



Financial Assurance Review - Providing Surety

Discussion Paper

Prepared for the Queensland Government Interdepartmental Committee on Financial Assurance for the Resource Sector

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Have your say

The Queensland Government seeks your feedback on the proposals in respect of the forms financial assurance you can provide and the administration of the Financial Provisioning Scheme. There are questions under each element to help guide your responses and provide targeted feedback.

Visit:

<https://www.treasury.qld.gov.au/growing-queensland/improving-rehabilitation-financial-assurance-outcomes-resources-sector/financial-assurance-framework-reform/>

Email your written submissions to:

financial.assurance@treasury.qld.gov.au

Post your written submissions to:

Financial Assurance Review Queensland Treasury PO Box 15216 City East Qld 4002

Please indicate whether you would prefer any elements of your feedback to remain confidential. Submissions not marked as confidential may be published in full or quoted in public documents or may be available to applicants under the Right to Information Act 2009.

Submissions close 22 September 2017

For more information visit Treasury website - FA Reform or call 13 QGOV (13 74 68)



Background

Queensland's resources industry remains a significant source of wealth and employment for Queenslanders and an important contributor to the economy. Last year, the resources industry provided approximately 60,000 people with direct employment in 2015/16 and contributed over \$21 billion to Queensland's economy. These are the numbers in the Financial Assurance Framework Reform paper for the 2015/2016 period.

The Government is the custodian of our natural resources, on behalf of the people of Queensland. It is responsible for ensuring that use of Queensland's resources is done sustainably and remains profitable for the economy for generations to come. Securing these outcomes can be challenging for governments and communities because resource exploration and extraction disturb and change the land.

Communities expect that the resource operator responsible for changing or disturbing land has the legal obligation to successfully rehabilitate it. Under the *Environmental Protection Act 1994*, resource operators must apply for an environmental authority and provide information about their plans to rehabilitate the site after completing their activities.

To minimise the financial consequences of a resource operator failing to meet their rehabilitation or environmental management obligations, the State obtains financial assurance from resource operators. The amount of financial assurance required is determined by assessing the size and nature of the disturbance, and the likely cost of third parties having to undertake the rehabilitation work. Resource operators provide the State with a surety to cover this amount. Financial assurance is called upon by the State in the event that resource operators fail to meet their environmental obligations and no alternative enforcement actions are available. Traditionally, financial assurance has been provided by resource operators in the form of bank guarantees and in some limited circumstances, cash surety.



Introduction

In 2016, the Queensland Government commissioned the Queensland Treasury Corporation (**QTC**) to carry out a review of the financial assurance framework for the resources sector. The findings of that review were published in the Review of Queensland Financial Assurance Framework (April 2017) (**QTC Review**). The QTC Review recommended a wide-ranging reform package to:

- promote good environmental outcomes
- better protect the State's financial interests
- reduce the financial burdens for resource operators.

The Queensland Government has committed to develop and implement a reform package in response to the recommendations in the QTC Review. To assist that process, the Government has also committed to releasing a series of discussion papers which focus on specific aspects of the key recommendations.

One of those discussion papers, Financial Assurance Framework Reform (**Framework Discussion Paper**), was released in May 2017. That paper provided an overview of the proposed reforms, focusing on redesigning the financial assurance framework. The Framework Discussion Paper proposed a tailored, risk-based financial assurance framework for resource activities and made the following key recommendations:

- expanding the available mechanisms for providing surety
- expanding the market and competition for surety, including by increasing the permitted forms of surety
- expanding the providers of acceptable third party surety beyond the Australian regulated banking sector to include other entities (including insurance companies).

The Framework Reform discussion paper can be accessed at the following website:

<https://www.treasury.qld.gov.au/growing-queensland/improving-rehabilitation-financial-assurance-outcomes-resources-sector/financial-assurance-framework-reform/>.

This discussion paper

This discussion paper, *Financial Assurance Review: Providing Surety*, addresses the recommendations of the QTC Review and Framework Discussion Paper relating to the ways that resource operators could provide financial assurance sureties.

The Government has identified a number of options which may assist in delivering the recommended outcomes which are described in the proposals that follow. The Government is seeking feedback from external stakeholders about the proposals to expand and reform the delivery and the types of surety.

