BACKGROUND DOCUMENT

RESOURCE CONSERVATION AND RECOVERY ACT
SUBTITLE C - HAZARDOUS WASTE MANAGEMENT

Section 3004 - Standards Applicable to Owners and Operators of Hazardous Waste Treatment, Storage, and Disposal Facilities

Parts 264 and 265, Subpart H

Interim Final Regulations on

CLOSURE AND POST-CLOSURE INSURANCE

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF SOLID WASTE

November 2, 1981

INTRODUCTION

On May 19, 1980, financial responsibility requirements for closure and post-closure care of hazardous waste management facilities were reproposed. Under the reproposal, the following mechanisms were allowed as means of satisfying these requirements: trust funds, surety bonds, letters of credit, a financial test, and a revenue test for municipalities. In the preamble (45 FR 33264) the Agency requested suggestions and information on other possible mechanisms.

EPA explored the possibility of insurance as a mechanism for assuring funding for closure and post-closure care in telephone conversations in June and July of 1980 with a representative of the insurance industry,[1] who in turn raised the question with his clients. Although no definite conclusions were reached at that time, it did appear that this application of insurance might be feasible. Such a policy would assure that the full costs estimated for closure and post-closure care would be paid whenever closure and post-closure care occurred. In effect, such a policy would protect the public against abandonment of the facility or bankruptcy by the owner or operator.

Shortly thereafter the subject was again raised in a discussion of insurance with a representative of the brokerage firm of Alexander and Alexander, who agreed to assess the feasibility of such a mechanism.[2] The concept was discussed briefly in the Background Document accompanying the January 12, 1981, interim final regulations (Background Document dated December 31, 1980, pages I-133-134).

In subsequent meetings, telephone conversations, and letters, the needs of the Agency were outlined to the insurance industry, which responded by creating a plan which insures payment of the estimated closure and post-closure care costs covered by the plan whenever these funds are needed.

RATIONALE FOR STANDARDS

When it was determined that closure and post-closure insurance could be made available to the regulated community, the Agency, with the cooperation of a wide segment of the insurance industry, developed regulations and a certificate of insurance.

The issues involved in that development are defined and explained in the following discussion.

Need for insurance mechanism

The Agency was aware that smaller, less creditworthy firms would not be able to pass a financial test or obtain an unsecured letter of credit or surety bond to assure funding for closure and post-closure care. To these firms would remain only the option of the trust fund. The trust fund has a build-up period of 20 years or the remaining life of the facility, whichever is shorter, during interim status, and the term of the permit or the remaining life of the facility, whichever is shorter, during permitted status. There is a substantial risk that the fund will never be fully paid up, either because of abandonment of the facility or bankruptcy of the owner or operator. It was mainly to eliminate

this risk that the development of the insurance option was sought. The expected high cost of the trust fund to owners and operators, due largely to current tax policies which apparently do not allow deduction of the payments or exemption of trust earnings, was also of concern. If the premium for the insurance is tax deductible, this would likely cause the insurance to be cheaper to the owner or operator than the trust. The Agency is requesting clarification of the tax treatment of these instruments from the IRS.

Limits on insurers

The Agency believes it is clearly important that the insurance companies writing the policies be reliable. The regulations state that the company must be licensed to transact the business of insurance, or eligible to provide insurance as an excess or surplus lines insurer, in one or more States. The Agency understands that these are minimal qualifications, but at present it has insufficient information to support more stringent standards. The preamble to the regulations refers to possible additional standards such as the rating in Best's Insurance Reports and suggestions received from the National Association of Insurance Commissioners (NAIC). The NAIC recommendations are as follows: Policies must be underwritten by an insurance institution which:

(1) Is domiciled in the United States and authorized to transact the business of insurance as an admitted or nonadmitted insurer in the State where the insured facility is located, or

(2) Is a captive insurer licensed under a state law authorizing the formation and operation of captive insurers, or

(3) Is an alien insurer in good standing on the Non-Admitted Insurers Quarterly List published by the Non-Admitted Insurers Information Office of the National Association of Insurance Commissioners.

The Preamble requests public comment on this issue.

Evidence of Insurance

Evidence that an owner or operator has obtained closure or post-closure insurance to satisfy the financial requirements must be submitted to the Regional Administrator in the form of a certificate of insurance. An owner or operator of an interim status facility must submit this certificate or, if no policy is issued, evidence of having established alternative financial assurance, within 90 days after the effective date of these regulations. If an owner or operator plans to use the insurance option, he need only submit to the Regional Administrator, by the effective date, a letter from a qualified insurer stating that the insurer is considering issuance of such insurance to the owner or operator in conformance with the regulatory requirements.

