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**TITLE:** Monitoring the Financial Soundness of  
Approved State Assurance Funds

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**ORIGINATING OFFICE:** Office of Underground  
Storage Tanks

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United States Environmental Protection Agency  
Washington, DC 20460

## OSWER Directive Initiation Request

1. Directive Number

9650.14

### 2. Originator Information

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3. Title

Monitoring the Financial Soundness of Approved State Assurance Funds.

4. Summary of Directive (include brief statement of purpose)

The purpose of this directive is to provide guidance to EPA Regional Offices regarding monitoring state assurance funds that have been approved by EPA to act as financial responsibility compliance mechanisms for owners and operators of underground storage tanks.

5. Keywords

State assurance funds, Regions, financial responsibility

6a. Does This Directive Supersede Previous Directive(s)?

☒

No

☐

Yes

What directive (number, title)

b. Does It Supplement Previous Directive(s)?

☒

No

☐

Yes

What directive (number, title)

7. Draft Level

☐

A - Signed by AA/DAA

☒

B - Signed by Office Director

☐

C - For Review & Comment

☐

D - In Development

8. Document to be distributed to States by Headquarters?

☒

Yes

☐

No

This Request Meets OSWER Directives System Format Standards.

9. Signature of Lead Office Directives Coordinator

Beverly Thomas, OUST

*Beverly Thomas*

Date

8/12/93

10. Name and Title of Approving Official

David Ziegele, Director, Office of Underground Storage Tanks

*David Ziegele*

Date

8/12/93

EPA Form 1315-17 (Rev. 5-87) Previous editions are obsolete.

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

AUG 12 1993

OFFICE OF  
SOLID WASTE AND EMERGENCY  
RESPONSE

OSWER Directive 9650.14

MEMORANDUM

SUBJECT: Final Guidance Entitled: Monitoring the Financial  
Soundness of Approved State Assurance Funds

FROM: David Ziegele, Director *David Ziegele*  
Office of Underground Storage Tanks

TO: UST Regional Program Managers  
Regions I - X

The purpose of this letter is to distribute the final version of the guidance entitled, "Monitoring the Financial Soundness of Approved State Assurance Funds." In addition, this package provides a brief overview of the comments received by our office as well as our response to those comments.

The purpose of the guidance is essentially two-fold: first, to help identify problems in approved funds, and second, perhaps even more importantly, to describe a process which will help resolve those problems. Flexibility has been purposefully incorporated into this guidance to encourage EPA Regions and states to work together to effectively solve state fund solvency problems. Only if the problems were so severe and if the process and solutions that the Region and state have negotiated and developed together to solve those problems failed to the point that no options remained, would EPA consider withdrawing approval of a state fund.

I would once again like to reiterate EPA's principal interest in monitoring the financial soundness of approved state assurance funds. EPA's principal interest is in ensuring that state funds remain viable financial responsibility mechanisms for owners and operators of underground storage tanks (USTs). It is also important to re-state that EPA's interest in monitoring state funds is only applicable with regard to compliance with the financial responsibility requirements. In other words, withdrawal of EPA approval from a State fund means that the fund no longer qualifies as a Federal financial responsibility compliance mechanism. A state fund could continue to exist, however, as a cleanup mechanism.



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We received a total of thirteen comments on the draft guidance from a variety of respondents including state UST programs, EPA Regions, state assurance funds, and a petroleum marketers' association. A discussion of those comments and our response is attached.

If you have any additional questions, please do not hesitate to contact Sammy Ng at 703 308-8882 or Andrea Osborne 703 308-8883 of my office.

Attachments

cc: UST/LUST Regional Branch Chiefs  
OUST Management Team  
OUST Desk Officers  
State UST/LUST Program Managers  
State Fund Administrators

Attachment 1

COMMENT AND RESPONSE DOCUMENT

Comment 1: *Measures of financial soundness need to be more specific.*

Several commenters expressed concern that the measures of financial soundness are not sufficiently specific. One commenter suggested a standardized approach across all Regions with regard to certain measures. Another expressed concern that some measures may not reflect actual fund operations. Other commenters suggested that additional measures, such as average cleanup cost and average claim frequency by type of tank be included in the guidance. Another commenter requested draft quantitative criteria in the form of specific examples.

Response:

OUST believes that the high degree of variation among state funds necessitates a flexible approach to measurement of financial soundness. Since no two funds are exactly alike, this guidance purposefully encourages Regions and states to develop and use measures which are meaningful to individual states and which accurately reflect a fund's operations. The list of measures in the guidance is intended to be illustrative and not necessarily prescriptive. In some cases, Regions and states may decide to add additional measures and/or replace suggested measures from this guidance. Region V, for example, recently met with its state fund administrators and agreed to consider adding additional measures which reflect not only the structure of the fund (i.e. eligibility criteria, deductible), but also intangibles such as legislative or industry support for the fund. It is also important to note that the measures are intended to be cumulative. A state with a low fund balance, for example, may be able to either explain the reason for the problem or compensate for the low balance by demonstrating strength in other measures. Finally, in response to the commenter requesting specific examples, OUST plans to complete three short case studies using fictional data to assist with implementation of this guidance.

Comment 2: *Measures are inappropriately weighted.*

One commenter felt that little weight should be given to the measure of cash balance because a large balance could invite raids on the funds.

Response:

Again, OUST stresses that the measures included in the guidance can be weighted as appropriate in different states and Regions. For example, a low fund balance in an otherwise stable fund is not necessarily an indication of a problem if the state explains the low fund balance in terms of its concern about a raid on the fund by other state agencies. Measures should be evaluated in terms of trends over time. Communication between Regions and states is a key element in explaining discrepancies, addressing concerns, and solving problems.

Comment 3: *EPA should require an independent actuarial determination of fund soundness.*

One commenter argued that a statistical determination of fund soundness should be performed to monitor the financial soundness of states' funds.