The measures proposed are designed to achieve a number of objectives, including:

- providing a greater number of options to resource operators to manage the cost of the provision of surety
- allowing greater flexibility for resource operators through the delivery of a combination of surety types
- ensuring the State has the funds available and can access these efficiently to complete rehabilitation and remediation work in circumstances where resource operators have failed to do so;
- managing the administrative burden to both resource operators and the State.

When reading this discussion paper, a holistic view should be taken of the proposed measures, which form part of the broader reform of the financial assurance framework proposed in the Framework Discussion Paper.

The Government is committed to working with all stakeholders to drive better outcomes in respect of protecting the environment, minimising financial risk to the State and supporting the economic and employment contribution in the resources sector.

For more information on the QTC Review and its findings, download *Review of Queensland's financial assurance framework* on the Queensland Treasury website at www.treasury.qld.gov.au.

For more information about redesigning the financial assurance framework download the Framework Discussion Paper and other Queensland Government discussion papers on the www.treasury.qld.gov.au/growing-queensland.

Providing sureties in the financial provisioning scheme

Current framework and practice for financial assurance sureties

Engaging in resource activities in Queensland comes with an obligation to rehabilitate any disturbances caused by those activities. The Department of Environment and Heritage Protection (**Department**) is responsible for overseeing these activities according to the requirements of the *Environment Protection Act 1994*.

At present, the holder of a site-specific environmental authority or an environmental authority for mining and petroleum leases is required to submit a plan of operations to the Department prior to commencing resource activities. The plan of operations includes information about the ways in which the resource operator intends to meet the conditions set out in the environmental authority, including rehabilitation requirements, over the subsequent period of up to five years (depending on the term of the plan).

The Department may require, as a condition of the environmental authority, that the resource operator provide financial assurance. To decide if financial assurance is justified, the Department considers:

- the degree of risk of environmental harm being caused, or that might reasonably be expected to be caused, by the relevant activity
- the likelihood of action being required to rehabilitate or restore and protect the environmental because of the environmental harm being caused by the activity
- the environmental record of the holder of the environmental authority.

The amount of financial assurance required is determined by assessing the size and nature of the disturbance, and the likely cost of third parties having to undertake the rehabilitation work. For site specific resource activities, the calculation is made using the Queensland Government's financial assurance calculator or the resource operator's own calculator, if approved.

If financial assurance is required, it must be provided as a surety and the existing framework allows the Department to decide between two available kinds of surety:

- an unconditional, irrevocable and on demand guarantee, this is known as a **bank guarantee**; and
- **cash** may be accepted in limited circumstances, subject to approval by the Department. The cash is held in appropriate security arrangements.

A bank guarantee is an undertaking from an acceptable financial institution in the form of an unconditional, irrevocable and on demand guarantee. This means that if the Department is forced to resort to the bank guarantee as surety to meet rehabilitation costs, it can receive those funds directly from the financial institution.

Acceptable financial institutions are those that satisfy credit rating requirements, legislative accountability and performance management standards.

Resource activities cannot start until the financial assurance has been provided and the financial assurance must remain in place for the life of the operation, including when sites enter care and maintenance. The plan of operations must be updated and submitted to the Department at least every five years, which then triggers a review of the financial assurance amount.

Bank guarantees currently represent the largest quantum of surety held by the State.



Summary of present financial assurance framework in Queensland

The Department assesses applications for environmental authorities and if justified, requires resource operators to provide financial assurance in the form of a surety.

The amount of financial assurance provided is based on an assessment of the likely costs for third parties to undertake the rehabilitation of existing and planned areas of disturbance.

Only two forms of surety are available: Bank Guarantees and cash. Department policy is to require surety in the form of a Bank Guarantee, but has a discretion to accept cash sureties in limited circumstances.

The Queensland Government will only use the financial assurance as a means of last resort, after considering all other options.

Shortfalls of the current framework

As set out above, under the present framework for financial assurance, only two forms of surety can be provided: bank guarantees, and in limited circumstances, cash. Although the framework goes some way towards mitigating the risk and burden of the State having to meet rehabilitation costs of disturbed land, it can be improved.

The QTC Review identified that both forms of surety were raising issues for the State. In either form, surety imposes administrative costs on the State. There is currently no mechanism for the State to recover these costs. There is currently no specific mechanism for the State to recover these costs, rather they must be covered from fees provided for general administration and compliance activities.

In addition to the State's concerns, bank guarantees were also the subject of concern for resource operators industry. The issues identified by the QTC Review are summarised below.

