ATTACHMENT I

RESPONSE TO RECOMMENDATION 4.1 – EPA's Plan for Addressing Concerns with the Existing Financial Assurance Regulations.

A. The Corporate Financial Test

EPA's experience and information is that the financial test and other financial assurance mechanisms have been effective elements of the hazardous waste program. The third-party financial assurance mechanisms have had a salutary effect in weeding out marginal facilities, and the financial test has similarly been effective in denying self insurance to economically marginal facilities. There have been relatively few documented cases of "failure" of the financial test leading to costs to the taxpayer.[1] However, EPA also recognizes the potential vulnerability of any "self insurance" mechanism[2] (we proposed changes to the test in 1991[3]), as well as the difficulties States and EPA Regions have had in implementing the current test. In response to concerns with the financial test and other aspects of the financial assurance program, in March 2004, EPA requested the Environmental Financial Advisory Board (EFAB), a federal advisory committee to EPA, to review a series of questions about the financial test, insurance and other aspects of the financial assurance program.

These concerns[4] have come from a variety of sources, including regulators and the regulated community. The concerns range from apparent inadequacies of the test itself to implementation issues related to the difficulty of oversight and the adequacy of expertise available to review test submissions. We have worked with the EPA Regions and States and other interested parties to address the identified concerns, and have developed a range of options to address issues related to the financial test. Some of these options are non-regulatory, such as training and securing specialized expertise for

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[1] The 2005 Inspector General's report noted two companies that passed the financial test, and subsequently entered or nearly entered bankruptcy. In one case, the State successfully obtained a trust fund from the company; in the other, the State successfully obtained an insurance policy.

[2] *See* for example, Discussion Paper 01-42, James Boyd, Resources for the Future, "Financial Responsibility for Environmental Obligations: Are Bonding and Assurance Rules Fulfilling Their Promise," August, 2001.

[3] *See* 56 FR 30201, July 1, 1991.

[4] This document addresses only the regulatory issues that have been raised. Specific concerns that have been raised include: (1) some States may lack the expertise required to review submissions; (2) the regulations allow companies to report information that is derived from their audited financial statements, and there may be no clear road map from the filing to the derivations, so States are uncertain whether these are appropriate derivations; (3) the test relies upon balance sheet information that may not reflect all of a company's environmental obligations; (4) the regulations do not clearly require the reporting of cleanup obligations; (5) the test relies on an inappropriate bond rating specification because it can be based upon the collateral backing the bond and acceptance of the lowest level of investment grade (e.g. BBB-); (6) the test is not as predictive of bankruptcy or ability to pay as the EPA tests in the standardized permit rule and for private owners and operators of municipal solid waste landfills (MSWLFs); and (7) some financially sound companies are not eligible to use it to assure all obligations associated with their facilities, and thus incur increased costs to comply with the financial assurance regulations.

difficult reviews. The major regulatory options under consideration at this time (some of which may be pursued together) are: (1) the status quo – that is, no regulatory changes; (2) issue a final rule based on the July 1, 1991 proposed Subtitle C financial test,[5] as modified in the Standardized Permit Rule;[6] (3) require companies using the ratio alternative of the financial test to receive a third-party assessment of their credit position, as recommended by the EFAB;[7] (4) modify the bond rating component of the test;[8] and (5) address documentation requirements for the RCRA Subtitle C financial test.[9]

Based on our current schedule, and with input from the EPA Regions and States, we expect to make a decision on whether to proceed with a rulemaking by the second quarter of FY 2007. During the first and second quarters of FY 2007, EPA will collect current financial information on companies that own or operate treatment, storage or disposal facilities; solicit additional cases of financial test failures; and assemble recent information on special reports. If the Agency decides to proceed with a rulemaking, it will develop a schedule and publish it in the Administrator's Regulatory Agenda.

B. Insurance

The Agency is gathering information on the use of insurance for financial assurance. This involves two major efforts.

Study on Insurance

The Agency is preparing a study focusing on insurance for solid waste landfills to determine if sufficient safeguards have been properly maintained and future liabilities minimized.[10] Some of the concerns that have been identified include possible failure of the insurer, complexity of policy wording, regulatory oversight, and disclosure.