An owner or operator of a new facility must submit a certificate of closure or post-closure insurance at least 60 days before the date on which hazardous waste is first received for treatment, storage, or disposal. This insurance must be effective before this initial receipt of hazardous waste.

Determination of face amount of policy

To assure the necessary funds for closure and post-closure care, the insurance policy must be issued in an amount equal to the adjusted cost estimate, unless it covers only part of the

estimate and another instrument covers the rest. This is called the "face amount." Face amount is defined as the limit of liability as set out on the Declarations Page of the insurance policy. It is always the total amount the insurer is obligated to pay under the policy.[3] Actual payments by the insurer do not change the "face amount", although the insurer's future liability will be lowered by the amounts of the payments.[4] Whenever the cost estimate increases, the increase must be covered by the policy or another instrument. The face amount may be decreased in the event of a reduction in the cost estimate, following written permission from the Regional Administrator. Similar provisions are included in the requirements for the other financial assurance mechanisms.

Availability of funds

The main feature of this insurance policy is that the full amount of the adjusted closure and post-closure care cost estimate, or that part to be covered, will be available whenever closure and post-closure care occur--whether on the expected date or when closure is required by emergency, by termination or revocation of the permit or interim status, or by court order.

This distinguishes the insurance policy from the trust fund which can only provide the full amount at the end of the pay-in period.

Reimbursement for expenditures

The Regional Administrator will direct the insurer to reimburse closure or post-closure care costs, up to an amount

equal to the face amount of the policy, incurred by any persons authorized to perform closure or post-closure care as long as the expenditures are in accordance with the closure or post-closure plan or otherwise justified. The Regional Administrator may withhold reimbursement of closure expenditures as he deems prudent if he determines that the actual cost of closure appears to be significantly greater than the face amount of the policy. Any funds withheld from reimbursement will be released when satisfactory certifications of closure are received by the Regional Administrator. These provisions for payment are the same as those for the trust fund.

Cancellation by owner or operator

The owner or operator may cancel the policy upon written consent from the Regional Administrator based on establishment of alternate financial assurance or when the owner or operator is no longer required to maintain financial assurance. Otherwise, failure to pay the premiums will constitute a serious violation by the owner or operator of the financial responsibility regulations.

Cancellation by insurance company

Cancellation, termination, or nonrenewal of the closure or post-closure insurance is allowed only if the insured fails to pay his premium. The automatic renewal of the policy must, at a minimum, provide the insured with the option of renewal at the face amount of the expiring policy. If the cost estimates to which the policy applies have increased, the insurer and insured may agree to cover that increase in renewing the policy.

Cancellation, termination, or nonrenewal of a policy for nonpayment of premium cannot be effected until 120 days after receipt of such notice by the owner or operator and the Regional Administrator. The policy will remain in full force and effect if, on or before the effective date of cancellation, termination, or nonrenewal, the facility is deemed abandoned by the Regional Administrator; the permit or interim status is terminated or revoked; closure is ordered by the Regional Administrator or a court of competent jurisdiction; the owner or operator is named debtor in a bankruptcy proceeding; or the premium is paid. The Agency believes 120 days' notice is necessary to allow opportunity to the owner or operator and the Agency to identify and carry out steps to maintain financial assurance. Such steps on the part of the Agency may include compliance proceedings, termination of interim status or the permit for the facility, or a closure order.

Based on discussions with the insurance industry the Agency expects that the policies will be issued on a yearly basis and, in the normal course of events, will be fully paid up before the post-closure care period begins. The insurer and the insured will work out between themselves the dates premiums are to be paid. The insurance industry has indicated that it may require premiums to be paid at least 120 days in advance of the beginning of a new term for a renewed policy, since in case of nonpayment of the premium, the insurer must give 120 days' notice before cancelling, terminating, or failing to renew the policy. The insurer and

the insured can determine the extent of credit the insured may receive for providing the insurer with the use of the premium money for the 120 days.

Assignment of policy

If a new owner or operator takes over management of an existing facility covered by a policy, it might be to his advantage to be able to assume the policy rather than establish a new mechanism. The regulations therefore require that the insurer allow assignment of the policy to a successor owner or operator. Such assignment is subject to the approval of the insurer, provided such approval is not unreasonably refused.

