



EPA Victoria

TO: Executive Management Team

SUBJECT: Management of financial assurances

DATE: 8 March 2011

RECOMMENDATIONS:

1. That you approve Option A for the **immediate management** of financial assurance compliance.
2. That you agree to proceed to detailed planning for the **reform of the financial assurance model**.

PURPOSE:

3. To clarify EPA's position on Financial Assurance (FA) compliance for the forthcoming Annual Performance Statement (APS), and establish a viable alternative to the current model of securing FA via bank guarantee.

BACKGROUND:

4. Provision of an FA is a requirement of the Environment Protection Act 1970 (The Act). They are provided by license holders to mitigate the State's exposure to clean-up at their site in the event of a business failure.
5. FA's are a financial security which offers a contingency for the State to address any costs incurred in site remediation, site closure and post-closure liabilities. These costs are incurred when business operators abandon their site, become insolvent, or are required to pay clean-up costs beyond their financial capacity; with the Authority unable to recover costs from the responsible party.
6. EPA's risk exposure stems from the fact that only one third of required FA's have been provided. Further risk is presented because the majority of FA's currently held are believed to be undervalued. The current calculation methodology is based on a publication dating to the late 1990s and reflects costs at that time.
7. As an interim measure, EPA identifies high risk clients who have not provided an FA and an ongoing process is in place to secure these as a priority. Lower risk license holders have been advised of the reform program underway and that the provision of an FA will be required once the reforms are in place.
8. A new calculation method to more accurately reflect contemporary clean up costs is being finalised and is likely to significantly increase the cost of securing an FA. It is projected the increase will be up to 300% for some operators.
9. Under the reformed licences, holders required to have an FA have the following licence conditions:
 - G6 - You must maintain a FA calculated in accordance with the EPA method.
 - G6.1 - You must submit a FA to EPA by 30 June 2011.

10. The Act provides some flexibility in terms of the form of the FA, but in practice almost all FA's obtained to date have been in the form of a bank guarantee. However, it is noted that this form of FA provision is cumbersome, specific to site and a burden on business.
11. Anecdotal evidence indicates some scheme participants are unable to secure a bank guarantee using the existing FA calculation method and for others the requirement for FA is impacting their financial viability. The adoption of the new calculation method is likely to exacerbate this issue and may lead to greater non-compliance.
12. To address the limitations of the existing FA model (securing bank guarantees on a site-by-site basis) EPA commissioned Price Waterhouse Coopers (PwC) to undertake a Financial Assurance Options Analysis to explore alternative models to deliver FA. The draft report was submitted to EMT in December 2010. The final version is attached to this paper.

ISSUES AND RISKS:

13. **Timing** – EPA need to advise businesses which FA calculation method should be used (i.e. current or new method) and when compliance must be achieved (i.e. by 30 June 2011 or beyond).
Resourcing – Under Option B there is a requirement to identify resources to facilitate securing the large number of outstanding FA's (123 for A01 scheduled premises, 21 for A05 scheduled premises [landfills] and 23 various others.)
14. **Financial exposure of EPA** – EPA is currently exposed to the cost of rehabilitating sites in the case of business failure where an FA is not held. It should be noted this is the same risk exposure EPA has carried for some time and is not "getting worse".
15. **Financial impost on business** – The adoption of the new calculation method with the existing model is likely to exacerbate the FA issue and lead to significant business dissatisfaction.

IMMEDIATE MANAGEMENT OPTIONS

16. There are two possible options to address the short term FA requirement.
 - **OPTION A** – continue with interim procedure of only chasing FA's as bank guarantees for high risk clients until new model is established under FA reform. Make licence condition G6 on APS an N/A option for the next attestation period, remove/deactivate licence condition G6.1
 - **OPTION B** – Require FA compliance by 30 June 2011 (using existing calculation methodology) for high risk A01 and A05 licensed scheduled premises only. Extend deadline for others to 31 December 2011 OR 30 June 2012.
17. It is recommendation that EPA continue with Option A.

REFORM PROPOSAL

18. Based on work completed by PwC, the suggested option for EPA to consider is the establishment of a fund to cover any clean up expenses incurred from fund participants in the case of insolvency. This would effectively replace the provision of a bank guarantee with an annual fund contribution (or "premium"). Each company would make an annual contribution based on a set percentage of their "total clean up cost" as determined by the new calculation methodology. The fund would be build up to the required amount over several years.
19. The size of the fund would be determined by EPA, based on the modelling work performed by PwC. EPA could set an annual contribution rate depending on the fund balance at a given time.
20. It is possible to investigate the possibility of funding the running the FA program and the fund out of the fund itself. There is currently no known reason why this could not be used as a source of funding for directly associated costs incurred.

21. License holders will have the option of not participating in the fund, in which case FA will be sought via the standard methods, such as bank guarantee.
22. A similar fund has recently been created by several landfills as part of a previous VCAT determination and is currently accepting funds. EPA has been involved in this process.
23. Prior to the establishment of the fund, EPA will need to conduct a consultation process. This will include major stakeholders including license holders, industry groups, DSE and DTF.
24. In addition to a consultation process, further investigation will be required into the mechanics of the fund. This will include:
 - i. Legal requirements (possibly modelled on the landfill arrangement above);
 - ii. Governance arrangements;
 - iii. Full and accurate modelling;
 - iv. Investment requirements; and
 - v. Fund rules and charter, including drawdown provisions.
25. If approved by EMT, the investigation could commence and more information provided. It is hoped a fund could be established and accepting funds by September, 2011.

CONSULTATION:

26. The immediate management options and interim alternate method (insurance) proposal have been determined in consultation with Regulatory Innovation (Shaun Green) and Service Knowledge (Eve West).
27. The Office of the Solicitor (Mark Payton) has been consulted around the establishment of a fund. At present they see no reason why the fund could not be established within existing legislation.