one size fits all assessment process and were eager for any opportunities to reduce assessment frequency. The revised approach, outlined in the table below, is intended to fit this purpose. Although, it is noted that a full assessment will still be required for all Initial Assessments and every third year for the Streamlined Assessment pathway. In addition, a full assessment can also be requested by the EA Holder or the Scheme Manager as needed.

Assessment Pathway	Overview	Review Frequency
Streamlined Assessment	Applied where EAs / assessed entities clearly meet their current risk category and would require a significant change event to warrant reclassification.	• Corporate structure and assessed entity check (**yearly**). • Credit Rating Assessment (CRA) check (where applicable) (**yearly**) • Standard Financial Soundness Assessment (FSA) (where applicable) (**yearly**). • Standard Resource Projects Characteristics Assessment (RPCA) (**Initial and every third year**)
Comprehensive Assessment	Required where the assessment is more complex in nature and requires more detailed analysis to determine a risk category allocation (to include non-traditional resource sector or unique projects).	• Corporate structure and assessed entity check (**yearly**). • CRA check (where applicable) (**yearly**) • Comprehensive FSA (where applicable) (**yearly**). • Comprehensive RPCA (**yearly**)

Table 6 Proposed assessment pathways

The process for initial and ongoing allocation of each EA and/or Assessed Entity to an assessment pathway is described below:

- For **Annual Reviews**, it is proposed that the Scheme Manager will initially allocate each assessable EA into an assessment pathway having regard to the current risk category allocation, the particulars of the EA (and Assessed Entity) and the major determinates of risk. Thereafter, the assessment pathway can be changed subject to changes in risk profile of the EA and/or Assessed Entity as determined by the most recent review.
- For an **Initial Review with an Assessed Entity previously assessed under the Scheme**, it is proposed that the Scheme Manager will initially allocate the EA to the same assessment type as the other EAs with the same Assessed Entity, unless there is a clear reason in relation to the risk of the particular EA which differs from the other EAs.
- For an **Initial Review with an Assessed Entity <u>not</u> previously assessed under the Scheme**, a Streamlined Assessment type will be undertaken (including a Standard FSA (if an acceptable CRA is not available) and RPCA), to assist the Scheme Manager in determining whether a comprehensive assessment is required.

2.2 Comprehensive Financial Soundness Assessments

Current situation

Under the current process, where the Assessed Entity has a long-term public credit rating (or a private credit rating no more than 12 months old) from a credit rating agency approved by the State, the Scheme Manager assesses the financial soundness of this entity based on this rating (using the weakest one if multiple ratings are available).

Where the Assessed Entity does not have an acceptable external credit rating, the Scheme Manager assesses the financial soundness of the Assessed Entity by undertaking a FSA on three years of audited financial statements. Industry sector and country risk (where applicable) are also considered.

Proposed change

It is proposed to implement differentiated risk assessment pathways according to the relative complexity of each assessment.

There are entities where consideration of additional financial and non-financial (qualitative) information may deliver a more robust and appropriate risk assessment (supporting either a higher or lower risk category allocation). In such cases, a Comprehensive FSA will be undertaken and will include the risk advice consortium forming a view of financial soundness influenced by the additional information provided. This includes an assessment of business strategy, operational capability, forecast financials, and deeper analysis of historical and current profit and loss, cash flow and balance sheet measures and metrics. The assessment will include a virtual meeting with management to discuss any questions the risk advice consortium may have arising from the information provided.

The Standard FSA will continue to be applied to those entities which do not require a Comprehensive assessment. The Standard FSA will continue to require three years of audited financial statement as per the current quantitative methodology.

It is further proposed that any entity, regardless of risk category allocation, may request the opportunity to engage in a Comprehensive analysis method, subject to Scheme Manager agreement and/or payment of any relevant fees.

2.3 Resource Project Characteristics Assessment Methodology

Current situation

The purpose of the Resource Project Characteristics Assessment (RPCA) is to complement the FSA by assessing the underlying saleability of an asset associated with an EA and the historic and ongoing rehabilitation efforts of the EA Holder.

The original RPCA design (RPCA 1), was designed to be an efficient and cost-effective assessment process, targeted to support the initial onboarding process of the Scheme. A strong weighting was placed on Remaining Economic Life (REL) based on reserves and production data, with rehabilitation and compliance having a small impact on RPCA 1 outcomes. To date, the majority of the RPCAs conducted have had an impact on the RCA outcome, most of which have reduced assessed risk outcomes.

Proposed change

The proposed RPCA 2 design would see the RPCA framework amended to the following weighted resource characteristics components:

- Saleability: 70%
- Rehabilitation: 30%

Saleability will retain REL as a factor but will also include other metrics to better reflect the strength of the asset. The Rehabilitation component will have a larger influence on overall RPCA assessment, with the intent of differentiating outcomes based on rehabilitation performance. The specifics of what each of these items are still being finalised and will be tested as part of the beta-testing.

3.0 Additional considerations for reducing risk to the State

As part of the Post Transition Review and reflecting upon three years of the Scheme's operation, the former Scheme Manager identified several risk areas that were known at the time of the FA Reform program that remain insufficiently addressed by the Scheme (even allowing for the proposed refinements outlined in Section 1.0 and 2.0 above).

These risk areas were presented to stakeholders in Discussion Papers 2 and are outlined below.

