For professional investors - Marketing communication - November 2021

DECOMMISSIONING TRUST SOLUTION

Dalriada. A better way

BNP PARIBAS ASSET MANAGEMENT

The sustainable investor for a changing world

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Despite often representing the single largest liability for nuclear, oil & gas, power, mining and other traditional power companies, decommissioning (remediation / rehabilitation / restoration) liabilities have traditionally been ignored by sell-side equity analysts and ratings agencies alike.

The COVID pandemic and subsequent acceleration in the energy transition (to meet governmental climate change obligations) has resulted in a paradigm shift focussing investor attention on these balance sheet components. This has led many CFOs to consider the efficient management and disclosure of these liabilities as a key element of their immediate corporate strategy.

Apart from the nuclear sector, there is generally only an obligation to recognise these liabilities and no legal requirement (e.g. in the UK) to set aside funds. This creates a material financial challenge: funding multi-year and non-income generating expenses from revenues often associated with volatile commodity prices. Meeting these decommissioning costs therefore weighs on the debt capacity, dilutes earnings, drains available cash flows and puts additional pressure on credit ratings and thus share prices. In addition, the lack of a clear plan to address the de-commissioning responsibilities also potentially positions the asset owner in a poor light as regards ESG and climate change further threatening long term financial viability, potentially reducing sources of funding.

An alternative approach is to prefund the decommissioning liabilities to help capture excess returns from market investments. This approach offers a number of advantages, among others:

- A reduction in the overall decommissioning costs for the responsible companies;
- A mitigant against potential decommissioning cost over-runs and their impact on the corporate balance sheet;
- A reduction in balance sheet, cost of capital and credit rating pressure;
- Deleveraging and de-risking opportunities on balance sheet; and
- A positive proposition to shareholders, market, regulators and the public

UNDERSTANDING THE RANGE OF OPTIONS

A key question for those considering pre-funding long-term decommissioning liabilities is which vehicle is best adapted to host the financial investments (and in some cases the decommissioning liabilities themselves)?

Key factors	Cash flow funding	Escrow	Insurance company (incl Captive)	External Trust
Off Balance Sheet	No	No	No	Yes
Capital Efficiency	No	Yes	Yes	Yes
Transparency	Limited	Limited	Yes	Yes
Investment risk	No	Yes	Yes	Yes
Complexity	Limited	Limited	Depends on strategy and regulation	Depends on strategy
SRI / ESG	No	Yes	Yes	Yes

Of the alternative ways to manage financial remediation & decommissioning an External Trust presents itself as a superior solution

Source: BNP Paribas Asset Management

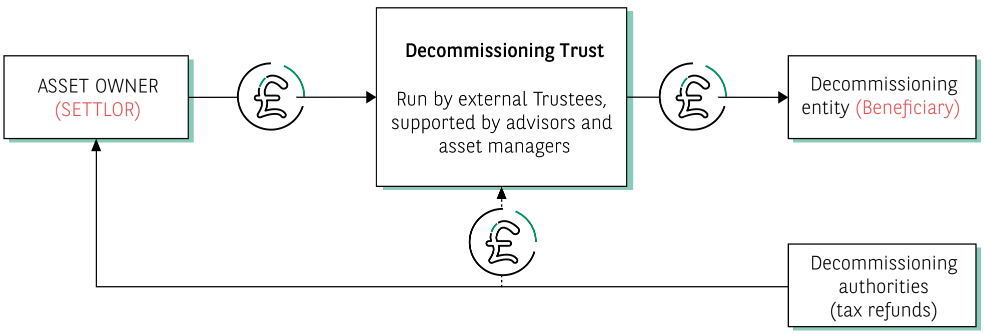
DECOMMISSIONING TRUST SOLUTION

The overall objective of a decommissioning trust solution is to help meet the asset retirement / **decommissioning obligations by holding dedicated financial assets in an external vehicle.**

- **Pre-Funding:** A trust solution provides a vehicle to manage the pre-funding investments dedicated to the asset retirement / decommissioning obligations.
- **Transfer of liability:** A trust solution reduces the on-balance sheet financial risk exposure of the asset owner by transferring the liability to an external party.
- **Energy transition:** A trust solution focuses the Settlor's energy transition objectives by putting actual investments in place to deliver decommissioning objectives.
- **Demonstrating ESG credentials:** There is the potential for the assets that are to be invested in the Trust to be raised through a 'green' bond and invested in assets with specific ESG objectives. When taken alongside the ESG benefits of the de-commissioning the overall approach cn significantly enhance ESG credentials.
- **Investment strategy:** A trust solution helps generate additional revenues (to direct payments) through invested assets to meet the decommissioning costs. In practice, a trust solution should reduce the decommissioning burden for the responsible company.

