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FEB 25 2000

Honorable Mathy Stanislaus
Assistant Administrator
Office of Solid Waste & Emergency Response
U.S. Environmental Protection Agency
Washington, D.C. 20460-0001

Dear Mr. Stanislaus:

The Environmental Financial Advisory Board (EFAB) was asked by the Office of Solid Waste and Emergency Response to review a range of questions concerning the financial assurance requirements for programs established under the Resource Conservation and Recovery Act (RCRA). This report addresses the use of commercial insurance as a financial assurance tool, and is the third in a series of reports responding to this request. Our earlier reports addressed the use of the financial test/corporate guaranty, and captive insurance. These reports can be viewed on the EPA website at www.epa.gov/efinange/efabpub.htm.

EFAB was charged with addressing three questions regarding Commercial Insurance: (1) *What are the strengths and pitfalls of insurance?;* (2) *Should there be minimum capitalization for insurers who provide policies for financial assurances and, if so, what requirements would best assure funds are available for protection of the environment, including closure, post-closure, corrective action and other environmental clean-up?;* and (3) *Many people have suggested standardized policy language for insurance. Would this be advisable and, if so, how might it be developed?*

EFAB conducted a workshop in New York City to focus on the use of insurance, at which time EFAB heard from insurance carriers, users of insurance, representatives of OSWER, and three state representatives familiar with the use of insurance for RCRA financial assurance. EFAB also heard from attorneys knowledgeable about the use of insurance as a form of financial assurance, and from consultants specializing in the area. EFAB also received public comment at the meeting.

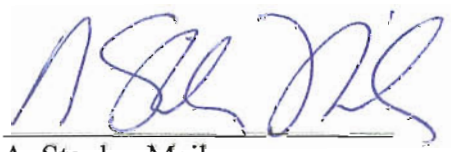
This report is the result of many months of deliberations. In general, EFAB believes that in many cases insurance is a viable, valuable mechanism for providing financial assurance. It is an option that may be even more useful during times of economic difficulty, when the market for alternative financial assurance

instruments may be restricted. EFAB believes that any changes made to the use of insurance should not result in insurance becoming impractical, unavailable, or prohibitively expensive as a financial assurance instrument. However, EFAB also believes that insurance should provide a level of protection to the regulatory agency and the public comparable to other financial assurance mechanisms, as explicitly stated under the policy and up to the stated limit of liability, in the event the owner/operator is unable to meet its closure, post-closure or corrective action obligations. EFAB believes that it is essential that insured parties, insurance companies, and regulatory agencies operate with a common understanding of the obligations and limitations of insurance as a financial assurance instrument. Finally, as it did for captive insurance, EFAB supports the concept of a third party evaluation of the soundness of providers of insurance as a financial assurance instrument.

EFAB appreciates the continuing opportunity to provide financial advisory assistance to EPA on issues of national importance. We hope that you find our recommendations constructive and useful.

Sincerely,

A. James Barnes
Chairman



A. Stanley Meiburg
Designated Federal Officer

Enclosure

cc: Lisa P. Jackson, Administrator
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Barbara J. Bennett, Chief Financial Officer

Environmental Financial Advisory Board

EFAB

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Financial Assurance: Commercial Insurance as a Financial Assurance Tool

This report has not been reviewed for approval by the U.S. Environmental Protection Agency; and hence, the views and opinions expressed in the report do not necessarily represent those of the Agency or any other agencies in the Federal Government.

February 2010

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REPORT ON COMMERCIAL INSURANCE

I. CHARGE

At the request of the U.S. Environmental Protection Agency (Agency), the Environmental Financial Advisory Board (Board) is examining questions concerning the financial assurance requirements established under the Resource Conservation and Recovery Act (RCRA).

These requirements address closure, post-closure, corrective action and other aspects of the RCRA Subtitle C hazardous waste program, the Subtitle D non-hazardous waste program**,** and the Subtitle I underground storage tank program. The Board acknowledges that the financial assurance mechanisms and requirements for the RCRA Subtitle C and D programs are different than those established for the underground storage tank program under RCRA Subtitle I. Notwithstanding these differences, the Board notes that administrative and litigation experience related to the use of underground tank insurance is applicable to the discussion of the RCRA Subpart H financial assurance requirements. Specifically, the statutory and regulatory language of the RCRA financial assurance program underpins the design of the UST financial assurance program; and as a consequence, the Agency's position, administration and litigation precedent are relevant to the subject matter of this report. As such, where relevant, this report includes reference to financial assurance programs beyond the RCRA Subpart H program to assure a full and fair description of the concerns with respect to the use of insurance as a means of demonstrating financial assurance. The Board limits its discussion to financial assurance as provided for under RCRA. It does not address the use of financial assurance under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), because the program administration, regulatory terms and statutory authorities are not bound by the RCRA financial assurance provisions.