Cash held in security arrangements

State issues

Risk

Cash surety imposes both a significant operational risk and an administrative burden on the State. Under Commonwealth legislation, if cash is taken as a 'security interest' it must be registered on a national register. If the State fails to properly register its 'security interest' and the surety provider becomes insolvent, the State may have difficulty in accessing the cash surety.

Documentation

There is a requirement for consistent documentation between all participants including any third party financial institution who may hold the cash.

Proposed framework delivery elements

Bank Guarantees

Resources Industry issues	State issues
<p>Increased Cost</p> <p>Due to Basel III* capital adequacy requirements and other factors increasing focus on capital management, existing bank guarantee providers are charging increased fees or requiring the entity obtaining the bank guarantee to deposit some or all of the value of the guarantee in cash with the provider.</p>	<p>Administrative Burden</p> <p>Bank guarantees take the form of a physical document. The State is exposed to operational risk and administrative burden from storing these documents.</p>
<p>Decreased Coverage</p> <p>Coupled with the Increased Cost issue, Banks are generally reducing exposure limits to resource operators or seeking increased return. This is resulting in a limited range of banks providing a Bank Guarantee services.</p>	<p>Concentration Issues</p> <p>The decreasing number of banks willing to provide bank guarantees to resource operators exposes the State to greater risk of unfunded rehabilitation costs because the failure of one provider will affect a large number of sureties.</p>
<p>Flexibility</p> <p>A Bank Guarantee is generally for a fixed value, meaning that any adjustment to the required amount of financial assurance generally incurs additional fees and administration.</p>	<p>Timely resolution of financial assurance</p> <p>The State has a template form of Bank Guarantee. However, it is possible to negotiate the terms of Bank Guarantees and the State is experiencing delay and administrative burden from managing requests to negotiate individual forms of Bank Guarantee</p>

After considering State and the Resources Industry's concerns about the current framework, the Government has identified the need to revise and enhance the system of surety in Queensland.

*The capital adequacy requirements known as Basel III issued by the Basel Committee on Banking Supervision (Basel Committee). Australia is a member of the Basel Committee.



The Queensland resources sector exhibits great diversity, with resource operators having unique financial and environmental risk profiles. The Framework Discussion Paper proposed redesigning the framework for financial assurance to accommodate this diversity in the form of a Tailored Solution. The tailored solution will be implemented in the new Financial Provisioning Scheme. Under the Scheme, the relative soundness of projects will be individually assessed and this will guide the assignment of the project to one of the alternative financial provisioning options.

The new financial provisioning scheme will provide alternative financial assurance options, and not all resource operators will be required to provide financial assurance in the form of a surety. Alternatively, depending on their individual circumstances, some resource operators will make a payment to a fund. This is discussed in the Framework Discussion Paper. The following sections of this discussion paper focus on circumstances in which a resource operator is required to give surety because of the relative soundness assessed for a particular project or because of the size of the operator’s overall rehabilitation liability across all its projects.

Where sureties are required, the financial assurance framework will be improved by introducing:

1. a modular approach to financial assurance administration
2. new forms of surety
3. enhancements to the existing forms of surety.

