

Risk Evaluation and Financial Assurance
Work Group
Draft Options for RAC Review

October 9, 2018

CZCPA Risk Evaluation and Financial Assurance Work Group

Initial Scope Issue #1 Strawman: Standard Financial Assurance Instruments

Summary Overview: The attached table identifies the different types of financial instruments commonly considered for use in a financial assurance (FA) context, provides a brief description of each instrument, identifies pros and cons, and identifies the federal programs that make use of them and the extent to which they are used to address compensatory damages and/or third party liability.

Financial Instrument	General Description	Pros	Cons	Alignment with Federal FA Regulations
Trust Fund	A grantor (owner/operator) transfers funds equal to the current cost estimate to a trust fund. The Trustee (financial institution) administers the trust for its designated purpose on behalf a designated beneficiary (regulator). It provides annual valuation statements to the Beneficiary. Funds are immediately available to the Regulator. The Trustee charges fees for administrative services	<ol style="list-style-type: none"> 1. Funds are immediately accessible. 2. Owner/operator no longer has direct access to the corpus of the trust without beneficiary approval. 3. Activities can be reimbursed to the owner/operator for approved activities. 4. Some trusts allow owner/operator to direct investments of the Trust. 5. Generally self-implementing, requires minimal regulatory oversight. 6. Generally best for long-term activities 7. If fully funded, can be an effective instrument in the event of owner/operator default, as funds are immediately available to the regulator. 	<ol style="list-style-type: none"> 1. Unless the trust realizes a rate of return equal to or greater than the rate of inflation, the corpus of the trust can erode over time. 2. Can be prohibitively expensive to the owner/operator, especially if the owner/operator is not allowed a pay-in period. 3. Unless/until the trust is fully funded, any withdrawal of principal balance ahead of schedule may yield insufficient funds for future activities. 	RCRA Subtitle C (HzTSDs), RCRA Subtitle D (SWMUs), RCRA Subtitle I (UST) SMCRA (Mining), CERCLA, SDWA (UIC), TSCA Compensatory Damages Established templates available
Letter of Credit	A document issued by a financial institution that guarantees payment of a customer's (owner/operator's) obligations up to a stated amount for a specified period of time. Requires the use of	<ol style="list-style-type: none"> 1. Funds are immediately accessible. 2. Once the LOC is called, and poured into the Standby Trust Fund, the owner/operator no longer has direct 	<ol style="list-style-type: none"> 1. Unless the LOC has an auto update provision increasing the face value for changes in inflation annually, the face value may not reflect actual purchasing power at the time of draws. 	RCRA Subtitle C (HzTSDs), RCRA Subtitle D (SWMUs), RCRA Subtitle I (UST) SMCRA (Mining), CERCLA, SDWA (UIC), TSCA

Financial Instrument	General Description	Pros	Cons	Alignment with Federal FA Regulations
Letter of Credit (cont.)	a Standby Trust Fund, wherein the stated beneficiary is the regulator.	access to the funds with out beneficiary approval. 3. Activities can be reimbursed to the owner/operator for approved activities. 4. LOCs should be evergreen (auto-renewed) and irrevocable. 5. Generally self-implementing, requires minimal regulatory oversight. 6. Generally best for short- to medium-term activities	2. Expense ratio is dependent on company financial health. Can be expensive to the owner/operator, if the owner/operator is in poor financial health, and is required to post collateral equal to the face value of the instrument. 3. The terms and conditions of the LoC will dictate survivability of the instrument in bankruptcy. 4. Not appropriate for long-term activities.	Established templates available
Surety Bond	The Surety provides its financial backing to the Principal (owner/operator) and guarantees the Principal’s obligations up to the penal sum of the bond. While the Principal is primarily responsible, if the Principal defaults on its obligations, as described in the bond, the Surety assumes responsibility for payment. The Surety will pursue reimbursement from the Principals. Surety bonds can be performance or financial guarantee (payment). If financial guarantee, a standby trust generally is established into which the Surety pours funds for use by the Obligee (the regulatory)	1. Funds are immediately accessible, as long as certain provisions are met consistent with the requirements of the bond. Particular attention needs to be paid to bond details. 2. In general, only the obligee can direct draws on the bond consistent with the terms of the bond for obligations approved thereunder. 3. Generally self-implementing, requires minimal regulatory oversight as long as the fundamentals of the bond cover the breadth of activities desired by the regulator. 4. Generally best for short- to medium-term activities, and well-defined environmental activities.	1. Availability tends to be a function of the breadth of obligations covered and intended coverage period (i.e., time). 2. Expense ratio is dependent on company financial health. Can be expensive to the owner/operator, if the owner/operator is in poor financial health, and is required to pay premiums equal to the PV of the future expected stream of costs. 3. Market accessibility of surety bonds is constrained for certain environmental activities.	RCRA Subtitle C (HzTSDs), RCRA Subtitle D (SWMUs), RCRA Subtitle I (UST) SMCRA (Mining), CERCLA, SDWA (UIC), TSCA Third-Party Liability Established templates available