Response:

OUST believes that actuarial studies are not necessary to assess fund soundness. If a region and state want to do a study to confirm their findings, or to satisfy state audit requirements, they would be able to do so on their own. However, OUST believes that the measures listed in the guidance can give an overall indication of fund solvency without the added cost of an actuarial study. In addition, it is important to realize that discovering a problem is only the first objective of the guidance. Even more importantly, the guidance intends to create a process to address solvency problems. An actuarial study might not assist with this second important component of the guidance.

Comment 4: *The guidance should consider that corrective action requirements (e.g. method of remediation selected at a site) affect the solvency of state funds.*

Response:

OUST acknowledges that the cost of cleanup is an important factor with regard to fund solvency. States, however, currently set their own cleanup levels for soil and groundwater and determine the appropriate remediation technique to be used at particular sites. EPA through training assistance and technical information transfer continues to promote the use of better, cheaper and faster technologies, but believes that this issue is beyond the scope of this guidance.

Comment 5: The guidance may hinder the ability of states to protect human health and the environment if a fund decides to reduce fund eligibility to improve solvency.

Response:

State assurance funds individually decide what to reimburse and whether to provide coverage to a particular owner or operator. Reducing the number of eligible owners or operators able to participate in a fund (e.g. due to technical non-compliance) is essentially a state decision which could reduce claims on a fund. It should be noted, however, that an owner or operator would still be required to pay for a cleanup using another financial responsibility mechanism if state fund coverage were not available.

Comment 6: General clarifications.

One commenter asked why a region would require additional information about a particular soundness measure. Another commenter requested clarification on the effect of a reduction in fund coverage with regard to financial responsibility compliance.

Response:

A Region would ask for additional information to explain a sudden change in the data it received or to clarify a possible problem area. For example, an amnesty period or short-term reduction in a deductible amount could explain a short-term change in overall data trends.

If a fund decided to reduce eligibility (i.e. not provide coverage to owners with more than \$20 million in net worth) those owners and operators would be required to supplement their coverage with one of the other allowable Federal financial responsibility mechanisms (i.e. private insurance, letter or credit, etc.) in order to obtain full coverage. OUST notes that financial responsibility mechanisms can be combined; that is, a state fund could provide coverage up to a certain amount, with the remaining coverage obtained through private insurance.

Comment 7: Guidance is acceptable.

Two commenters stated that the reporting requirements were acceptable and that the data could be obtained with no great difficulty, since it is already required by some state legislatures. Four commenters agreed with the intent of the guidance, stating that the guidance contained the essential components necessary to determine financial soundness.

Response:

OUST appreciates the comments and support.

Comment 8: *The reporting requirements are overly burdensome.*

Two commenters felt the guidance imposed excessive reporting burdens. One felt the six-month requirement was too time consuming. Another asked for additional information on the proposed reporting time frames.

Response:

OUST emphasizes that the reporting time frames referred to in the guidance are suggested time frames, subject to negotiation between the Regions and states. Six month time frames may make sense, for example, when the reporting is combined with a Region's semi-annual review of the tank program. In other cases, an annual review may be more appropriate. In states with solvency problems, more frequent data collection may be needed. This flexibility has been clarified in the guidance document.

Data collection and reporting should balance the need for timely collection of information (so that a problem can be solved before it becomes unworkable) with the level of effort required by the state to report the information.

Comment 9: *Solvency of state funds is not a federal concern. Several commenters questioned EPA's authority to withdraw approval of a fund.*

Response:

EPA approves state assurance funds for use as acceptable Federal financial responsibility compliance mechanisms (40 CFR 280.101). Since the Agency approves state funds, it is incumbent upon EPA to withdraw its approval for funds which no longer provide the requisite Federal financial responsibility coverage. OUST notes that withdrawal of fund approval refers only to the ability of that fund to act as a Federal financial responsibility mechanism; the fund, however, could continue to operate as a cleanup mechanism in a state.

Comment 10: *This guidance appears to conflict with the 1989 state fund approval guidance, entitled "Reviewing State Funds for Financial Responsibility." Two commenters also requested clarification on whether the guidance applies to states that have received state program approval.*



Response:

The 1989 guidance is still used to determine whether a fund which has been submitted to EPA could be approved as a Federal financial responsibility compliance mechanism. Today's guidance for monitoring the financial soundness of approved state funds would be required only for funds that have already received EPA approval. Therefore, funds which have been submitted and not yet approved would not be required to submit data to EPA.

In response to the second comment, the Agency notes that today's guidance is also not required for funds in states which have received state program approval under 40 CFR 281. For States with program approval, EPA would monitor any changes in state assurance funds in terms of whether the program remains at least as stringent as the Federal requirements.

OUST strongly recommends, however, that today's guidance be implemented voluntarily as a sound fund management practice in states with funds which have not yet been approved or in states which have been delegated the program under state program approval.

Comment 11: One commenter believed that the document should focus on a risk-based approach to cleanups in order to avoid costly remediation in properties that pose no risk to human health and the environment. Another commenter suggested use of a prioritization system which pays the worst sites first as a way of ensuring the adequacy of state funds.

Response:

OUST agrees that cost control and reductions in the overall costs of remediation at leaking underground storage tanks sites is a key component to the success of not only state assurance funds, but the UST program in general. For this reason, EPA has been actively promoting the use of improved technologies and administrative streamlining. A risk-based approach to clean-ups is not at all precluded by this guidance.

A prioritized reimbursement system ensuring that the worst sites are cleaned up first is also a workable option under this solvency guidance. States with prioritization schedules may want to work with a region to modify the guidance accordingly. For example, a state may argue that the measure of time required to pay a claim should be different for high versus low priority sites.



## MONITORING THE FINANCIAL SOUNDNESS OF APPROVED STATE ASSURANCE FUNDS

### Introduction and Summary

The purpose of this guidance is to provide staff in EPA Regional Underground Storage Tank (UST) programs with criteria and procedures for monitoring the financial soundness of approved State financial assurance funds. EPA's principle interest in monitoring the financial soundness of approved State assurance funds is to ensure that they remain viable mechanisms for complying with the financial responsibility requirements.