Captive insurance is defined as insurance issued by a wholly-owned subsidiary of the company being insured.[11] In recent years, concerns about the use of captive insurance (and insurance in general) as a financial assurance mechanism have emerged from a

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[5] *See* 56 FR 30201, July 1, 1991, proposal to revise: 1) the financial test criteria for closure and post-closure care by amending the financial ratio requirements; and 2) the financial test criteria for closure, post-closure, and third-party liability coverage by amending the net worth and net working capital multiples.
[6] *See* 70 FR 53419, September 8, 2005.
[7] *See* Letter from the Environmental Financial Advisory Board to EPA Administrator, January 11, 2006. A copy is available from Dale Ruhter in the Office of Solid Waste.
[8] *See* Letter from the Environmental Financial Advisory Board to EPA Administrator, January 11, 2006.
[9] *See* Office of the Inspector General Evaluation Report: Continued EPA Leadership Will Support State Needs for Information and Guidance on RCRA Financial Assurance, September 26, 2005.
[10] EPA's 2001 appropriations bill included language that expressed concerns about the potential lack of sound environmental insurance coverage at solid waste landfills. Therefore, the bill directs the Administrator to conduct a study of existing financial assurance agreements to determine if sufficient safeguards have been properly maintained, and future liabilities minimized.
[11] *See* EPA Office of Inspector General Report: Continued EPA Leadership Will Support State Needs for Information and Guidance on RCRA Financial Assurance, September 2005.

number of sources, including the Association of State and Territorial Solid Waste Management Officials (ASTSWMO), the OIG, and the State of California.

Based on these concerns, several options have emerged for consideration. In the case of insurance policies issued by an independent insurer, options include establishing a minimum rating, exploring uniform policy language, and requiring additional disclosure/policy declaration. In the case of captive insurance, options include requiring or encouraging fronting,[12] establishing a minimum rating, and requiring a policy declaration. We expect a draft of the study to be ready to enter an internal EPA review process by the second quarter of FY 2007.

Environmental Financial Advisory Board (EFAB)

In March 2004, EPA requested that the EFAB review a range of issues, including use of insurance as a financial assurance mechanism. The Agency specifically requested that the EFAB consider the strengths and weaknesses of insurance as a mechanism, the need for minimum ratings of insurers, whether a captive insurance policy should be considered equal to a policy written by a commercial insurer, whether such policies should be written differently, whether standardized policy language should be developed, and what safeguards are appropriate for insurance policies written for Brownfields cleanups. After its work on the financial test, the EFAB convened a workshop on captive insurance in June 2006, and continues to examine the issue.

In light of the ongoing efforts in this area, we are not in a position at this time to make a determination regarding whether to amend the existing regulations related to the use of insurance as a financial assurance mechanism. We will continue conducting the study of the use of insurance, and consider additional information as it becomes available. In addition, we will continue to receive input from the EFAB as it progresses in its efforts. After the EFAB provides findings on the issues we presented to them and with the information from our study on insurance, we will commit to a schedule for deciding whether to pursue a rulemaking related to insurance (including captive insurance) as a financial assurance mechanism. Based on our current expectations, OSWER expects to be in a position to make such a decision within one year after receiving EFAB's recommendations and completing the insurance study. If the Agency decides to proceed with a rulemaking, it will develop a schedule and publish it in the Administrator's Regulatory Agenda.

[12] "Fronting" is a form of reinsurance. In a fronting arrangement, an independent commercial insurance company issues a policy, and a company (or a captive insurer) reinsures the policy and reimburses the independent insurance company for costs paid. (For a discussion of fronting, *see* the March 30, 2001 Office of Inspector General Audit Report entitled "RCRA Financial Assurance for Closure and Post-Closure").

C. Financial Assurance for Corrective Action

In 1986 and in 1990, the Agency proposed detailed regulations for financial assurance for corrective action.[13] In 1996, the Agency again revisited the issue of whether detailed regulations governing financial assurance for corrective action were needed.[14] For a variety of reasons, the Agency did not promulgate detailed regulatory requirements in this area. Rather, the Agency continues to rely on guidance to implement the requirements in 40 CFR 264.101 that financial assurance be provided for corrective action.

Based on information gathered through years of implementing the corrective action program, and through the above-mentioned rulemakings and other outreach efforts, the Agency has identified several key areas for potential guidance development. Those areas include the timing of financial assurance for corrective action, cost-estimating, financial assurance mechanisms, and discounting of costs for long-term care.

EPA already has issued guidance in some of those areas. For example, in a September 30, 2003, guidance entitled "Interim Guidance on Financial Responsibility for Facilities Subject to RCRA Corrective Action," the Agency provided guidance on the timing of financial assurance, cost estimating, and available financial assurance mechanisms. At the same time, we recognize that there continues to be a need for additional guidance in these areas, and in other areas related to financial assurance for corrective action. We continue to hear from Regions and States that they would like to see guidance and/or rulemaking to address financial assurance for corrective action, particularly, the timing of financial assurance for corrective action, cost-estimating, and discounting of costs for long-term care.

At this time, the Agency does not have sufficient basis to conclude that detailed rules governing financial assurance for corrective action are needed, and we have not made a decision, at this time, to pursue regulatory changes to the general requirement for financial assurance in 40 CFR 264.101. During FY 2007, the Agency will establish a workgroup, which will include representatives from the Regions and States, to address issues related to financial assurance for corrective action. Through this workgroup, we will identify and work through issues in this area, and identify areas where we need to develop new guidance (or enhance our existing guidance). If during this process, information arises indicating that the current regulations may not be adequate, we will assess whether regulatory changes in this area are needed.

