Financial Assurance Primer

Deliberative - For Work Group Discussion Purposes Only

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Congress and State legislatures have mandated that owners and operators provide financial guarantees for the safe management of activities that may result in environmental harm.

- **Intent.** Polluter Pays’ principle.
- **Intent.** Minimize the number of orphaned/abandoned facilities.
- **Intent.** Minimize environmental risks from facility releases.

Financial responsibility presumes that the project developer is an active business entity. Capable of setting aside funds today to pay for future expected environmental obligations.
Market Impacts of Effective FA

• **Capital Investment.** Encourage firms to design and site facilities to minimize adverse environmental costs, and thereby maximize financial returns.

• **Deterrence & Precaution.** Foster operating decisions that consider risk, and reduce the likelihood of environmental injury and attendant damages.

• **Optimal Pricing & Consumption.** Stimulate firms to appropriately internalize costs, and thereby prevent excessive consumption of environmentally damaging goods.
Financial Assurance Design Considerations

• Effective financial assurance will support activities in an economically efficient, yet safe and environmentally sound manner by encouraging sound site selection and sound operational behavior.

• An effective framework will assure funds are available to:
  
  • **Pay for activities necessary to detect problems** before they adversely impact public welfare or the environment.
  
  • **Finance remedial action** should such action become necessary.

• It also will establish minimum standards for companies that choose to self-insure, or for financial institutions managing funds or underwriting risk; and should ensure continuity of financial assurances, when ownership of sites is transferred.
<table>
<thead>
<tr>
<th>Statute</th>
<th>Activities Covered</th>
<th>CFR Citation</th>
</tr>
</thead>
<tbody>
<tr>
<td>SDWA</td>
<td>Plugging and Abandonment</td>
<td>40 CFR 144.63</td>
</tr>
<tr>
<td>UIC Class VI</td>
<td>Criteria and Standards Applicable to Class VI Wells</td>
<td>40 CFR 146</td>
</tr>
<tr>
<td>RCRA Subtitle C</td>
<td>Hazardous Waste Closure, Post Closure, Corrective Action, and Third Party Liability</td>
<td>40 CFR 264.143</td>
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<td></td>
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<td>40 CFR 264.145</td>
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<td>40 CFR 264.147</td>
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<tr>
<td>RCRA Subtitle D</td>
<td>MSWLF Closure, Post Closure, and Corrective Action</td>
<td>40 CFR 258.74</td>
</tr>
<tr>
<td>RCRA Subtitle I</td>
<td>Corrective Action and Third-Party Compensation</td>
<td>40 CFR 280.93</td>
</tr>
<tr>
<td>TSCA</td>
<td>PCB Storage Facility Closure</td>
<td>40 CFR 761.65.g</td>
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<tr>
<td>CERCLA</td>
<td>Hazardous Waste Remedial Action</td>
<td>Section 108(b)</td>
</tr>
<tr>
<td>SMCRA</td>
<td>Surface Coal Mining and Reclamation</td>
<td>30 CFR 800</td>
</tr>
</tbody>
</table>
Standard Financial Assurance Instruments

- Third-Party Instruments
  - Liquid Instrument
    - Escrow Accounts
  - Letter of Credit
  - Insurance
  - Surety Bond
    - Financial Guarantee
    - Performance
  - Financial Test
  - Corporate Guarantee
- Self Insurance
  - Collateral
  - Bond Pools
  - Trust Fund
- Alternative Instruments
• Accurate and current cost estimates are essential to ensuring effective financial assurance.
  • Identify the site characteristics, conditions and factors that drive the estimated costs of each required activity.
  • Understand the timeframe over which activities will occur.
  • Estimate the dollar amount(s) required to complete the array of required activities.
  • Ensure sufficient funds are available in the timing and amounts necessary.

• In general, costs are a function of plant design and location, and must be estimated on a site-specific basis.
Step 1. Describe the Covered Activity

Step 2. Identify the Cost Components
- Site Characterization
- Capital Costs
- O&M Costs
- Periodic Costs

Step 3. Estimate Costs by Activity and Component

Step 4. Apply Contingency Factor
Does significant uncertainty exist in key cost factors?
- Yes: Sensitivity Analysis
- No

Step 5. Review & Finalize Cost Estimate

Does significant uncertainty exist in key cost factors?
## FA & Risk Management

<table>
<thead>
<tr>
<th>Financial Responsibility Mechanisms</th>
<th>Site Life Cycle</th>
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<tbody>
<tr>
<td></td>
<td>Active Operations</td>
<td>Closure / Post-Closure</td>
</tr>
<tr>
<td>1. Third-Party Instruments (Trust Funds, LOCs, Insurance, Bonds)</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>2. Self-Insurance (Financial Test, Corporate Guarantee)</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3. Public/Private Risk Sharing (Compensation Funds Risk Pooling Models Insurance Mutuals)</td>
<td><strong>No</strong></td>
<td><strong>No</strong></td>
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</table>