EPA believes that State funds play a vital role in the UST program. They provide tank owners and operators with an affordable financial responsibility compliance mechanism and they provide large sums of money for UST cleanups; money that would not be available otherwise. Therefore, it is in the interest of not only EPA, but States, tank owners and operators, and the environment that these funds remain financially viable. This guidance is intended to help EPA work with State assurance funds to help them identify deficiencies over time and to work to remedy deficiencies. The guidance is particularly relevant given the financial pressures that many State funds are under, as the number of claims outpaces the amount of funding available. In addition, by issuing this guidance, we hope to foster consistency between Regions in the monitoring of approved State funds.

If the financial soundness of a State fund is so questionable that it no longer is a viable financial responsibility compliance mechanism, Regions may be required to withdraw fund approval. This guidance will help describe those circumstances under which fund approval must be withdrawn. Withdrawal of EPA approval of a State fund means that the fund no longer qualifies as a Federal financial responsibility compliance mechanism. A State fund could continue to exist, however, as a cleanup mechanism.

Previously-issued guidance (November 17, 1989) enabled Regional staff to evaluate the appropriateness of State funds submitted to EPA for approval as equivalent financial assurance mechanisms. The 1989 guidance contained the following fund evaluation criteria: funding source, amount of fund, coverage provided, fund eligibility, and method of payment to tank owners and operators.

This guidance differs from the 1989 guidance in that it focuses strictly on the availability of funds for corrective

action and third party claims. In addition, the guidance provides an array of solvency measures which can be tailored to each State fund. Applying these measures should not burden Regional staff or States, but should provide Regions with an oversight mechanism for identifying potential problems in sufficient time to work with States to take appropriate steps to address weaknesses. By providing step-by-step monitoring and remedial measures, the guidance should provide a vehicle for assuring the viability of funds. This guidance should also provide States and the regulated community with information on how they should assess their State funds.

### Background

In promulgating financial responsibility requirements for owners and operators of underground storage tanks (USTs), EPA attempted to assure adequate and reliable financial assurance for the costs of UST releases while also allowing flexibility to the regulated community. Accordingly, the financial responsibility requirements permitted a wide array of compliance mechanisms, including State assurance funds, insurance, risk retention group coverage, financial tests of self insurance, guarantees, letters of credit, surety bonds, fully-funded trust funds, and state-required mechanisms (40 CFR Part 280.94). However, since the financial responsibility regulations took effect on January 24, 1989, State assurance funds have become the most available and lowest cost financial responsibility compliance mechanism for tank owners and operators. For some segments of the regulated community, State funds constitute the only feasible compliance mechanism currently available.

To date, 43 States have passed legislation to establish funds to assist tank owners and operators in complying with the financial responsibility requirements. Although all of these funds are designed to assist tank owners in meeting Federal requirements, no two funds are identical. These funds vary in the amounts and types of coverage they provide, in their eligibility requirements, in the amount of funding, funding source, method of payment, and program implementation. Even the responsibility for implementing the fund can vary; the agency administering the fund could be the Department of Environment, Commerce or Insurance. In a few States, all or part of the fund implementation has been contracted out to private third party administrators.

This diversity is expected since States are not required by law or the financial responsibility rule to establish assurance funds. Rather, States that have chosen to establish funds have done so to provide assistance to tank owners and operators in complying with the Federal financial responsibility requirements, cleaning up releases from tanks, and, in some cases, paying for third party damages associated with releases from USTs.

As States have gained experience in the implementation of funds, many have modified their programs, either by statute, regulation, or operating procedures. Some have streamlined claims administration procedures, increased funding, limited activities that the fund will pay for, or established reasonable cost guidelines. In other cases, States have experienced an unanticipated demand for reimbursement. State financial crises have sometimes impacted funding and administrative resources, and threaten to compromise the ability of those State funds to consistently achieve their dedicated purpose.

There are currently no independent State agencies with clear-cut responsibility for oversight of these assurance funds. In general, when creating these funds, the States did not assign responsibility for overseeing the soundness of these funds to State entities similar to those that were created to regulate insurance, sureties and other equivalent mechanisms that owners and operators might use to satisfy financial responsibility requirements. Even if a State agency does have an oversight role, EPA has no control over how well that function is exercised. While many assurance funds have Fund Boards or Advisory Committees (composed of members of the regulated community, officials from State Departments of Environment or Insurance), these Boards main functions are to approve or disapprove claims for reimbursements, and recommend changes to fee structures.

#### EPA's Role

In terms of assuring that a State fund is established on sound financial footing, the financial responsibility regulations establish a well-defined role for EPA. A State must submit its fund to EPA for formal approval if the fund is to qualify as an equivalent financial assurance mechanism for use by its UST owners and operators in meeting the Federal financial responsibility requirements in whole or in part (40 CFR Part 280.101). On November 17, 1989, EPA issued a document entitled "Final Guidance for Reviewing State Funds for Financial Responsibility" to help EPA reviewers understand what to look for as they evaluate submissions of State funds as financial assurance compliance mechanisms. The review of a State fund includes the following elements: funding source, amount of fund, coverage provided, fund eligibility, and method of payment to tank owners and operators. In examining these elements of State funds, reviewers were to ascertain that money would be reasonably certain and available to pay for cleanup and third-party damages. It should be emphasized that this solvency guidance doesn't replace the 1989 guidance with regard to the initial review and approval of a submitted fund.

To date, 30 funds have been approved by EPA Regional Administrators to serve as Federal financial responsibility

compliance mechanisms. Once approved, tank owners and operators in these States are deemed to be in compliance with the financial responsibility requirements for the types and amounts of coverage provided by the State funds. In addition, seven funds have been submitted to EPA Regional Administrators for approval. Owners and operators in these seven States are also deemed to be in compliance with the financial responsibility requirements until a final determination is made by EPA. This guidance is only intended to help monitor approved State funds, and is not applicable to those funds that have only been submitted.