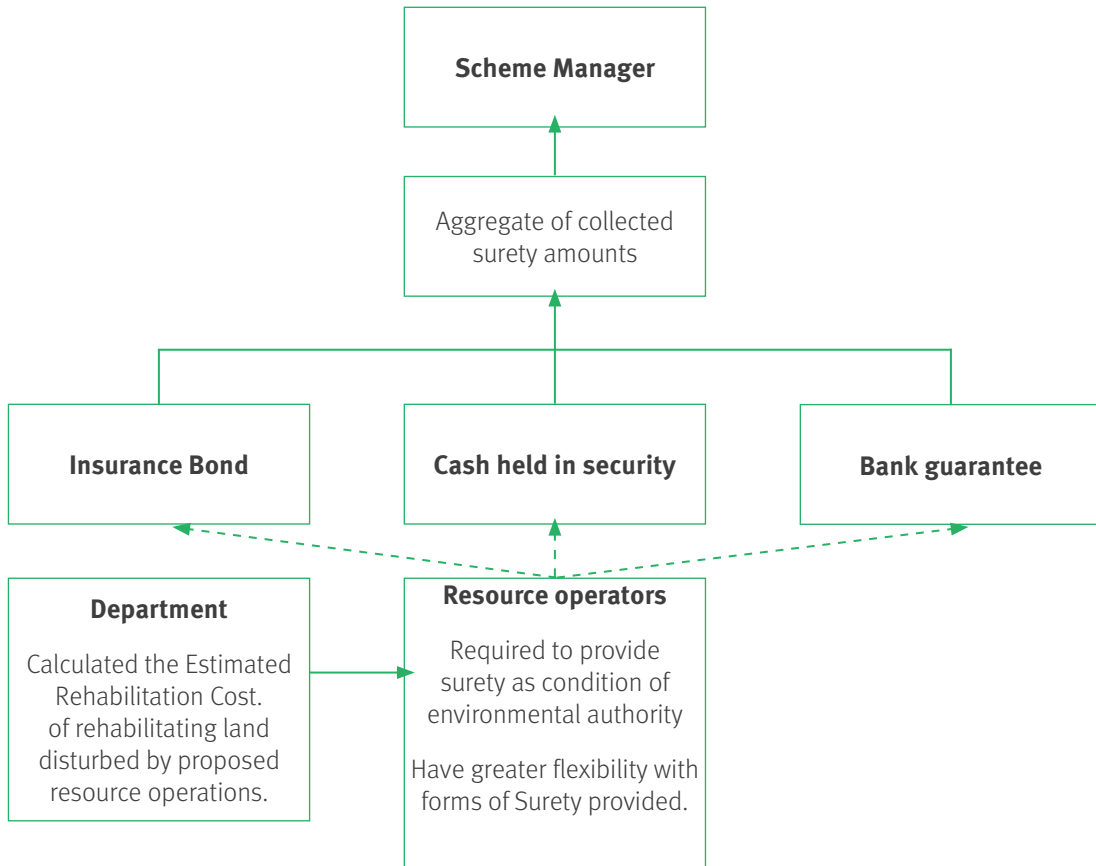
1. The Modular Approach

For those entities required to give surety, the State is proposing to take a modular, centralised approach.

Current framework	Tailored Solution framework: modular approach
The Department determines that amount and form of financial assurance	The Department will continue to calculate the estimated cost (Estimated Rehabilitation Cost) of rehabilitating land disturbed by the proposed resource activities Under the proposed new financial assurance framework there will be a Scheme Manager who will manage the scheme. The Scheme Manager will decide the amount of surety (Surety Amount), which will effectively equate to the estimated rehabilitation cost.
	Environmental authority holders that are required to provide surety will be entitled to adopt a ‘modular’ approach and have a combination of any of the acceptable forms of surety in order to provide the total Surety Amount. The types of surety which may be provided is expanded to include Insurance Bonds (discussed below).
	As the Surety Amount is varied (for example by progressive rehabilitation of disturbed land) the environmental authority holder will be entitled to request that the Scheme Manager release an existing financial assurance and replace it with different forms of surety. This process allows greater flexibility. For example a ‘cash float’ consisting of cash held in security may be utilised to cover short term financial assurance requirements. Resource operators will be better able to address their liquidity requirements as rehabilitation is completed under the modular approach.
	The Scheme Manager will determine a ‘minimum transfer amount’ in relation to variations of lodged surety. Environmental authority holders will only be able to request a release where the amount to be transferred is above the threshold amount.

	The Scheme Manager may determine a maximum balance over which the environmental authority holders will be unable to lodge further cash held in security, and must then lodge other forms of surety.
	It is proposed that the administration costs of the Scheme Manager be met equitably by all participants in the Financial Provisioning Scheme.

Summary of proposed feedback



Questions for public feedback?

Do you think participants would utilise the potential flexibility allowed by the provision of different forms of financial assurance surety?



2. Introduction of new forms of surety

Insurance Bonds

The QTC Review received feedback from several sectors for surety to be given in the form of insurance or ‘performance bonds’ (**Insurance Bonds**) issued by insurance companies or providers that are not authorised deposit-taking institutions. Under the modular approach, Insurance Bonds could be provided to satisfy all or part of the Surety Amount.

The Scheme Manager will publish the required form of Insurance Bond that is acceptable as Surety which will include terms that:

- it must be irrevocable
- it must allow on demand and unconditional payment to the Scheme Manager without any other financial or other action required by the Department or Scheme Manager
- be governed by Queensland law.