The financial assurance requirements established under the RCRA program are complex and multi-faceted. For this reason, in collaboration with the Agency, the Board is addressing discrete, manageable pieces of the inquiry into the use of insurance as a means of demonstrating financial assurance. For example, the Board provided its views on the "financial test" and "captive insurance" to the Agency on January 11, 2006 and March 20, 2007, respectively. In addition, the Board views the accuracy of cost estimates as a matter of paramount importance and plans to address this issue in a separate report. This report on commercial insurance addresses insurance used to satisfy financial assurance for closure, post-closure and third party liability requirements.

Specifically, the Board was charged with the following questions relating to insurance:

> **What are the strengths and pitfalls of insurance?**
>
> **Should there be minimum ratings for insurers that provide financial assurance?**
>
> **Should there be minimum capitalization requirements for captive or other insurers which provide policies for financial assurance and, if so, what requirements would best assure funds are available for protection of the environment, including closure, post-closure, corrective action and other environmental clean-up?**
>
> **Should insurance policies written by captives and commercial insurers be treated as equally acceptable mechanisms?**
>
> **Should the language of insurance policies written by captives differ in any way from those issued by commercial insurers?**
>
> **Is standardized policy language for insurance advisable? If so, how might it be developed?**
>
> **What are appropriate safeguards (such as capitalization, rating, coverage, etc.), if any, for insurance for a Brownfields cleanup?**

By letter dated March 20, 2007, the Board partially addressed these questions by focusing on issues relating to captive insurance. Specifically, the Board answered three questions related to captive insurers as follows:

> "*(1) Should there be minimum capitalization requirements for captive or other insurers who provide policies for financial assurance and, if so, what requirements would best assure funds are available for protection of the environment, including closure, post-closure, corrective action and other environmental clean-up?* Yes. The Board concludes that minimum capitalization requirements are necessary. It also concludes that a nationally recognized statistical rating organization (NRSRO), such as AM Best, is in the best position to determine the minimum capital and surplus levels necessary to ensure that a particular insurer will have funds available commensurate with the amount and types of risks underwritten.
>
> *(2) Should policies written by captives and commercial insurers be treated as equally acceptable mechanisms?* Yes, assuming they meet the same licensing standards as those noted with respect to the program implemented by the State of Vermont, and assuming the insurers are subject to effective, independent oversight.

(3) Should the language of policies written by captives differ in any way from those issued by commercial insurers? No. Policies issued to provide coverage for purposes of financial assurance should clearly meet all applicable regulatory requirements, and the policy language should reflect the adequacy of coverage in all instances."[1]

The Board further recommends that a captive insurance policy may be used as a financial assurance tool, if the captive carrier meets certain tests set forth in the report accompanying the Board's March 20, 2007 letter and meets the general regulatory requirements established for commercial insurers.[2]

The current report addresses the requirements for commercial insurance, as a financial assurance tool. In June 2008, the Board conducted a workshop in New York City to focus on the use of insurance, at which time the Board heard from insurance carriers, users of insurance, representatives of OSWER, and three state representatives familiar with the use of insurance for RCRA financial assurance. The Board also heard from attorneys knowledgeable about the use of insurance as a form of financial assurance, and from consultants specializing in the area. The Board received public comment at the meeting.

This report is the result of many months of deliberation. The Board recognizes that a divergence of opinion exists between the regulators, the regulated community and third parties with respect to the legal parameters underpinning the use of financial assurance. Specifically, the Board recognizes that divergences of opinion exist with respect to conflict of laws involving the regulation of insurance and the regulation of environmental issues. These divergences of opinion manifest in ongoing and periodic litigation. The Board is not in a position to assess or resolve matters at issue in subject litigation. Rather, the Board's position is to offer practical, financially-oriented recommendations designed to assist the Agency in achieving its strategic objectives. It is this practical advice on which the Board's deliberations have focused, and which is the subject of this report. In this report, the Board focuses on providing meaningful responses to the questions posed by the Agency. The Board leaves it to the Agency to weigh the recommendations offered below in the context of its statutory authority and established public policy framework for financial assurance.