The 1989 guidance did not establish absolute levels of funding as a prerequisite to approval, but instructed reviewers to consider the amount in the State fund in terms of the overall design of the State's cleanup and enforcement program, as well as the ability of the State to expend monies from the fund. This pragmatic approach recognized that a fund could be approvable if adequate funds would be reasonably available over time, although fluctuating demand could result in temporary periods when funding might not be keeping pace with expenditures.

Once a fund is approved, neither the 1989 guidance nor the financial responsibility regulations impose specific requirements for continuing oversight of fund soundness, either on the State or EPA. Nor do the approval guidance or the regulations set forth criteria for revoking approval. The regulations contain procedures for addressing the effect of bankruptcy, disability on the part of a guarantor, and other situations where a provider of financial assurance is unable to assure funding for corrective action or third-party damages, but do not specify what should be done when a State fund's ability to provide assurance is questionable. If, as EPA's research indicates, financial assurance funds do not receive the same oversight as insurance companies, sureties, risk retention groups, or similar enterprises, EPA needs to scrutinize the ability of a fund to provide financial assurance that is equivalent to other approved mechanisms. This guidance fills the need for explicit procedures for EPA review of the on-going soundness of approved State funds.

Once a State has an approved UST program, EPA will continue to monitor overall program performance, including the financial soundness of State assurance funds, but only as it relates to the overall stringency of the UST program as a whole. Therefore, there will be no additional monitoring of the financial soundness of funds above and beyond the routine oversight of approved State programs. While use of this solvency guidance is not mandatory in States with approved programs, or in States with submitted funds, EPA recommends that these States voluntarily collect data to assess fund soundness as part of routine fund management.

### Purpose of Guidance

This guidance is intended to provide staff in EPA Regional UST programs with specific procedures for monitoring the financial soundness of approved State assurance funds. The purpose of the guidance is to ensure that each approved State fund provides reasonable assurance that funds are available to pay for the costs of corrective action and third party damages. In satisfying this purpose, EPA will ensure that approved State assurance funds provide financial assurance that is equivalent to the other compliance mechanisms allowed by the Federal financial responsibility regulations.

This guidance builds on the previously-issued guidance for evaluating the overall viability of State funds. The additional tools contained in this guidance should enable Regional staff to assure that these funds continue to provide reasonable assurance that monies will be available for corrective action and third party claims. The guidance provides flexible measures which should minimize the burden on Regional staff and on States, but will provide a mechanism for identifying potential problems in ample time to work with States to take appropriate steps. A primary objective of this guidance is to provide a vehicle for improving the solvency of funds rather than necessitating drastic action, such as withdrawing fund approval. In addition, we hope that this guidance serves as a tool to help States identify fund weaknesses and provides them with a framework for improving these deficiencies. This guidance can also serve to bolster a fund board's recommendation for a tax or fee increase.

### Definition of Financial Soundness

The definition of financial soundness provided in this guidance is built upon the functional definition of soundness provided in the State fund approval guidance. A State assurance fund is financially sound if it provides reasonable assurance that funds are available to pay for the costs of corrective action and third party damages. "Reasonable assurance" would be evident, for instance, if the fund assets are greater than liabilities or there are sufficient funds to meet current demands, that is, the normal timing of payment of claims is not significantly delaying cleanups. If funding levels or claim processing time has a negative impact on the cleanup of releases from USTs (i.e., causing undue delays in cleaning up releases therefore harming human health and the environment), then EPA is concerned about the financial soundness of the fund. The reviewer should look for evidence that reasonable assurance is provided, but other parties such as cleanup contractors, fund administrators, other State officials, and tank owners and operators should also have reason to believe that the funds are reasonably available.

In the following section, this guidance will provide Regional reviewers and States with indicators with which to track and evaluate the viability and financial soundness of approved State assurance funds. Finding the appropriate evidence and correctly interpreting it is by no means a precise or mechanical exercise. EPA has researched the approaches to oversight used by well-established institutions, such as insurance commissions, State and Federal bank regulators, and the U.S. Department of the Treasury. While the experience of these institutions is too specific to the businesses regulated for direct application to UST fund guidance, their general approach is helpful. They allow regulators considerable discretion in defining and evaluating measures of soundness, and in acting on signals provided by these measures. These institutions explain that oversight must be conducted with great care and sensitivity because overzealous intervention could have a profound impact on regulated enterprises or on the public that relies on the enterprise. Similarly, State assurance funds meet a critical need for demonstrating financial assurance as well as providing another source of funds for response to releases.

#### Measures of Fund Soundness

There are a number of potentially useful measures of the financial soundness of State assurance funds:

- (a) Fund Balance
- (b) Rate of Collection
- (c) Rate of Disbursement
- (d) Collections Projected for Next Reporting Period
- (e) Disbursements Projected for Next Reporting Period
- (f) Number or Dollar Amount of Pending Claims
- (g) Number of Days Between Claim Submittal, Approval, and Payment
- (h) Major or Pending Changes to Fund

Each of these measures is discussed in more detail in Appendix A.

In using a measure, a reviewer needs to clearly define the time period over which the data is collected, whether calendar or working days are intended, whether a term like "payment" means issuance of a reimbursement check or transfer of approval to the accounts payable department. The time frame, therefore, is critical for comparison of measures.

We do not believe that any one measure will indicate whether or not a fund is financially sound. Obtaining data on all the measures is also not necessary to develop a reliable picture of a fund's soundness. Each Region should select from among the measures those that the Region can obtain with relative ease, that have inherent meaning for the fund under review, and



that provide a meaningful indicator over time. Combinations of measures could be used, or certain measures or ratios could be used to trigger analysis of other measures. As discussed earlier, State funds exhibit great diversity in design and implementation, and oversight should take into consideration the unique characteristics of each fund. Regions will be accorded broad discretion in selecting and applying measures. However, since this area is a novel one for many Regional staff, EPA has some suggested procedures that could be used.

### Procedures

The following procedures present one logical approach to using the measures to establish a monitoring methodology and apply it over time. Even for those funds that are currently experiencing financial difficulties, it is important that Regions follow these procedures to establish a baseline of information and to allow the State to discuss fund problems and, perhaps, to begin to remedy the problems.