Financial Instrument	General Description	Pros	Cons	Alignment with Federal FA Regulations
Insurance	Contract between two parties, whereby the Insurer agrees to pay, on behalf of the Policyholder (owner/operator) for claims made against the policy. In general, such claims are made with the authorization of the named insured (the beneficiary).	<ol style="list-style-type: none"> 1. Funds are immediately accessible, as long as certain provisions are met consistent with the requirements of the insurance policy, including all endorsements and exclusions. Particular attention needs to be paid to plan details. 2. Requires regulatory oversight to the extent partial claims are made against the policy for approved environmental activities. 3. Generally best for short- to medium-term activities, and well-defined environmental activities that fall within standard policy coverages. 	<ol style="list-style-type: none"> 1. Availability tends to be a function of the breadth of obligations covered and intended coverage period (i.e., time). 2. Exclusions or endorsements can limit regulator access to insurance coverages. Regulator should ensure that activities identified by the regulator qualify as covered activities under the insurance policy. 3. Expense ratio is dependent on company financial health. Can be expensive to the owner/operator, if the owner/operator is in poor financial health, and is required to pay premiums equal to the PV of the future expected stream of costs. 4. Market accessibility of insurance is constrained for certain environmental activities. 5. Can be burdensome for the regulator if the span of coverages is extensive, and the policy is claims reimbursement upon approval of the regulator. 6. Insurance is a contract between the insurer and the insured for the benefit of the regulator. 	<p>RCRA Subtitle C (HzTSDs), RCRA Subtitle D (SWMUs), RCRA Subtitle I (UST) SMCRA (Mining), CERCLA, SDWA (UIC), TSCA</p> <p>Third-Party Liability</p> <p>Established templates available</p>

Financial Instrument	General Description	Pros	Cons	Alignment with Federal FA Regulations
Insurance (cont.)			<ol style="list-style-type: none"> 7. Insurance companies can cancel policies, add exclusions or otherwise change plan terms in ways that reduce its effectiveness/sufficiency as a financial assurance instrument. The regulator should ensure that it receives advance notification of policy cancellation or policy changes and reviews all exclusions/endorsements carefully. 8. In bankruptcy, the regulator may need to make premium payments to avoid cancellation of the policy. 	
Liquid Instruments	<p>The Principal (owner/operator) provides the <i>liquid</i> instrument to the Regulator. The instrument is held as an offset to the Principal's obligations. Liquid instruments generally include: Cash, check, escrow accounts, CDs, Treasury/Municipal bonds.</p>	<ol style="list-style-type: none"> 1. Readily available funds 2. Generally best for very short-term, clearly-defined activities by owner-operators with very low chances of default. 	<ol style="list-style-type: none"> 1. If not carefully structured, the liquid instrument may be cashed out or canceled by the Principal prior to forfeiture. 2. At the state-level, there is the concern of Miscellaneous Receipts Act provisions. 3. Likely inappropriate for long-term activities, especially if there is concern about owner-operator default down the road. 	SMCRA (Mining)
Self-Insurance	<p>The owner/operator provides certification of a Corporate Financial Test (with, in some instances, a Corporate Guarantee). The certification entails compliance with an array of financial metrics,</p>	<ol style="list-style-type: none"> 1. Provides maximum flexibility to the owner/operator in so far as funds are not set aside in a dedicated account, nor is the owner/operator required to set aside an environmental reserve. 	<ol style="list-style-type: none"> 1. In general, regulator does not have direct access to funds. 2. Generally best for short- to medium-term activities, wherein 	RCRA Subtitle C (HzTSDs), RCRA Subtitle D (SWMUs), RCRA Subtitle I (UST) SMCRA (Mining), CERCLA, SDWA (UIC), TSCA

Financial Instrument	General Description	Pros	Cons	Alignment with Federal FA Regulations
Self-Insurance (cont.)	as well as financial reporting requirements.	2. Owner/operator (or guarantor) assumes responsibility for payment of all covered activities in the amounts and timing required.	the owner/operator has demonstrated financial strength. 3. Past financial performance is not a guarantee of future financial performance, and availability of funds.	Third-Party Liability Established templates available

Additional Information

For all financial assurance instruments, regulators need to consider building in mechanisms to update covered amounts to address inflation and/or other changes in costs if covered events occur.

CZCPA Risk Evaluation and Financial Assurance Work Group

Initial Scope Issue #2 Strawman: Options for Identifying Existing Financial Assurances at a Site

Summary Overview: The Work Group (WG) believes that conversion permit financial assurance should avoid duplicating existing financial assurances (FA) applicable to the site and address only those elements where existing coverage is absent or insufficient for Delaware’s needs. The WG recommends that the RAC consider including a requirement in the conversion permit regulations for applicants to identify existing financial assurance relevant to a site.