II. BACKGROUND & CONTEXT

A. The Nature of Insurance

An insurance policy is a contract between two parties, the insurer and the insured. Generally, the insurance policy covers specific risks, as stated in the policy and up to a prescribed limit of liability (i.e., a dollar amount) specified in the policy. Depending on the nature of the policy, the insurer agrees to pay, pay on behalf of, or reimburse the

[1] See page 7 of the Board's report accompanying the March 20, 2007 letter.
[2] See pages 6 – 8 of the report accompanying the letter.

policyholder(s) under triggering conditions specified under the terms and conditions of the policy. In general, such conditions might include:

1. The occurrence of a policy triggering event, as such events are defined under the terms and conditions of the policy;
2. Satisfaction of the conditions of the policy (e.g., providing required notice, payment of premium, etc.) have been met;
3. Determination that exclusions either are not applicable or apply only to certain components of the claim; and
4. Satisfaction of all other requirements and conditions of the policy (e.g. a policy procured by fraudulent means may be void ab initio in some cases).

In exchange for this protection, the insured agrees to pay a policy premium to the insurer. Depending on the agreed-upon policy terms, and the financial condition of the insured, this premium payment may be paid "up front" or over a period of time. The dollar amount of the premium is based primarily on the insurer's assessment of the covered risks (i.e., likelihood that the risk will manifest and a claim will be made against the policy).

The terms of the insurance policy may result from negotiations between the insurer and the insured; or, state law may prescribe some or all of the terms (e.g., as in the case for Workman's Compensation and Employer's Liability, Homeowner's Coverage). Commercial insurance also may be used to comply with the laws and regulations concerning financial assurance.

The RCRA Subpart H, e.g., Subtitle C and Subtitle D, financial assurance regulations do not mandate specific policy language for insurance policies. Instead, the owner or operator shall provide a certificate from the insurer which states: (1) the policy conforms to the requirements of the regulations, and (2) the insurer agrees that any inconsistent provisions of the policy are amended to eliminate such inconsistencies.

In the context of RCRA Subtitle I financial assurance provisions for Underground Storage Tanks, some regulatory agencies have taken the position that the insurance policy covers risks that appear to be excluded under traditional insurance law and the specific language of the policy.[3] As evidenced by litigation, this position reflects a divergence of opinion involving the regulation of insurance and the regulation of environmental issues, as noted above. In certain jurisdictions, the consequence of the regulator's legal position may be that insurance is rendered unavailable or becomes prohibitively expensive, Another potentially unintended consequence of the regulator's position may be that insurance, as a means of financial assurance, is treated like surety, and therefore becomes subject to applicable surety regulations, which may affect availability, price, terms and conditions.

[3] See Zurich American Insurance v. Whittier (9th Circuit, 2004). Note, this case relates specifically to the financial assurance provisions underpinning the Underground Storage Program (Subtitle I). The same issues have not, to date, been tested under other RCRA Subpart H, e.g., Subtitle C or Subtitle D, provisions.

Further, the nature of risks for which insurance provides protection varies. For example, companies may seek insurance to:

- ✓ Manage environmental risks which are known to manifest on occasion at regulated sites, using insurance as a risk transfer mechanism.

- ✓ Manage risks of cost overruns associated with known, as well as unidentified or unknown risks.

- ✓ Manage both the probability of an environmental risk manifesting, as well as the potential for a cost overrun associated with its concomitant remediation obligations, because the company knows neither the extent of possible environmental contamination, nor the cost of remediation.

In general, a company's decision as to which type of insurance product to purchase is a function of administrative risk and risk arising from governmental decision-making, as well as a function of the advancement in science before (and sometimes after) discovery of the event and/or its remediation.

According to witnesses who presented before the Board, and to conversations with EPA and State officials, the circumstances involving the transfer of risk of cost over-runs for a defined or unknown environmental risk is less likely to occur in the case of closure or post-closure, and more likely to occur when dealing with RCRA corrective action requirements. Regardless of the situation, the use of insurance as a financial assurance mechanism is intended to provide assurance to the regulatory agency that closure, post-closure and/or corrective action will occur when necessary, within the conditions and extent of coverage provided by the policy.

B. The Statutory Framework

Congress through a series of Acts, including the Solid Waste Disposal Act of 1965, the Resource Conservation and Recovery Act of 1976, and the Hazardous and Solid Waste Amendments of 1984, enacted legislation collectively known as the Resource Conservation and Recovery Act (or RCRA). Generally, RCRA places primary responsibility for closure and post-closure obligations of a covered facility**'s** environmental obligations, as well as any corrective action that may be required, on the owner and operator of the facility.

The statute at 42 USC §6924 (a)(6) provides that the Administrator of the Agency shall set standards by regulation for financial responsibility of the owners and operators.

At USC 42 § 6924 (t)**,** the statute further provides that:

…

(1) Financial responsibility…may be established…by any one, or any combination, of the following: insurance, guarantee,

surety bond, letter of credit, or qualification as a self-insurer. In promulgating requirements under this section, the Administrator is authorized to specify policy or other contractual terms, conditions, or defenses which are necessary or are unacceptable in establishing such evidence of financial responsibility in order to effectuate the purposes of this chapter….