**(1) Establish baseline measures.** Begin by selecting the most useful set of measures for the State. Since each State fund will differ even from other funds in the Region, measures should be tailored to each State fund on a state-by-state basis. As noted above, each measure will need to be clearly defined. Although a measure could have different meaning for different States, the purpose is to establish a baseline for each State fund, evaluate soundness at the start, and compare performance based on uniform measures over time. When selecting measures, Regions and States should also consider factors such as ease of reporting by a State, whether the measures are stable or can be expected to fluctuate dramatically, and whether a measure already indicates a problem.

In developing this guidance other approaches were considered and rejected. The Federal Reserve looks at banks as peer groups based on common characteristics such as size and location. In the case of State financial assurance funds, the small number of States with approved funds and the diversity of these funds undercut the ability to create meaningful peer groups.

**(2) Estimate baseline soundness.** What do the baseline measures tell you about current soundness? At this early stage in measuring soundness, this determination cannot be conclusive. Instead, discretion should be used to decide what indicators will be most helpful. This guidance does not propose absolute measures for determining soundness. The Federal Reserve and other bank and insurance regulators designate absolute levels of capitalization or liquidity as a measure of an institution's soundness. Without greater experience, we cannot accurately determine what would be comparable benchmarks for State funds.

While absolute values are not available, some relationships between measures should prove helpful. For example, if the current rate of disbursement is several times larger than the rate of contribution, a reviewer should examine other measures and track these rates over time. If the dollar amount of the pending claims is several times larger than the fund balance, then the fund's soundness could be compromised. Again, there may be simple explanations for why these measures are not threatening the fund's soundness or delaying cleanups. The persistence of measurement gaps over time, however, will provide a better indication of the problem.

(3) Check for explanations for current status. EPA research into the approaches to oversight taken by other financial institutions shows that indicators are used as screens to identify the need for action, but that early action usually means further exploration of apparent problems. If a measure indicates a potential problem, discussions with State staff would be appropriate. There may, for example, be a simple explanation for the problem. More importantly, these measures might not threaten the fund's soundness or delay cleanups. The persistence of a measurement gap over time will provide a better indication of the problem.

(4) Monitor trends over time. State funds are like bank accounts that can fluctuate over time without threatening the account's stability or solvency. However, increasing disparities between income and disbursements over time could indicate underlying weakness. Similarly, the time interval between submittal of an invoice for a cleanup action and payment could be several months without affecting the willingness of contractors or owners to undertake response to releases. If the interval is increasing over time, delays might begin to impact cleanup and should trigger the need to investigate other measures or factors to determine the effect of payment delay on release response.

We recommend in this guidance that States which are experiencing financial difficulties with their funds should report data on each applicable measure to EPA Regions at the frequency that the State currently generates such information, but no less frequent than six month intervals. There is no readily adaptable experience from other oversight programs for setting response times. Banks report financial data quarterly, but that frequency is consistent with other events that occur on a quarterly basis in the financial community. Semi-annual reporting is a compromise between setting an interval that does not allow enough time to encompass important events (e.g., periodic replenishment of funding or average time periods for administration of claims) and setting an interval that is too long to catch serious erosion in soundness. This frequency also will afford EPA greater opportunity to provide timely assistance before more serious intervention becomes necessary.

(5) **Use discretion.** At this stage in the evolution of the UST financial assurance program, there is no perfect guidance for oversight. The measures provided and steps suggested are imprecise instruments for monitoring soundness. At any step, oversight should be tempered with discretion. Explanations should be sought, discussions held, and assistance offered to remedy problems. Despite any measure, the important criterion is whether funds are reasonably available for cleanup and third party claims. This determination will continue to require a considerable amount of subjective judgement on the part of EPA Regions.

#### EPA Regional Response

This section elaborates on the steps described above by focusing specifically on the Regional action required to implement the monitoring process. The suggested process is displayed in Appendix B.

After the State and Region have identified and defined the key performance measures that will be used to monitor the soundness of the State's assurance fund, the State should report those measures to the Region. Once the Region has received the baseline data from the State and the Region has reviewed the data, the Region should ask the State any questions it has regarding the information. The Region can then make an initial determination about the financial soundness of the fund. If the Region is uncertain about what the financial measures reported by the State indicate, the Region may consider asking the State to do more in-depth analysis.

As a result of the initial assessment of fund soundness, the Region may determine that the fund is basically sound. If this is the case, the Region can determine how frequently the State should provide information on the financial status of the fund. As a rule, the Region should ask the State for a financial status report during its semi-annual review of the program.

If, after the initial assessment of fund soundness, the Region determines that the financial status of the fund is questionable, data could be collected from the State more frequently, as deemed necessary by the Region and the State. When the next set of data is sent, the Region should review and compare it to the prior data that was submitted by the State. The Region should pay particular attention to any trends indicated by the data. If the data show a negative trend, (e.g. the amount of time to reimburse a claim increases), the Region should verbally inform the State of its concern and ask the State to explain why the time has increased. At this time, the Region should also inform EPA Headquarters about its concerns. If claim processing time is the problem, for example, perhaps the increase in processing time resulted from the State assurance fund losing

key staff. The Region can then ask the State about its plans for filling those fund positions and encourage the State to proceed with plans to fill those positions. The Region should, of course, continue to monitor the financial status of the fund.

If the downward trend persists, the Region should write a formal letter to the State requesting a meeting to discuss EPA's concerns and possible remedies. The letter should be sent to the State official who originally requested formal approval of the fund. (The appropriate addressee may vary by State, and can be left to the discretion of the Region.) At the meeting, the Region should ask the State to develop a plan that addresses the identified deficiencies and a schedule for implementing the plan. It might be helpful to think of this step as analogous to requiring a tank owner or operator to develop a compliance plan. After receiving the plan, the Region should monitor the progress of the plan's implementation by the State. EPA Headquarters should also be notified when the letter is sent, when the State meeting is scheduled, and when the plan is submitted to the Region.