Annexure 1 to this paper is a draft of the proposed standard form surety instrument, that can be adapted for Insurance Bonds and Bank Guarantees as required.

There will also be requirements that an acceptable issuer of an Insurance Bond will be:

- companies authorised under the *Insurance Act 1973* (Cth) to carry on insurance business
- issuers not incorporated or regulated in Australia, provided that they are regulated by a regulator that the Treasurer approves in writing for that purpose
- meet certain rating criteria:
 - Fitch Ratings with an insurance claims-paying ability rating not less than A-, or
 - Moody’s Investors Service with an insurance financial strength rating not less than A3, or
 - Standard & Poor’s with an insurer financial strength rating not less than A-

Questions for public feedback?

Do you agree with the proposed criteria for Insurance Bond Issuers? Please provide us with details of any alternatives or amendments you would recommend?

What degree of separation do you think is required between a acceptable issuer of an Insurance Bond and the resource operator on behalf of which the Insurance Bond is issued?

Do you agree with the form of surety instruments attached to this paper? Please provide us with details of any alternatives or amendments you would recommend.

Other forms of surety

The current proposal is to expand the allowable forms of surety to include Insurance Bonds only. The QTC Review identified other forms of surety that are permitted in other jurisdictions however at this time it is not proposed to include those options. In particular:

- escrow arrangements involving cash (other than the types discussed below) present additional complexity and enforcement risk to the State
- non-cash collateral (such as equities and bonds) present additional operational complexity. Use of non-cash collateral also creates risks inherent to those types of sureties (such as the administrative burden of collateral holding arrangements, haircuts, market to market valuations, margin calls etc)

Questions for public feedback?

Do you agree with the form of Insurance Bond proposed in this paper? Please provide us with details of any alternatives or amendments you would recommend.

Should the Queensland Government consider any other alternative forms of surety beyond the types outlined? Please provide details.

3. Enhancements to existing surety requirements

In order to better manage the financial risk for the State and to provide participants with certainty around acceptance, the State proposes the following changes to cash held in security and Bank Guarantees.

Cash held in security

As noted above, the administration of the security interest held over cash will be undertaken by the Scheme Manager. In order to standardise the process:

- cash will be deposited in a bank account managed by the Scheme Manager (this account will be separate from monies held from contributions to the Financial Provisioning Scheme).
- there will be a standard suite of documents which will include priority and other documents to ensure that the risk of enforcement and registration under the *Personal Property Securities Act 2009* (Cth) is properly managed.
- There will be a streamlined document suite for resource operators that have a surety obligation of less than \$100,000
- Through a combination of agreed conditions and legislative provision, the Scheme Manager will retain interest earned on cash surety amounts and have power to use it for scheme purposes such as funding rehabilitation of existing abandoned mines and research into rehabilitation. An advisory committee established under legislation will be consulted in relation to proposals for expenditure on these purposes.

Bank Guarantees

It is not proposed that existing Bank Guarantees be replaced as a result of the reform package. However, going forward, the Scheme Manager will publish a single form of Bank Guarantee based on existing practice.

Annexure 1 to this paper is a draft of the proposed standard form surety instrument, that can be adapted for Insurance Bonds and Bank Guarantees as required.

Where circumstances require the amendment or lodgement of a new Bank Guarantee, it must comply with the revised form determined by the Scheme Manager.

As part of the efficient administration of the surety, the Scheme Manager may consider establishing electronic databases using Distributed Ledger or other 'Block Chain' technologies as an alternative to retaining physical custody of the surety documents.

Questions for public feedback?

Do you agree with the form of surety instruments attached to this paper? Please provide us with details of any alternatives or amendments you would recommend.

Would you agree with the introduction of technology to improve the administration of the Bank Guarantees, Insurance Bonds or other forms of FA Surety held by the Scheme Manager? If so, please describe what technologies you consider may be appropriate and how the Scheme Manager might use them to administer surety?



4. Implementation

It is intended that the revised surety measures outlined in this discussion paper will be implemented in conjunction with the broader package of reforms and apply from 1 July 2018.

More detailed information about the final form of the new regulatory requirements will be made available before that date to give resource operators time to implement any changes to their arrangements necessary to comply.

Please note that while it is intended the Scheme Manager will manage all financial assurance for resources activities, including existing sureties, from 1 July 2018, this will simply involve a transfer of administrative responsibilities between government agencies and will not necessitate changes to existing surety arrangements in place at that date.