(3) The total liability of any guarantor shall be limited to the aggregate amount which the guarantor has provided as evidence of financial responsibility to the owner or operator under this chapter….

(4) For the purpose of this subsection, the term "guarantor" means any person other than the owner or operator, who provides evidence of financial responsibility for an owner or operator under this section.

C. RCRA Financial Assurance Regulations

The Code of Federal Regulations at 40 CFR 264/265 Subpart H sets forth allowable mechanisms for an owner or operator of a hazardous waste treatment, storage or disposal ("TSD") facility "to establish financial assurance" in order to assure that funds necessary to satisfy closure and post-closure care and third-party liability are available. The Code of Federal Regulations at 40 CFR 257/258 sets forth allowable mechanisms for new and existing Municipal Solid Waste Landfills – the management of non-hazardous solid waste.

Financial assurance options delineated by the regulations under RCRA Subtitle C and Subtitle D include: (1) trust funds, (2) surety bonds guaranteeing payment or performance, (3) letters of credit, (4) insurance, (5) proof of financial responsibility by the owner or operator in the form of a corporate financial test, or (6) guaranty of a party with a 'substantial business relationship' to the owner or operator. With respect to corrective action, the regulatory requirements under RCRA at 40 CFR 264.101, require demonstration of financial assurance, but do not specify the type or nature of the financial mechanisms that may be used to comply; for example, the section does not refer to the financial mechanisms delineated at 40 CFR 264.151. The Board does not wish to limit the financial mechanisms available for corrective action to those set forth in the RCRA Subtitle C and Subtitle D regulations. However, the Board's comments on these regulations are similarly applicable to corrective action to the extent similar financial instruments are used.

The above-listed financial instruments are designed to satisfy the financial assurance requirement in different ways. For example, the surety of a payment or performance bond "must be liable on the bond obligation when the owner or operator fails to perform as guaranteed on the bond", whereas the trustee of a trust is obligated to "make payments from the fund as the EPA Regional Administrator [or delegated state authority] shall

direct."[4] Moreover, the regulations under RCRA Subtitle C and Subtitle D establish different requirements for the parties providing (or underwriting) the financial assurance instrument. For example, the surety of a payment or performance bond must be listed on Circular 570 of the U.S. Department of the Treasury. The issuing institution of a letter of credit must have its letter of credit operations regulated and examined by a federal or state agency.

Both the RCRA Subtitle C and Subtitle D regulations require that the insurer be licensed to transact the business of insurance, or be eligible to provide insurance as an excess or surplus lines insurer, in one or more States. Neither the RCRA Subtitle C, nor the RCRA Subtitle D, regulations establish minimum requirements concerning the financial strength of the insurer. Further, neither set of regulations provide specific (standardized) language for an insurance policy used to comply with the financial assurance provisions. Rather, the closure regulations at 40 CFR 264.143(e) and at 40 CFR 265.143(d), and the post-closure regulations at 40 CFR 264.145(e) and at 40 CFR 265.145(d) specify several requirements that the owner or operator must meet, and terms and conditions that must be provided for in the insurance policy.

For example, the closure and post-closure regulations require that the applicable insurance policy assure that the insurer shall pay out funds upon the direction of, and to the party specified by, the governing regulatory agency. The regulations also require that the limit of liability of the insurance policy be at least equal to the current estimated cost for the event(s) covered, unless the insurance policy is being used as part of a combination with other allowable financial mechanisms (i.e., trust fund, surety bond guaranteeing payment, or letter of credit).

With respect to the use of commercial insurance as a form of financial assurance, the RCRA Subtitle C regulations for hazardous waste require the owner or operator to provide the governing regulatory authority with a "certificate of insurance," as provided for at 40 CFR 264.151(e) within a specified time frame. A similar provision does not exist under the Subtitle D regulations for non-hazardous solid waste management. The certificate of insurance must have the following exact language (except that instructions in brackets are to be replaced with the relevant information and the brackets deleted). The text highlighted in bold below conforms the policy to the regulations.

> Certificate of Insurance for Closure or Post-Closure Care
>
> Name and Address of Insurer
>
> (herein called the "Insurer"):_____
>
> Name and Address of Insured
>
> (herein called the "Insured"):

[4] See 40 C.F.R. pt. 264.

Facilities Covered: [List for each facility: The EPA Identification Number, name address, and the amount of insurance for closure and/or the amount for post-closure care (these amounts for all facilities covered must total the face amount shown below].