Growth in post-closure funds

The regulations for the insurance plan have a provision to assure that funds for post-closure care will continue to grow apace with inflation. The face amount will increase annually. The increase must be equivalent to the face amount, less any payments made, multiplied by an amount equal to at least 85 percent of the most recent investment rate (also known as the equivalent coupon-issue yield) announced by the U.S. Treasury for 26-week Treasury securities. Yield on the Treasury bills was selected because it is competitive with other low-risk investments and is widely published.[5] Also, for these long-term policies, a standard that can be expected to be available far into the future is preferable. Since issuance of 26-week Treasury securities is a well-established practice,

having been done for almost 50 years, the rate for these securities is also a suitable standard because of its expected long-term availability.[5] The investment rate was chosen above the discount rate because it reflects the true return realized by the seller.[6]

The 85-percent standard sets a minimum rate of growth and allows what the Agency believes to be a reasonable payment to the insurer for administrative costs. The insurer and insured may agree on a higher rate of return.

Costs

The cost of the insurance to the owner or operator will naturally be a key factor in determining whether he will purchase it rather than establish a trust fund or other mechanism. The Agency expects that the cost of the insurance will be significantly cheaper than that of the trust fund if payments for the premiums are tax deductible and payments into the trust are not. During most of the period of development of the insurance plan, the Agency believed that such would be the case. However, recently an insurance company representative and a representative of an insurance brokerage firm expressed uncertainty about the deductibility of the premiums.[7] On the other hand, a tax specialist for the American Insurance Association expressed the belief that the payments would be deductible.[8] Informal discussion with an IRS staff member tends to support the latter view.[9] To clarify the tax treatment of the premiums, however, EPA intends to ask IRS for a written opinion. The Agency has already asked IRS for review of the tax treatment of the trust fund.

Aside from the tax treatment, there can be a cost advantage to the owner or operator of a permitted site in using the insurance plan over the trust fund because payments into the plan may be scheduled over the expected life of the facility rather than the 10-year permit life, which is the maximum pay-in period for trusts under Part 264. If the policy spreads the payments over a 20- or 30-year expected facility life, this may represent substantial savings to the owner or operator. Another possible advantage to the owner or operator in using insurance as the means of financial assurance is the effect on his financial statements. With the other methods of financial assurance, the estimated costs of closure and post-closure care will probably show as a form of liability on financial statements, but with insurance coverage of the costs, they will not.[10]

One company, the St. Paul Insurance Company, has indicated its present thinking on premiums that would be charged on this insurance using a hypothetical case of a facility with an estimated closure cost of $100,000 (current dollars) to be funded over 20 years. If a 10 percent inflation rate is assumed, then the closure cost would be $670,000 in 20 years. Calculating 11.2 percent interest on the payments and then equalizing the payments, the annual premium would amount to $12,000. This may be compared to a trust fund established in the same case where the initial payment would be $5,000 under interim status or $10,000 under permitted status and would increase by 10 percent a year. The

company said that about $4,000 of the initial premium for the insurance would be for covering the risk of early closure. This amount would probably be reduced as the years went by, while the portion for expected costs of closure or post-closure care increased correspondingly. The company would also allow larger yearly payments for the first few years and smaller ones later on if the insured so chooses. One example it gave was $15,000 for the first 5 years, then $12,000 for the next 5 years and $7,200 for the last 10 years.[7]

The cost of the insurance should also be affected by growth of competition among insurers. The regulations set forth only the requirements that affect assurance of funds for closure and post-closure care whenever such funds are needed. Other aspects of the policy are left to the insurer and insured. Therefore, specifications and premium rates are likely to differ from one policy to another.

PROMULGATION AS INTERIM FINAL REGULATION

The closure and post-closure insurance regulations were not sufficiently developed for inclusion in the previously proposed regulations for the financial requirements. The Agency is promulgating the insurance regulations without going through the proposal stage because it believes that the insurance plan should be an option available to owners and operators on the effective date of the regulations. The insurance mechanism provides strong financial assurance for closure and post-closure care. It may furthermore provide cost advantages to owners

and operators, especially those who would otherwise establish trust funds. This option does not impose additional burdens on the owner or operator but rather expands his range of choices. Because the financial requirements are being issued as interim final regulations, there will be a 60-day comment period. Any inadequacies in the regulation may be called to the Agency's attention during this time, and any corrections that are necessary and feasible will be made.