Financial institution's undertaking in respect of environmental authority

NUMBER: **[xxxx] note: Financial institution to insert reference number (if applicable)**

ISSUER: [Financial Institution Name] [ACN/ABN [xxxx]] of [Financial Institution Address] ("Financial Institution")

BRANCH: **[xxxx] note: Insert Financial institution branch address if applicable: see notes below.]**

BENEFICIARY: **[The Scheme Manager (from time to time) of the Mineral and Energy Resources Financial Provision Scheme ("Scheme Manager")]**

APPLICANT: **[Company/Business Name] [ACN/ABN [xxxx]] of [Company/Business Address] ("Holder")**

BACKGROUND: The Holder has been granted Environmental Authority No. [xxxx] ("**Environmental Authority**").

The Financial Institution asks the Scheme Manager to accept this undertaking ("**Undertaking**") in connection with the Holder's [financial assurance obligations] in relation to the Environmental Authority.

MAXIMUM AMOUNT: **[Amount in words] in Australian dollars (A\$[Amount in figures])**

UNDERTAKING

The Financial Institution unconditionally undertakes and agrees as follows:

1. To pay to the Scheme Manager on written demand [made at the Branch, or any other branch or office of the Financial Institution in Australia], accompanied by [a certified copy of this Undertaking], any sum or sums which may from time to time be demanded by the Scheme Manager to a maximum aggregate sum up to the Maximum Amount. [Payment may be effected by bank cheque or by transfer to the bank account nominated in writing by the Scheme Manager.]
2. Upon the receipt of a written demand from the Scheme Manager for a sum or sums less than the Maximum Amount, the Financial Institution will issue to the Scheme Manager a new Undertaking for the balance of the Maximum Amount then remaining at the same time that payment by the Financial Institution of the amount demanded by the Scheme Manager is made and in exchange for this original Undertaking.
3. This Undertaking will remain in full force and effect until the first to occur of:
 - (a) payment by the Financial Institution of the Maximum Amount; or
 - (b) the Financial Institution is notified in writing by the Scheme Manager that the Undertaking is no longer required; or
 - (c) this Undertaking is returned to the Financial Institution.

In the event that clause 3(a) or 3(b) applies, the Scheme Manager will return this original Undertaking to the Financial Institution



4. This Undertaking is not to be regarded as a contract of surety and the liability of the Financial Institution is a primary liability, and not a secondary obligation, which will remain in effect notwithstanding any event affecting the relationship between the Holder and the Financial Institution including, without limiting this, those set out in clause 5.
5. Any payment or payments demanded by the Scheme Manager in accordance with the terms of this Undertaking will be paid forthwith:
 - (a) without reference to the Holder (even if the Holder has given the Financial Institution notice not to make the payment);
 - (b) without regard to the performance or non-performance of the Holder or Scheme Manager in relation to the Environmental Authority, or to any dispute between the Scheme Manager and the Holder;
 - (c) without the Scheme Manager first being required to exhaust any remedy it may have against the Holder or to enforce any other guarantee or security it may hold;
 - (d) without making any further enquiry, including as to the authority of any person signing for or on behalf of the Scheme Manager; and
 - (e) notwithstanding the grant of any time or other indulgence to the Holder or any other circumstance, act or omission.
6. The Financial Institution may at any time without being required to do so pay to the Scheme Manager:
 - (a) an amount equal to the Maximum Amount less any amounts it may previously have paid under this Undertaking; or
 - (b) such lesser sum as the Scheme Manager may require.
7. Return of this original Undertaking to the Financial Institution by the Scheme Manager will constitute a release of the obligations under this Undertaking.
8. The Financial Institution acknowledges that this Undertaking is for the benefit of the Scheme Manager of the [Mineral and Energy Resources Financial Provision Scheme] from time to time, and continues in full force and effect notwithstanding any change to the identity of the holder of that office. The benefit of this Undertaking is not otherwise able to be assigned, transferred, charged or dealt with by the Scheme Manager.
9. This Undertaking is governed by the laws of the State of Queensland [and all actions between the Financial Institution and the Scheme Manager including any and all payments made by the Financial Institution to the Scheme Manager pursuant to this Undertaking shall be undertaken in Australia].

DATED at.....this.....day of.....20.....

Signed