Face Amount:_____
Policy Number:_____
Effective Date:_____

The insurer hereby certifies that it has issued to the Insured the policy of insurance identified above to provide financial assurance for [insert "closure" or "closure and post-closure care" or "post closure care"] for the facilities identified above. **The insurer further warrants that such policy conforms in all respects with the requirements of 40 CFR 264.143(e), 264.145(e), 265.143(d), and 265.145(d), as applicable and as such regulations were constituted on the date shown immediately below. It is agreed that any provision of the policy inconsistent with such regulations is hereby amended to eliminate such inconsistency.** [Emphasis added.]

Whenever requested by the EPA Regional Administrator(s) of the U.S. Environmental Protection Agency, the Insurer agrees to furnish to the EPA Regional Administrator(s) a duplicate original of the policy listed above, including all endorsements thereon.

I hereby certify that the wording of this certificate is identical to the wording specified in 40 CFR 264.151(e) as such regulations were constituted on the date shown immediately below.

[Authorized signature for insurer]

[Name of person signing]

[Title of person signing]

Signature of witness or notary:_____

D. DISCUSSION OF CHARGE QUESTIONS

1. STRENGTHS AND PITFALLS OF INSURANCE

An insurance policy is a contract between the insured and the insurance carrier. In general, the regulatory agency is not a party to the contract. However, under certain circumstances, the regulatory agency may request that it be listed as a beneficiary and/or be a party to the contract.

Owners and operators of RCRA Subtitle C and Subtitle D facilities seek insurance for a variety of reasons. The stated terms and limits of liability established by an insurance policy will vary depending on the underlying objective of the policy, and the expectations of the parties bound by the policy. For example, assume that the owner or operator of a RCRA Subtitle C or Subtitle D facility intends to pay for its closure, post-closure and corrective action obligations using cash flows directly from its operating activities, from the sale of assets, or from its affiliates (e.g., a corporate parent). For business reasons, the same owner or operator chooses not to (or can not) use the corporate financial test as a financial assurance option. Under the RCRA regulations, the owner or operator is required to provide a financial instrument to the regulator as demonstration of financial assurance. In this case, the owner's or operator's primary driver for acquiring insurance is the need to meet its regulatory obligation to have compliant financial assurance.

In general, insurance may be used either to make the insured whole upon the manifestation of the covered risk or to compensate an injured party, assuming adequate coverage has been purchased. An insurer usually makes a payment to the policyholder once the claim is valued.[5] Further, under the RCRA closure, post-closure and corrective action provisions, an insurance policy may be used in combination with a subset of other financial instruments, including a letter of credit, surety bond guaranteeing payment or a trust fund.

The characteristics which evidence both the strengths and pitfalls of insurance are detailed below.

Strength. Independent Valuation of Risk

The insurance carrier independently evaluates the risk in determining whether to assume the risk of issuing a policy. The Board heard from experts who suggest that this independent valuation adds credibility to the cost estimates on which the regulatory agency relies. However, the accuracy of the cost estimate itself cannot be inferred from the acceptance by an underwriter; only that the limit of liability stated in the policy can be satisfied.

When closure, post-closure and, as necessary, remediation for corrective action occurs, the carrier may independently review the methods and cost of the activities proposed. This has the advantage of encouraging efficiency and controlling costs; but also can contribute to the disadvantage of possibly delayed, or denied, payment of a claim. The Board heard differing views on claims payment. Some regulators stated that insurance carriers unnecessarily delay or deny claims, while representatives of the insurance carriers disagreed with this characterization. At times**,** disputes over payment of claims have been resolved by litigation.

[5] Some insurance carriers view their role as more than paying out a sum of money requested (or demanded) in the precise amount requested (or demanded). These carriers may wish to make their own assessments to determine that the amount requested is appropriate**,** and may seek a voice in the selection of a particular remedy. These carriers believe that they are experienced in reviewing remedies, and can "add value" or reduce costs by virtue of their expertise.

Strength. Flexible Financial Instrument

In general, most insurance policies addressing RCRA closure, post-closure and corrective action are negotiated on a site-specific basis. As such, insurance represents a flexible financial instrument that can be tailored to the needs of the insured and the regulatory agency.

In general, insurance carriers price insurance policies based on the type, expected frequency and magnitude of risk assumed. For some policies, the primary risk is environmental, and not the creditworthiness of the insured. In such cases, where the triggering event of risk is truly fortuitous, the insurance carrier may not require collateral or impose credit-based restrictions that a provider of other types of financial assurance may require. If the insurer is willing to assume the risk for costs associated with closure, post-closure or corrective action, insurance may be available to owners/operators, who cannot meet the corporate financial test or are unable to obtain other types of financial assurance (e.g., letter of credit). Insurance sends risk-based price signals in the form of premiums – how much must the insured pay for the coverage delineated by the policy. As such, the premiums efficiently reflect assumed risk.

All of the experts who presented to the Board acknowledged that the flexibility inherent to insurance constitutes a significant advantage.