3.1 The increased risk of sites in long term care and maintenance

Recent Scheme research has identified that there is more than $1.0 billion of ERC tied to EAs in care and maintenance (as acknowledged by the holder). While some of those sites have been assessed at High risk (and therefore are provisioned by surety), a material amount is provisioned by way of the Fund. Throughout this time, many EAs have experienced favourable commodity price cycles without being returned to production.

Introduction of PRCP obligations is one measure through which some of these risks may be addressed. It is noted however that PRCP obligations do not price the risks for the State arising from long term care and maintenance.

There is no proposed change at this time, however consideration was given to whether a pricing signal could be introduced for these sites. Stakeholders reflected that this approach would need to be highly tailored and more clearly defined, to minimise confusion about the interaction with PRCPs.

3.2 The increased risk of asset transfers

A consequence of the trend for smaller and/or newer entities to acquire assets from stronger current EA holders is that it increases the government's counterparty rehabilitation risk exposure. This infers higher probabilities of default and/or claim on Fund.

Consideration was given to identifying a way to manage and offset the additional risks incurred through asset sales and transfers, recognising the inherent complexities. No option is straight forward nor without potential impact on holders and or prospective acquirers.

Stakeholders had mixed responses about whether this is a 'legitimate' risk with some suggesting addressing this item would see "Government interfering with commercially agreed arrangements". As such, there are no proposed changes at this time.

3.3 Voluntary Rehabilitation Risk Reduction Agreements

A voluntary Rehabilitation Risk Reduction Agreement (RRRA) would present an opportunity for holders to define a best intention to accelerate the reduction of existing legacy rehabilitation (beyond that defined in an agreed PRCP). The rationale to agree to higher rehabilitation activity levels than committed to in a PRCP could be based on the incentives and rewards for both entity and State. The proposed agreements would be voluntary and not a part of any proposed legislative changes.

The majority of stakeholders were not interested in exploring this proposal, stating they feel that PRCP obligations are sufficient. As such, there are no proposed changes at this time.

3.4 Additional measures to optimise the extent to which the Scheme meets its design principles

There are several complementary actions and initiatives that can further aid the optimal achievement of the Scheme's principles and further rehabilitation activity. These additional measures include:

- Development of publicly available rehabilitation performance metrics.
- Development of a government rehabilitation recognition system.

- Execution of a government to stakeholder rehabilitation communication and awareness program.
- Review regulatory conditions that are (unintendedly) limiting rehabilitation activity.
- Investigate un-provisioned sub-surface oil and gas wells and old coal bore hole rehabilitation cost exposures as a potential risk to Fund and State.
- Investigate the scope for differentiation between ERC outcomes and actual delivered rehabilitation cost claim on Scheme in the event of failure.
- Investigate Rehabilitation Industry Assistance Initiatives.

There was mixed sentiment of the merit of the proposed suggestions by stakeholders, with many stating they sit outside the Scheme's remit and should not be investigated further. There are no proposed changes at this time; however, the Scheme plans to explore these measures further, in collaboration with industry.

3.5 Energy Transformation

Stakeholders were given an opportunity to consider how decarbonisation may increase claims to the Scheme and the financial soundness of entities following the transfer of assets. Almost all stakeholders expressed strong opposition to the Scheme adopting a position whereby any commodity is classified at a higher risk.

In response, no changes were proposed in the Discussion Paper to introduce any specific measures to further weight, on a differentiated based on commodity. The proposed RPCA methodology will take account of market fundamentals and EA specific context.

3.6 Surety Accessibility

Surety accessibility was raised by industry as an emerging issue through the different consultation phases. It is unclear if this issue is due to financial markets refraining from issuing bank guarantees or that the cost of the facility is considered prohibitive by EA Holders.

Given Scheme viability is based on readily available surety instruments, Government will continue to explore other options such as expansion of approved surety providers on a case-by-case basis; the Scheme is currently in discussion with a number of alternate surety providers and will update stakeholders in due course.

4.0 Next steps

The below graphic provides an overview of next steps following the Post Transition Review of the Financial Provisioning Scheme.

3 Streams of work progress in parallel

Legislative	Guidelines	Rehabilitation Additional Considerations
February 2023		
OPRTR for legislative changes	Risk Advisor draft Guideline changes	FPS IDC define priorities for progressing
March 2023		
CLLO for Cabinet submission for legislative changes	Risk Advisor commences beta-test guidelines with industry	FPS IDC work with DES and industry to progress
October 2023		
Passage through Parliament of amendments	Revised Scheme Manager Guidelines to IDC	IDC update on progress
April 2024		
Updated MER(FP) inforce	Guidelines inforce	IDC update on progress
October 2024		
		Recommendations to IDC

Glossary

Acronym	Term
The Act or MERFP	Mineral and Energy Resources (Financial Provisioning) Act 2018
Assessed Entity	The entity which is to be assessed for financial soundness
CRA	Credit Rating Assessment
EAs	Environmental Authorities
EA holders	Holders of a resource activity environmental authority
FA	Financial Assurance Framework
FPS or 'the Scheme'	Financial Provisioning Scheme
FSA	Financial Soundness Assessment
Fund Threshold	A cumulative ERC threshold
IDC	FPS Inter Departmental Committee
Prescribed ERC	Prescribed Estimated Rehabilitation Cost
QTC	Queensland Treasury Corporation
REL	Remaining Economic Life
RPCA	Resource Project Characteristics Assessment
RPCA 1	The original RPCA design
RCA	Risk Category Allocation
The State	State of Queensland