If the State fails to implement the plan in a timely fashion or if the implemented remedies haven't resulted in any improvements in the downward trend, and EPA makes a judgement that the fund is no longer a viable financial responsibility mechanism, the Region should write a formal letter to the head of the Agency that is responsible for implementing the State fund. In this letter, the State will be notified that EPA may withdraw approval of the State fund, in which case, it can no longer be used by tank owners and operators to comply with the Federal financial responsibility requirements. The State will then be required to send a notice to the tank owners and operators that are covered by the State fund, informing them that their coverage under the State fund will no longer be acceptable as a mechanism for complying with the financial responsibility requirements as of 60 days after receipt of the notice (40 CFR 280.105). Within 30 days after receipt of this notification, owners or operator must obtain alternate financial assurance provided that the owner or operator is required to comply with the financial responsibility requirements. (40 CFR 280.110)]

It is our hope that both the tiered Regional Response process that has been outlined and the reliance on monitoring and evaluating trends over time will serve to alert States as early as possible in the review process about potential fund deficiencies. If appropriate, this communication will also put stakeholders on notice that there is a problem with a fund and that their involvement may be required to remedy the situation. It is important to stress that EPA does not want to precipitate a crisis; EPA recognizes that solutions to identified weaknesses will be State-specific and may require months or years to implement. By alerting affected/interested parties of EPA's

concerns regarding the financial soundness of funds, adequate time will be given to discuss the reasons for the fund weaknesses, identify possible remedies to improve the weaknesses, and agree on appropriate and reasonable time frames for States to implement remedies.

#### Possible Remedies

When establishing deadlines for remedial action, Regions should acknowledge that some remedies may take varying amounts of time to implement. When evaluating fund weaknesses and negotiating possible solutions with States, Regions must consider the amount of time necessary to implement the remedies. Possible remedies might include:

- o Raising additional revenues. This would help a fund keep up with claim demand.
- o Modifying the coverage provided by the fund. By reducing the coverage that the fund provides to tank owners the amount of funding required to pay claims in a timely fashion might be reduced. In addition, by reducing the coverage that the fund provides, existing funding could be adequate to process claims in a timely fashion.
- o Streamlining the administrative processes of the fund. This might help speed up the processing of claims.
- o Hiring additional fund staff. This remedy could also help speed up the processing of claims, or have other positive effects depending on the weaknesses identified.
- o Limiting fund eligibility (e.g. requiring tank owners and operators to be in "substantial compliance" with State regulations.) This could also conserve fund monies; fewer tank owners would be eligible to submit claims to the State fund.

Implementation of these remedies may require statutory changes which, depending on the length and timing of the legislative sessions in States, may take up to two years to implement. Other possible remedies would require program policy changes that also might require a significant amount of time to implement. Regions need to keep these timing issues in mind when working with the State on remedies.

#### EPA Headquarters Response

During the collection of baseline information and throughout the monitoring process, EPA Headquarters will be available to

informally discuss and evaluate the fund data at the request of the Region. Headquarters can provide comments concerning the evaluation of the fund data and will provide other technical assistance necessary to help Regions implement the monitoring process. For instance, if the Region is unable to evaluate the measures provided by the State and believes that further analysis is required, EPA Headquarters can provide support (technical, financial, etc.) to the Region. At the request of the Region, EPA Headquarters will also be available to provide written comments on any formal letters that the Region sends to States regarding the financial soundness of the fund. Finally, if the Region has concerns about the financial soundness of the fund and discusses those concerns with the State verbally, EPA Headquarters should be notified. EPA Headquarters should also be informed about the plan that a State develops to address the identified deficiencies and the schedule for implementing the plan.

If a Region determines that fund approval must be withdrawn, Headquarters must be consulted and must concur on the Regions withdrawal determination for a number of reasons. First, EPA Headquarters has an obligation to ensure National consistency and uniformity in fund withdrawal decisions. Headquarter's involvement at this time will also lend support to the withdrawal action.

## APPENDIX A

**PROPOSED DEFINITIONS OF MEASURES OF  
SOUNDNESS FOR STATE FUNDS****Fund Balance**

There are several potential measures of fund balance. The least conservative is the cash-basis definition: the fund balance is defined as the amount of cash currently in the state fund (or in the account maintained by the state treasurer for the fund), minus any outstanding checks for reimbursement under the fund. Under this definition, the fund balance would exclude as-yet unprocessed claims against the fund or any recognition of future claims likely to be submitted for known releases.

$$\text{Fund Balance} = \text{Cash in Fund} - \text{Claims Processed}$$

A slightly more conservative definition would require the region or state to acknowledge claims received against the fund but not yet processed. Using this definition, the state would start with the cash in the fund and subtract the sum of all claims submitted for reimbursement by owners and operators, including those not yet processed.

$$\text{Fund Balance} = \text{Cash in Fund} - \text{All Claims Received (Processed + not yet Processed)}$$

The most conservative definition would adopt modified accrual standards typically required under government accounting standards, in which liabilities are recognized as soon as they can be reasonably measured, but income is not recognized until received. Under this definition, the state would estimate the total potential liability associated with all known releases and subtract it from the amount of cash currently in the fund. Because most state funds have adopted some version of a pay-as-you-go system, in which revenues are set to correspond with anticipated cash payments for corrective action and third-party liability expenses, this definition would likely show most funds in a deficit position, even though future revenues to the fund would increase the cash available for payment of these future claims.

$$\text{Fund Balance} = \text{Cash in Fund} - \text{All Potential Liabilities}$$

The above three measures for determining the size of the fund balance reflect different management philosophies. For most funds, the second definition of the fund balance would be adequate. When using the fund balance in conjunction with other measures, however, the least conservative measure may be selected as the most appropriate measure to use. If the fund balance decreases dramatically, some states and regions may opt to change to a more conservative definition of the fund balance. The three choices outlined in the fund balance definition give the states and regions more measurement flexibility. It is important to note, however, that changes in fund balance cannot be compared with earlier fund balance estimates if different definitions were used. EPA hopes that regions and states will work together in selecting a fund balance measure that meets the specific needs of both parties.