Pitfall. Complex Contractual Instrument

The Board appreciates that with flexibility comes the potential for complexity. Insurance policies tend to be complex legal documents, varying from jurisdiction to jurisdiction, from owner/operator to owner/operator, and from site to site. Experts specializing in the use of insurance as financial assurance acknowledged challenges in appreciating the implications of the varying provisions (exclusions, endorsements) underlying insurance policies. These experts stated that substantial time and effort tends to be devoted to the administration of insurance policies used to comply with financial assurance requirements.

Pitfall. Jurisdictional Challenges with Respect to the Interplay of State and Federal Law

It has come to the Board's attention that some insurance carriers, and at least some regulatory agencies, have fundamentally differing views on the scope of coverage provided by an insurance policy, and of the required certificate issued pursuant to the RCRA regulations at 40 CFR 264.151. In the Board's opinion, these differences of opinion go beyond questions of interpretation of specific policy language and extend to the interplay between federal and state environmental regulations and state/general insurance law, including the resulting impact on the legal obligations of the insurance carrier.

The Board notes that some carriers and some regulating agencies have fundamentally differing views on the scope of coverage provided by an insurance policy and of the

required certificate issued pursuant to the RCRA regulations. These differing views go beyond questions of interpretation of specific policy language, an inevitable consequence of any complex contract, and reach the extent to which state and general insurance law affect the carrier's obligations.[6] Simply stated, one recurring issue is whether the insurance policy provides a "guarantee" or simply "assurance" to the regulating agency. Divergent views of the obligations of the parties furnishing or relying on an insurance policy create different expectations. In such circumstances**,** the regulatory agency may not feel it has the financial certainty that it believes it has with other financial assurance instruments**,** such as a letter of credit. Likewise, the insurance carrier may believe it is required to assume risks and to provide guaranties, for which it did not contract.

The Board notes that all of the experts from whom it received information, including those who focused on the pitfalls of insurance, emphasized that insurance is a viable, valuable tool for providing financial assurance. When asked, each presenter stated that any changes or recommendations concerning the use of insurance as a means of RCRA financial assurance should not render it prohibitively expensive or unavailable.

2. MINIMUM FINANCIAL REQUIREMENTS FOR INSURANCE CARRIERS -- Minimum Ratings and Capitalization

Each state has a detailed regulatory scheme concerning the use of insurance within its jurisdiction. The current RCRA regulations do not establish minimum standards for the financial strength of insurance carriers. Instead, the regulations simply require that insurance carriers "be licensed to transact the business of insurance, or eligible to provide insurance as an excess or surplus lines insurer," in at least one state. When asked, no presenter saw a need for a more stringent federal licensing requirement except as may be required by existing state law.

As with any financial assurance instrument, including surety bonds and letters of credit, the strength of the instrument is predicated on the financial strength of the issuing institution and the underlying underwriting criteria. In the absence of meaningful criteria measuring the financial strength of the issuing financial institution, the value of the financial assurance may be questionable.

In response to questions posed by the Board, the presenters from state environmental agencies stated that they did not have the capacity to evaluate the financial strength of each insurance carrier. Instead, if inquiries were made, they relied on the determination of the state regulating insurance agency or on the evaluation of independent third party entities which rate the financial strength of insurance companies.

Each presenter who was asked stated that there should be minimum requirements to evidence the financial strength of the insurer. The presenters, who were asked, stated that a minimum rating of A from A.M. Best or from a nationally recognized statistical rating

[6] Id. for Whittier v Zipmart

organization (NRSRO) would be appropriate. The exception, the representative of the State of Washington, stated that a minimum rating of B+ was satisfactory.

The Board previously determined that a captive insurance company which relied on a rating from an independent agency to establish its financial capacity should have a rating of "Secure" or better. No presenter suggested that there should be a lesser minimum standard for commercial insurers than for captive insurance companies.

3. STANDARDIZED LANGUAGE

As the Board understands, not all states receive or review the actual insurance policy, including endorsements, provided by companies for purposes of complying with RCRA financial assurance requirements. As a result, many regulators are unaware of the specific provisions which underpin the policy. Rather, these regulators rely on the certificate required at 40 CFR 264.151 as proof of compliant financial assurance and adequate coverage for closure, post-closure and corrective action. Conversely, according to representatives of both the insurance carriers and the regulators, there are some state regulators who carefully review and negotiate the insurance contracts. The Board finds that there is a divergence of views among regulators as to the level of review that is deemed advisable**,** as well as the level of review that actually is performed.