Options: The RAC could address this issue by:

- *Option #1: Disclose all Site FA.* Requiring applicants to identify all existing financial assurance related to the site;
- *Option #2: Disclose CZCPA-related FA.* Requiring applicants to identify only financial assurances associated with portions of the site/activities involved with the proposed converted/new use; or
- *Option #3: Flexible Disclosure.* Allowing applicants to choose what FA information to provide, based on their judgment of what the Secretary of DNREC would need to make a conversion permit decision (with the DNREC having the ability to request more information).

Option #1: Disclose all Site FA

<u>Pros</u>	<u>Cons</u>
<ul style="list-style-type: none"> • Some issues/risks to be considered as part of the CZCPA process (e.g., sea level rise) might, by their nature, be relate to the entire site. • Disclosure of all FA related to a site is not likely to be burdensome to the applicant. • Applicants may want to identify all existing FA at the site, as that information may help minimize additional FA required for the conversion permit. 	<ul style="list-style-type: none"> • For some applicants, portions of a site and/or some site activities may have nothing to do with the proposed converted/new use. Extraneous information should not be required by the CZCPA process.

Option #2: Disclose CZCPA-related FA

<u>Pros</u>	<u>Cons</u>
<ul style="list-style-type: none"> • Focuses on information most relevant to the CZCPA process. 	<ul style="list-style-type: none"> • DNREC may not agree with applicant judgment about portions of the site/activities relevant to the CZCPA process.

Option #3: Flexible Disclosure

<u>Pros</u>	<u>Cons</u>
<ul style="list-style-type: none"> • Provides application-specific flexibility to tailor FA information provided. • DNREC can require additional information, if needed. 	<ul style="list-style-type: none"> • DNREC does not receive a “standard” set of information for each application, which may complicate evaluation. • May increase the likelihood of “back and forth” communication between DNREC and the applicant regarding FA information, which may add time to the conversion permit application process.

Additional Information: To the extent Options 1 and/or 3 are utilized by the RAC, for evaluation purposes it would be helpful to have applicants identify “CZCPA-related” financial assurance in one part of the application and “other site-related” financial assurance in a following part. If the RAC requires applicants to provide information about existing financial assurance relevant to a site and site activities (or a portion thereof), the WG suggests that the RAC consider specifying minimum information requirements about each relevant financial insurance instrument, such as:

- Type of instrument
- Issuing financial institution
- Face value
- Expiration date/time period
- Regulatory authority/reason for which the instrument was obtained
- Conditions under which the instrument may be accessed
- Conditions under which the instrument may be canceled
- All named beneficiaries

CZCPA Risk Evaluation and Financial Assurance Work Group

Initial Scope Issue #6 Strawman: Ensuring DNREC Has Access to Financial Assurance Expertise and/or Third-Party Verification

Summary Overview: Conversion permit decision-makers may not have the internal resources necessary to critically evaluate financial assurance information provided in support of CZCPA permit applications. Options for addressing this issue are identified below.

Options: The RAC could address this issue by:

- *Option #1: 3rd Party Verification.* Integrating third party verification into the conversion permit application process;
- *Option #2: DNREC Hires Consulting Expert.* Charging applicants a reasonable processing fee to provide funding for DNREC's Coastal Zone Act program to hire financial assurance experts (on a consulting basis); or
- *Option #3: Leverage Delaware Expertise.* Leverage existing financial assurance expertise from other Delaware state programs with established financial assurance divisions.

Option #1: 3rd Party Verification

<u>Pros</u>	<u>Cons</u>
<ul style="list-style-type: none"> • Minimizes burden on DNREC to corroborate key FA information submitted by the applicant. • Provides applicant flexibility to choose verification consultant/company, subject to DNREC approval. 	<ul style="list-style-type: none"> • Safeguards need to be put in place to ensure that the third party is "arm's length" from the applicant.

Option #2: DNREC Hires Consulting Expert

<u>Pros</u>	<u>Cons</u>
<ul style="list-style-type: none"> • DNREC's Coastal Zone Act program is able to directly interact with the FA expert to ask questions/explore potential concerns. • Cost of expert could be covered through a permit fee. 	<ul style="list-style-type: none"> • Increased administrative complexity to identify and contract with expert. • Depending on fee amount, fees may act as a deterrent to potential conversion permit applicants.

Option #3: Leverage Delaware Expertise.

<u>Pros</u>	<u>Cons</u>
<ul style="list-style-type: none">• Least costly option for the applicant.	<ul style="list-style-type: none">• Delaware employees with financial assurance expertise may not have availability to assist review of conversion permit applications. The Work Group believes DNREC would need to hire an employee with financial assurance expertise to implement this option.

Additional Information: If the RAC chooses to integrate third-party verification into the conversion permit regulatory process, potential requirements for establishing entities as viable third parties commonly include:

- Appropriate licensing, professional qualifications
- A contractor with no existing/other business relationship with the applicant
- Must be pre-approved by the regulator, or be part of a pre-established list of acceptable practitioners issued by the state