## Rate of Collection

The rate of collection is the amount of money collected for use by the fund over a specified period. The period should correspond to the fee collection mechanism. For example, many funds collect annual tank fees; consequently, the appropriate period is one year, corresponding to payments of the fees. Other funds, especially those funded through per-gallon fees on petroleum products, may have more frequent requirements for payments (e.g., monthly or quarterly), and thus allow for a shorter period for estimating the rate of collection. For the purpose of tracking fund solvency, the rate of collection on a semi-annual (six month) basis probably provides a reasonable balance between the information collection burden and the amount of information obtained.

$$\text{Rate of Collection} = \text{Amount of Money Collected} / \text{Reporting Period}$$

The rate of collection can be used in at least two ways. First, decreasing trends in the rate of collection may indicate that tanks are being taken out of operation, reducing the amount of revenue available to the fund because closed tanks do not pay fees. In comparing period-to-period collections, however, it may be important to consider any significant seasonal patterns. For example, gasoline sales are generally higher in the summer, so that fund revenues may show a decrease from summer to winter months.

Second, the rate of collection should be compared to the rate of disbursement as a means of anticipating potential future shortfalls in the fund. If the rate of collection exceeds the rate of disbursement, then fund balances will increase over time and the fund will become increasingly more solvent. If the rate of collection is less than the rate of disbursement, then fund balances will decrease and the fund will become less solvent.

## Rate of Disbursement

The rate of disbursement is the amount of money spent by the fund (in actual payments) over a set time period. As discussed under rate of collection, the appropriate time period may vary between states depending on their different fiscal cycles. In general, disbursements per period should provide a time period long enough to smooth out the effects of single, large disbursements, but short enough to provide timely identification of significant increases or decreases in the rate of disbursements. The period used for rate of disbursement should correspond to the period used for the rate of collection.

$$\text{Rate of Disbursement} = \text{Actual Payments} / \text{Reporting Period}$$

## Collections Projected for Next Reporting Period

Collections projected for the next reporting period is the state's estimate of the dollar amount of funds that will be collected for use by the fund at any time during the next state fund solvency reporting period. This measure is similar to the rate of collection, but, rather than calculating current collections over time, the measure projects total collections over a future time period. The measure is intended to estimate additions to the fund for use in paying existing and projected future claims against the fund, and should not be confused with fund balance. The state must rely on its judgement in estimating future collections. The state should make a reasonable judgement of funds that it believes will be available for disbursement to pay claims made against the fund, rather than either a



liberal or conservative estimate. The estimate should account for other relevant information, such as past rates of collection and major or pending changes to the fund.

**Collections Projected = Estimated Amount of Money to be Collected in a Reporting Period**

As in the case of the rate of collection, the reporting period should be as short as possible subject to constraints imposed by the fee collection mechanism. In many states, financial information is commonly reported on a quarterly basis for fiscal purposes, consequently, quarterly projections should provide reasonably accurate data without unduly burdening the state. Semi-annual reporting would also be appropriate if no appreciable collections would be received in some quarters, the estimate would be misleading or unreliable, or rates of collections are fairly constant.

The projection of collections, while speculative, may be used as an early indicator of potential solvency problems. First, the projection of collections may be compared with the projection of disbursements as a means of drawing attention to potential future shortfalls in the fund. Second, the projections of collections and disbursements could be combined with the backlog and fund balance to determine whether the current backlog will grow or contract.

### **Disbursements Projected for Next Reporting Period**

Disbursements projected for the next reporting period is the state's estimate of the dollar amount of anticipated disbursements from the fund to pay claims for the next full reporting period. In projecting disbursements, the state should make a reasonable estimate of the costs of claims it expects will be submitted and require payment during the reporting period. This measure of disbursements projected from the fund will be compared with the measure of collections projected into the fund in order to establish an early indicator of potential problems with fund solvency. Consequently, when developing estimates for disbursements projected and collections projected, the assumptions and reporting period used should be consistent (e.g., if the state has a six month reporting period and is accounting for a pending change to the fund when determining collections projected, it must also have a six month reporting period for the disbursements projected and account for the same pending change in the fund). Although projecting disbursements requires speculation by the state, the projection should account for past patterns of claims received and the current number of claims filed but not paid, and reflect pending or major changes to the fund that are likely to affect disbursements.

**Disbursements Projected = Estimated Dollar Amount of Disbursements to be Paid in a Reporting Period**

### **Number or Dollar Amount of Pending Claims**

The number of pending claims is defined as the total number of claims against the fund that have been received but that have not been approved for payment at the close of the reporting period. Similarly, the dollar amount of pending claims is the dollar amount of received claims that have not been approved for payment at the close of the reporting period. These measures are intended to provide the state and region with a firm estimate of claims against the fund that are likely to be realized as disbursements at a later date, even though processing is not complete.

Number of Pending Claims = Number of Claims Received but not yet Processed  
or

Dollar Amount of Pending Claims = Dollar Amount of Claims Received but not yet Processed

The region may request that the state report either the number or the dollar amount of pending claims in order to track a rise or fall in either measure over time. The state or region might find that the dollar amount of pending claims is a more direct indicator of the fund's future liabilities than number of claims, because it can be compared to the fund balance and rate of collection to provide a measure of solvency. In contrast, collecting data on the numbers of claims permits observation of the trend in claims without bias introduced by individual large claims.

### **Number of Days Between Claim Submittal, Approval, and Payment**

The number of days to process claims is only a partial indicator of fund solvency. Even a relatively long period for processing may not indicate solvency problems, as long as owners and operators and corrective action contractors continue to clean up sites. An increasing period, however, may indicate that the state fund has inadequate staff or administrative procedures to process claims on a consistent schedule. A decreasing period probably reflects reduced demands on the fund, or improved administrative procedures.