We also will continue to look to the Superfund program to help us identify approaches adopted by that program that RCRA program implementers might adopt. In addition, we have entered into a dialogue with industry on financial assurance for corrective action, which will inform our approaches.

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[13] *See* 51 FR 37854, October 24, 1986, and 55 FR 30798, July 27, 1990.

[14] *See* 61 FR 19432 at 19463, May 1, 1996, where the Agency solicited comment on the need for detailed corrective action financial assurance regulations.

D. Financial Assurance for Post-Closure Care Beyond 30 Years

As many facilities approach the end of the 30 year post-closure care period for regulated units (as required under the regulations at Parts 264 and 265 Subpart G), greater attention is being focused on whether continued care is needed beyond that period. Although the RCRA regulations currently allow for the post-closure care period to be adjusted,[15] under the Subpart H regulations, there are financial assurance challenges associated with extending the care period. For example, questions arise regarding how to revise cost estimates to cover activities that may extend for prolonged periods of time (particularly once a facility has entered the post-closure care period), whether there are particular procedures that should be followed if these costs are assured by third-party mechanisms, and how to ensure that a financial assurance mechanism will continue to be available to cover the costs of long-term activities. (These same issues, or similar issues, arise for long-term post-remedial financial assurance for RCRA corrective actions, although the current regulations for corrective action provide more flexibility.)

During FY 2007, we will work with program implementers as they confront long-term post-closure care situations, and determine whether financial assurance can be effectively implemented through existing regulations, or whether regulatory changes are necessary. We are aware that a number of Regions and States are developing their own approaches to implement long-term post-closure care within the current regulatory structure, and we will have further discussions with them on this issue. Thus, we are not currently pursuing regulatory revisions to the financial assurance requirements for post-closure care. However, we recognize that we have very limited information available to make a decision regarding regulations at this time. If, in the future, additional information indicates that the current regulations may not be adequate, we will reassess whether regulatory changes in this area are needed.

E. Expansion of Financial Assurance Beyond TSDFs

In November 2003, the Acting Deputy Administrator requested a brief study of the Superfund program, commonly referred to as the "120 Day Study." This "120 Day Study" resulted in more than 100 recommendations, three of which are related to the area of financial assurance.

Recommendations 10 and 11 address facilities subject to RCRA, including hazardous waste generators, which are not subject to the financial assurance requirements of Parts 264 and 265. Recommendation 12 addresses facilities managing hazardous substances, but not subject to RCRA requirements. Specifically, the study recommended:

[15] *See* 40 CFR 264.117(a)(2).

Recommendation 10

> OSWER should evaluate the history of NPL listings and removal actions to determine what percent were RCRA treatment, storage, and disposal facilities or hazardous waste generators and to what extent these facilities present a continuing burden to the Superfund program.

Recommendation 11

> If the evaluation confirms a high correlation with RCRA-regulated facilities, OSWER and OECA should examine different approaches to financial assurance under the RCRA program to reduce the likelihood of RCRA-regulated facilities becoming part of the future Superfund universe.

Recommendation 12

> For facilities not covered under RCRA, OSWER should study whether promulgating new regulations under CERCLA's broad authorities could reduce the future needs of the Superfund program.

EPA has completed its analyses under Recommendation 10 with respect to RCRA TSD facilities. Based on these analyses, EPA has concluded that most RCRA TSD facilities proposed to or listed on the NPL were proposed or listed based on contamination that predated the implementation of the RCRA waste management program. Thus, the proposed or final listing of these facilities does not represent a failure of RCRA regulations.[16] Given this information, EPA is not undertaking further analysis of RCRA TSDs on the NPL under Recommendation 11. EPA will assess whether to undertake changes to the RCRA financial assurance regulations and guidance based on recommendations of the IG, GAO, and the EFAB, which are proceeding on a separate track, and which will provide useful information to EPA in evaluating the RCRA financial assurance regulations.

With respect to generators of RCRA hazardous waste and generators of hazardous substances not regulated under RCRA, EPA is analyzing site information to determine whether the hazardous substances released at proposed or final NPL sites, as well as removal sites, were from legacy contamination that occurred before modern federal and state environmental regulation. If a significant number of NPL sites are being created from recent hazardous substance releases then financial assurance mechanisms under CERCLA section 108(b) will be considered among the tools that may be used to prevent the creation of additional NPL sites. The decision as to whether financial assurance requirements for non-TSDs under CERCLA 108(b) are appropriate will be part of the 120 Day Study follow-up for Recommendation 12.

[16] In fact, it is clear from the analysis that the RCRA waste management program worked as designed. Marginal RCRA TSD facilities were forced to cease operations as environmentally protective RCRA requirements were promulgated and these facilities were unable to comply with RCRA standards and RCRA corrective action requirements.