

Environmental Tools:

Financial Security

What is financial security?

Regulators use financial securities to ensure all environmental requirements are met and/or resolve any environmental problems that may arise during a site's operation or after the owner has abandoned the site. Financial securities provide a social risk management mechanism to protect the environment even when the regulated entity is unable to resolve an environmental issue. This may be due to bankruptcy, insolvency, or where the operator is unwilling to comply with environmental obligations. In these situations, the government has the capacity to adequately respond by forcing the regulated entity to set aside funds, often held in trust by the regulator, to ensure the site is reclaimed to a useful, productive and environmentally sound state when operations conclude.

To ensure performance to a regulated requirement, a party or its agent places financial security with a regulator. Security may be provided in several forms, most commonly cash, letter of credit and bond.

Estimates of the liability to be secured may be done by industry and approved by government, or by industry alone based on a government-approved method. It may be based on actual costs or flat rates.

Financial security is generally required and must be provided in order for a regulated party to get approval to develop a site. Financial security is renewed on a periodic basis to ensure an appropriate amount of money is set aside to cover environmental liabilities. Reviews ensure the public is protected as liabilities go up, and companies are refunded as liabilities decrease.

The regulator returns the financial security to the regulated party when all the environmental obligations have been met.

This approach ensures the regulated entity, not the government or the public, is held responsible for funding and carrying out environmental obligations (i.e. it is a cost of doing business). The financial security posted with the regulator provides an incentive for the regulated entity to complete its obligations in a timely manner.

Where is it used?

Many jurisdictions use variations of financial security to ensure reclamation, especially in the mining industry.

In Alberta

- Reclamation security is currently collected under the *Conservation and Reclamation Regulation* for coal and oilsands mines, coal processing plants, sand

and gravel pits, and oil production sites (the wells, pipelines, batteries and roads that feed into heavy oil plants). As of March 31, 2003, over \$300 million security was held by the department for these industries.

- Reclamation security is also collected for all landfills, hazardous waste and recycling facilities under the *Waste Control Regulation*. As of March 31, 2003, \$17 million was held for those facilities.
- The *Water Act* also provides the potential for financial security to be provided but no regulations have been enacted to implement this requirement.
- The Alberta Energy and Utilities Board administers an abandonment and reclamation financial security program, coupled with an industry-funded orphan fund for the upstream oil and gas facilities. The program collects security when a company's assets are deemed to be less than its abandonment and reclamation obligations (i.e. the program is risk-based).

Tool Performance:

Pros

- May drive better, and quicker, performance by providing an economic incentive (return of the financial security).
- Protects the public from the expense of environmental protection measures that they might otherwise inherit if a regulated entity does not perform.
- There is some flexibility in defining reclamation costs to be secured.
- The amount of security can be revised as often as necessary, ensuring public protection is maintained during the start-up and development phases when liabilities are increasing.
- Can be structured to ensure refunds are made quickly when industry does reclamation work (especially during the wind-up phase of development).
- Alberta Environment allows for partial return of financial security for completion of part of the reclamation work.

Cons

- Requires the regulator to properly evaluate the estimated environmental liability.
- Administrative burden for the regulator in tracking financial security instruments.
- Dedicates industry money that could have otherwise been used to undertake alternative environmental performance measures or to foster continued economic development.
- The federal and provincial taxation systems may not provide sufficient incentives for financial security deposits/costs to be as effective as they could be.

Special Considerations:

Experience in Alberta and other jurisdictions shows the amount of security posted is usually less, sometimes considerably less, than the actual costs to undertake the environmental obligations. Therefore, it is important to accurately estimate the needed amount of security to ensure environmental obligations are met.

There have been few Alberta cases where the security has been used by the government. Some argue this shows the preventive aspect is working, others argue it shows the industry is advanced enough that it will always meet its obligations and so the security is not needed.

Industry needs clarity upfront on how, when and how much security will be required to allow for proper financial planning and management.