Measure = Number of Days between First Receipt and Payment  
or

Measure = Number of Days between Receipt of Complete Package and Payment

The start date for each part of the approval process must be clearly defined. In some cases, there may be a significant lag (up to several months) between the time a claim is first submitted and the time the owner and operator finally supplies all necessary information (for example, complete invoices, documentation of types of costs covered by the invoices). As a consistent measure, the *first* date the claim is submitted is probably best. A lengthy period may suggest that states need to streamline their guidance for claims and/or improve their outreach to consultants and contractors so that they know what must be submitted. In addition, the date used as the date of approval may vary between funds. In some states, the technical staff reviewing claims have the authority to approve payment, based on their review. In other states, an independent board or agency must ratify the decisions of the technical staff. The appropriate date is the date that all necessary approvals and reviews have been met. The date of payment should be the date the check is written by the state treasury to the owner or operator (or cleanup contractor in states that allow direct payment). Significant lengths of time between approval and payment may indicate that disbursements are held up to prevent overdrawing accounts.

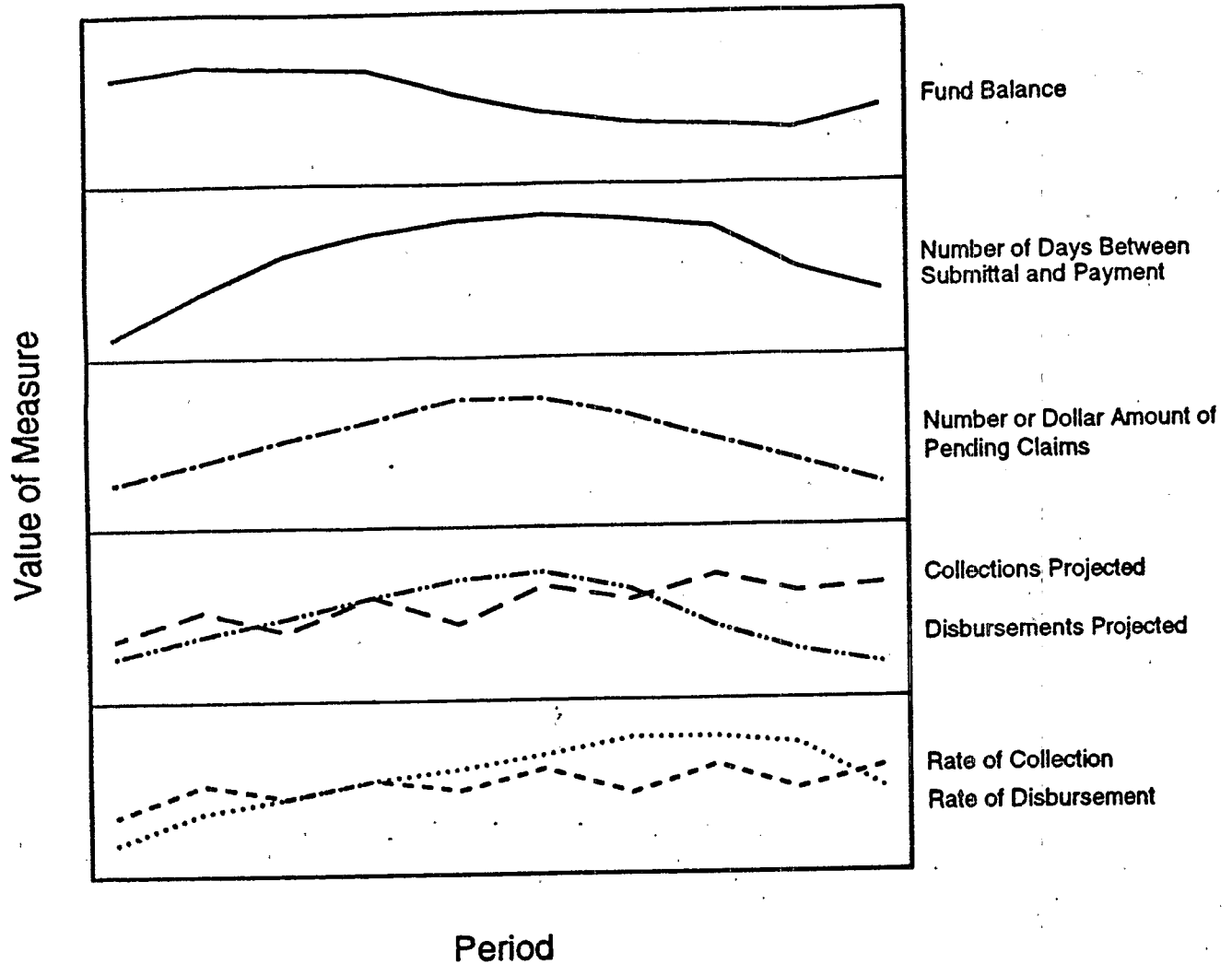
### **Major or Pending Changes to the Fund**

Major or pending changes to the fund could be either economic or administrative, positive or negative. Impending negative impacts could include legislative expansion of fund coverage to include a larger universe of tanks or facilities without additional funding. Regulatory amendments that either lowered or raised the costs of corrective action are respective examples of potentially positive or negative impacts. Direct effects on staffing levels or productivity, such as hiring freezes, would be included here. Finally, the most obvious major change to be considered would be one that will likely

have a direct effect on a fund's finances, for example, the reporting of an extraordinarily large release.

Besides the measures listed above, another important factor in assessing the financial soundness of a fund is gauging the degree to which cleanups are being delayed due to fund-related issues. One approach to getting such qualitative information is to monitor the complaints made by the regulated community and/or cleanup contractors to the state or EPA about the cleanup delays that are being caused by slow fund payments. There may also be other ways to obtain this information. Obviously, the reasons for delays in fund payments may not always be financial. For instance, the delays could be caused by lack of staff to process claims. Reviewers should use complaints as a starting point for further analysis rather than as a financial determination of a fund's financial condition.

## Illustrative Representations of Trends in Measures of Soundness for State Funds



## STATE FUND SOLVENCY