While some states have “suggested” or “pre-approved” provisions, the Board is unaware of any environmental agency that states that specific language is required for insurance policies, which are used for purposes of demonstrating financial assurance. In some states, the policies often are negotiated to fit particular risks at a particular site. The Board, however, heard anecdotal reports that some states are uncomfortable with insurance as a viable financial assurance instrument and have established restrictive requirements, such that no or few carriers are willing to underwrite policies in that jurisdiction.

For example, to the Board’s knowledge, no new insurance carriers have entered the market in California since the state regulatory body introduced “pre-approved” language. Further, all newly effective insurance policies in California contain the recommended language.

When asked, every presenter opposed having federally mandated, standardized language for an entire insurance policy – regardless of whether the individual favored recommended or pre-approved language or expressed serious reservations about insurance. As a rationale, each presenter emphasized the flexibility afforded by insurance in varying situations; federally mandated (or standardized) insurance language would limit this flexibility. Moreover, when asked, most presenters stated that an insurance carrier should be required to assume obligations only as explicitly provided for in the insurance policy, and up to the maximum allowable coverage (or limit of liability). The representatives of the insurance carriers stated that they underwrite and price insurance policies based on the underlying terms and conditions of the policies, and the existing state of the law at the time.

As stated before, the Board finds that there is fundamental disagreement as to the effect and meaning of the RCRA regulations and the required certificate which conforms the insurance policy to the regulations. One state representative contended that the insurance policy together with the certificate constitutes a "financial guarantee." Representatives of the insurance carriers**,** as well as a presenter who was an independent consultant, argued that insurance is fundamentally a risk management tool, insurance is not a financial guarantee – insurance represents a contract covering agreed upon risks up to a financial limit of liability.

RESPONSE TO THE AGENCY'S CHARGE

With regard to the questions posed by the Agency, the Board responds as follows:

1. What are the strengths and pitfalls of insurance?

This question has been addressed in the section entitled Strengths and Pitfalls of Insurance.

2. Should there be minimum capitalization for insurers who provide policies for financial assurances and, if so what requirements would best assure funds are available for protection of the environment, including closure, post-closure, corrective action and other environmental clean-up?

The existing minimum requirement that an insurance carrier be licensed in one or more states is not sufficient to assure financial viability but is necessary protection that should be retained.

The Board believes that this requirement should be augmented with an objective third-party analysis of the capacity of the carrier to meet its obligations.

3. Many people have suggested standardized policy language for insurance. Would this be advisable and, if so, how might it be developed?

Answer: Mandatory policy language is not advisable.

E. RECOMMENDATIONS

Minimum Capitalization. Particularly in times of economic uncertainty, the Board believes that the financial strength of institutions providing financial assurance takes on increasing importance. In the Board's opinion, the current minimum requirement, namely that the institution "be licensed to transact the business of insurance, or eligible to provide insurance as an excess or surplus lines insurer" in at least one state, is necessary but not sufficient protection. The Board recognizes that not all insurers have equal financial strength. Establishing a minimum financial standard, in addition to the existing licensing requirement, may lessen the number of insurance carriers capable of writing

insurance. This raises the issue of what measure of financial strength would be appropriate.

The regulatory agencies, which presented at the workshop, readily admitted that they lacked the capacity to evaluate the financial strength of insurance carriers. The Board believes that this function may be best served by a nationally recognized statistical rating organization (NRSRO), such as AM Best, which specializes in objective third-party analysis of financial viability.

The Board notes that all members agree that there should be minimum requirements to evidence the financial strength of an insurer underwriting insurance for environmental financial assurance. The Board also agrees that a minimum acceptable rating from AM Best or a similar nationally recognized rating agency is appropriate. However, there is a divergence of opinion among the Board as to what constitutes an appropriate minimum acceptable threshold rating.

The Board believes that the various financial instruments used for financial assurance should provide a comparable level of protection to the regulatory agency and the public against insolvency of the provider of the financial assurance instrument. Such level of protection should consider both the risk of insolvency of the provider, and the availability and cost of the product. The Board has not yet examined letters of credit or surety bonds. Accordingly, the Board is deferring the recommendation of a specific minimum rating for a third-party provider until such study is complete.

Standardized Policy Language. As stated above, the Board does not recommend mandatory language for insurance policies for purposes of RCRA financial assurance. The Board believes that both the regulated community and the public are better served when insurance policies contain specifically negotiated provisions to meet the specific characteristics of each insured and each facility. The Board believes that keeping insurance policy language flexible and targeted to specific sites helps to ensure that insurance remains an affordable and readily available financial assurance instrument.

Moreover, the Board recommends caution in adopting "recommended," "pre-approved," or "suggested" provisions. The states that have done so appear to be pleased with the results to date. Nevertheless, the Board sees the potential that "recommended" provisions become *de facto* required. This may result in limiting the availability of insurance or possibly other financial assurance instruments in times of economic uncertainty. The Board is concerned with the different views of the rights and duties of the regulatory bodies and the insurance carriers under insurance policies. This seems to be especially the case in situations where the regulatory body is not involved in negotiating the coverage of the insurance policy, and may not have seen the policy itself.