DECOMMISSIONING TRUST STRUCTURE

Trust structures have long been used by corporate entities to ring-fence pension assets and liabilities and hence are well understood. The asset owner (Settlor) appoints the trustee and decommissioning entity (Beneficiary) and creates the governance framework for the management of the assets.



Source: BNP Paribas Asset Management

As separate legal entities assets and liabilities may be transferred 'off balance sheet' though accounting standards may still require that net obligations are included as footnote to financial statements. Ratings agencies in turn therefore may, as has been seen with pension liabilities, simulate the pre-funding of obligations when determining credit-ratings. In order to reduce this potential impact if it is a pre-requisite to pre-funding asset owners would need to consider (as with pension buy-outs) whether the liabilities could be passed to an insurance or reinsurance company as part of the trust's creation.

DECOMMISSIONING TRUST BENEFITS

- Proven approach in other liability situations
- Brings objectivity but with a degree of control – sponsor can replace trustees
- Allows Company to move liabilities off balance sheet which fits with investor and regulator preferences
- Subject to some level of investment risk, pre-funding through a Trust allows investment returns to fully or partly meet decommissioning costs
- External expertise can be sought on the nature and timing of the liabilities so that the investment strategy can be aligned
- Being seen to be providing for decommissioning costs will be looked upon very favourably by markets, the public and regulators alike
- Tax benefits to be had

BNPP AM

The pre-funding of decommissioning liabilities is analogous to UK Defined Benefit pension requirements industry, where the legal ring-fencing and pre-funding of liabilities is enshrined in law. Whilst that may not currently be the case for all decommissioning liabilities the best practises that have been developed over many decades will help corporates shape and govern pre-funded decommissioning solutions. Over the last decade BNPP AM has extended this expertise to decommissioning clients within the nuclear, mining and oil and gas sectors.

Drawing on this expertise BNPP AM is able to offer decommissioning clients:

- Optimised modelling of asset portfolios to meet client liabilities through the Multi-Asset and Quantitative Solutions (MAQS) division.
- Utilise public and private markets to build innovative cash-flow driven investing (CDI) portfolios.
- Origination of private debt and real assets in tandem with the BNP Paribas Group (including climate aligned ESG assets).
- Offer a fully bundled investment solution utilising the custodial, loan administration and loan servicing capabilities of BNP Paribas Security Services.
- Ongoing portfolio management of the CDI portfolio encompassing capital calls, cash management (of principal re-payments and interest), re-investment, active asset allocation and FX hedging.

DALRIADA

Dalriada is one of the largest professional pension scheme trustee companies in the UK offering advice on scheme transactions and restructuring, governance and secretariat services. In the context of decommissioning Dalriada will offer corporates independent structuring and governance advice, able to bring independent and professionally accredited trustees to monitor and manage the Trust and Trust's advisors. Dalriada is recognised as a market disruptor with a passion for creating real intellectual and commercial value for clients. This means having the appetite to accelerate the journey from concept to adoption, finding a way to deliver real advantages over the competition.

Drawing on this expertise Dalriada is able to offer decommissioning clients:

- Advice pertaining to the most suitable pre-funding structure (e.g. cash-flow, escrow, captive or trust based solution).
- Effective engagement with sponsor, decommissioning entity, regulator and tax authorities.
- Assistance with the structuring and creation of the Trust.
- Experience in monitoring third-party asset managers responsible for the CDI investment portfolio.
- Expertise related to ESG and stewardship.
- Ongoing governance advice and participation by professional trustees brings objectivity and independence.

OUR COMBINED SOLUTION

BNPP AM and Dalriada have formed a strategic partnership to offer corporates with decommissioning liabilities a full end-to-end solution. This partnership offers decommissioning clients:

- A proven approach to liability driven investment and decommissioning.
- Utilising investment returns to lower the cost of decommissioning.
- Allows the corporate to move liabilities off the balance sheet which meets investor and regulator preferences.
- Enhancing the ESG credentials of the corporate by investing pre-funding proceeds into climate aligned assets.
- Governance arrangements offer independence and objectivity whilst the sponsor can retain overall control.

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