The Board believes that it is not in the public interest, nor in the interest of the parties to any contract, in this instance a contract between the insurer and the insured, for the various parties to enter into a new arrangement under which each has fundamentally different expectations. Accordingly, the Board encourages involved parties to express

explicitly their respective expectations. In the event, they are not able to come to an agreement, the parties may determine that insurance is not available or may not be an appropriate method for financial assurance in the particular situation. *The Board suggests that the Agency adopt procedures under which the regulatory authority can specifically agree to limitations contained in the insurance policy, or in the alternative specifically reject such limitations prior to the time the carrier becomes legally obligated to issue the policy.* If the regulatory agencies fail to adopt such procedures, the insurance carrier may choose to ask the regulatory body to state affirmatively its position on a particular insurance policy. If the regulatory body declines to do so, the carrier may refuse to issue the insurance policy or charge a different premium.

The Board recognizes that the introduction of additional procedures further complicates what some stakeholders have represented as an already difficult administrative task. The Board also understands that imposing additional procedures may not eliminate all contract disputes. Further, these additional procedures may not effectively resolve all issues that may come about when the insurer is obligated to renew an existing policy, the regulatory agency seeks to materially change the existing terms of the policy, or the insured is unable to furnish other satisfactory financial assurance. In some circumstances, the application of additional procedures may result in insurance not being available or chosen as a financial assurance mechanism. The Board believes, however, that the advantages of having common expectations outweighs these disadvantages and would lessen the suspicion with which some in the regulatory community view insurance as a viable financial assurance instrument.

The Board recognizes that the use of insurance for financial assurance purposes is a highly complex area, with which few have expertise. As the presenters at the workshop pointed out, regulators have widely divergent views on its use. The Board encourages the Agency to provide outreach and education to state regulatory authorities on the use of insurance as a financial assurance instrument.

Finally, the Board reemphasizes the importance of cost estimation. Specifically, the Board believes that developing analytically rigorous and defensible cost estimates is the cornerstone of all financial assurance instruments, including insurance. A financial assurance instrument that is predicated on a cost estimate which is too low limits the amount of financial protection afforded by the instrument. Likewise, a cost estimate which is too high unnecessarily increases the cost to the insured, and may even render the financial assurance instrument unfavorable.

CONCLUSION

The Board believes that, in many cases, insurance is a viable, valuable mechanism for providing financial assurance. It is an option that may be even more useful during times of economic difficulty, when the market for alternative financial assurance instruments may be restricted. The Board believes that any changes made to the use of insurance should not result in the use of insurance being impractical, unavailable, or prohibitively expensive. However, the Board also believes that insurance as a financial assurance

mechanism should provide a comparable level of protection to the regulatory agency and the public, as explicitly stated under the policy and up to the stated limit of liability, in the event the owner/operator is unable to meet its closure, post-closure or corrective action obligations.

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

JUL 21 2010

OFFICE OF
SOLID WASTE AND
EMERGENCY RESPONSE

MEMORANDUM

SUBJECT: EFAB Report on Commercial Insurance as a Financial Assurance Tool

FROM: Mathy Stanislaus
Assistant Administrator

TO: Barbara J. Bennett, Chief Financial Officer
Office of Chief Financial Officer

Thank you for your March 18, 2010 transmittal of the Environmental Financial Advisory Board (EFAB) report, *Commercial Insurance as a Financial Assurance Tool*. Earlier, the EFAB had provided the agency with reports on the financial test and corporate guarantee, and the use of captive insurance. This report provides the EFAB's advice on commercial insurance as a financial tool, including the strengths and pitfalls of insurance, the value of minimum ratings and capitalization requirements for commercial insurers, and the feasibility and advisability of standard policy language for the insurance used to provide financial assurance.

We recognize and appreciate the considerable amount of work the EFAB expended on this report, and will be taking its recommendations under advisement. The Agency is currently developing financial responsibility rules under Section 108(b) of the Comprehensive Environmental Response, Liability, and Compensation Act (CERCLA). The Charge specifically states that EFAB limited its evaluation to financial assurance as provided under the Resource Conservation and Recovery Act (RCRA). However, since many of the same questions concerning commercial insurance as a financial assurance tool will arise in developing the CERCLA 108(b) rules, we plan to also consider these recommendations in developing these rules.

We appreciate this valuable report from the EFAB. If you have questions, please contact me, or your staff may contact Jim Berlow, in OSWER's Office of Resource Conservation and Recovery, at 703-308-8404.