



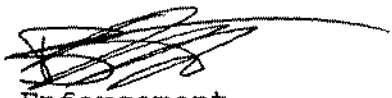
UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

APR 17 1995

OFFICE OF
ENFORCEMENT AND
COMPLIANCE ASSURANCE

MEMORANDUM

SUBJECT: Exploring Use of Annuities as Funding Tools for
Superfund Settlements

FROM: Bruce M. Diamond, Director 
Office of Site Remediation Enforcement

TO: Waste Management Division Directors,
Regions 1, 4, 5, 6, 7, 8
Emergency and Remedial Response Division Director,
Region 2
Hazardous Waste Management Division Directors,
Regions 3 and 9
Hazardous Waste Division Director, Region 10
Regional Counsel, Regions I - X

One of the major emphases in the Superfund program is to identify mechanisms that will facilitate settlements and increase fairness across the program. As a part of that effort, the Office of Site Remediation Enforcement is currently examining the use of annuities as funding mechanisms for Superfund settlements. Specifically, we are exploring the option of permitting potentially responsible parties (PRPs) to use annuities, where appropriate, to fund cash payments in settlements with EPA or in global settlements among PRPs. The Agency is also examining the possibility of EPA owning such annuities. As discussed below, there may be potential advantages from the use of annuities that could ultimately result in making more cash available for funding cleanups. I am requesting your input in examining this issue and in developing criteria for pilot projects involving the use of annuities in Superfund settlements.



Recycled/Recyclable
Printed with Soy/Canola Ink on paper that
contains at least 50% recycled fiber

Background

An annuity is an investment (typically issued by an insurance company)¹ that produces a cash flow for a defined period in exchange for payment of a one-time premium. In a CERCLA settlement, an annuity is a potential funding mechanism for future response costs that will be incurred either by EPA (at fund-lead sites) or by some or all of the PRPs. PRPs at a Superfund site might purchase an annuity from a third-party financial institution who would then be responsible under the annuity contract for making future payments, either to EPA or to the PRPs performing the work, according to a schedule designed to meet the needs of the specific case.

The use of annuities as funding mechanisms for Superfund settlements may offer several advantages to EPA and to settling PRPs. First, an annuity takes advantage of the "time value" of money. Because the PRP's initial payment into the annuity is held and invested by the trustee for several years, it earns returns that are paid to the beneficiary that augment the original sum, with the result that more money ultimately becomes available for remediation at the site.²

Further, the use of annuities may offer tax advantages to PRPs. The PRPs may be able to deduct the cost of purchasing the annuity at the time payment is made, and the interest that accrues over the life of the annuity may not be taxable at all if

¹ The U.S. Supreme Court recently held that a bank's brokerage subsidiary is permitted under the National Bank Act to serve as an agent in the sale of annuity contracts. In so holding, the Court sustained an interpretation by the Comptroller of the Currency that variable annuities, fixed annuities, and hybrid annuity accounts are financial investment instruments and not "insurance" as that term is used in the National Bank Act. Nationsbank v. Variable Annuity Life Ins. Co., Nos. 93-1612, 93-1613, 1995 U.S. LEXIS 691, slip op. at 16 (January 18, 1995).

² The same advantage might theoretically be accomplished by placing the proceeds of a lump-sum cashout in an interest-bearing account such as a trust fund or escrow account. At present, however, the interest earned on cashout funds deposited in a Superfund "special account" accrues to the general Superfund trust fund--not to the special account established for the site. We are continuing to work on this issue with OMB. The interest earned on cashout funds maintained in trust accounts established by PRPs is reinvested, making both principal and interest available to fund the cleanup. However, the use of PRP-owned or EPA-owned annuities may have tax advantages, discussed infra, which make them more attractive than trust accounts or similar mechanisms.

EPA takes ownership of the annuity. Another possibility is the formation by the PRPs of a tax exempt special purpose organization for the purpose of performing the work, to be funded with the proceeds of the annuity. The organization would take ownership of the annuity, again potentially avoiding taxes on the interest.³ The reduced tax liability would result in increasing the amount of PRP funds (principal and income) available for remediation. (Of course, the tax impacts of a structured settlement involving the use of an annuity are the responsibility of the PRPs, their tax attorneys, and the I.R.S. EPA will make no representations in any consent decree, in any related documents, in any guidance documents, or in any oral discussions, about the tax treatment of annuities.)

Finally, the use of an annuity may bring an additional party with substantial financial resources into the settlement. Life insurance companies that typically issue annuities are closely monitored by state regulators, and have a low risk of insolvency combined with an excellent history of meeting long-term payment obligations. Objective independent rating services exist that permit evaluation of annuity providers. Because annuities are sold and administered by large, regulated, conservative financial institutions with substantial assets, their promise to pay over a long time may be more reliable than that of a business PRP lacking the same resources or long-term financial stability.

It appears that the only site where an annuity has been used previously in connection with a Superfund settlement is the Liquid Disposal, Inc. site in Region V. In that settlement, a PRP established an annuity with an initial payment of \$1.5 million that, after maturing for a total of 16 years, will provide \$6.5 million to finance operations and maintenance. If you are aware of other sites where annuities have been used, please let us know.

Preliminary criteria and next steps

Annuities could be particularly useful in settlements involving a number of parties that have contributed small amounts of waste, including de minimis and non-de minimis parties, whose liability may appropriately be resolved by a cash contribution to site remediation performed by other PRPs or EPA. As a practical matter, however, annuities should not be used in lieu of

³ One drawback of this proposal is that it would represent a significant departure from the agency's usual practice of holding all of the settling defendants jointly and severally liable for performance of the work, regardless of its cost. EPA would have to look to the special purpose corporation for enforcement of the work obligations, and those obligations would be limited by the income stream generated by the annuity.

performance of the work by appropriate PRPs. Other practical issues that would require resolution include (in PRP-lead cleanups) defining the procedures for EPA to approve transfers of the proceeds of the annuity to the PRPs performing the work, and establishing criteria for approving the financial institution to issue the annuity.

We have identified several factors which should be present in order for the use of annuities to be most beneficial. First, the cash from the annuity must not be needed for several years after the fund is established so that there is time for the annuity to grow sufficiently in value. Second, the future requirements for when the funds will be needed must be fairly well known; this will ensure that the amount of money required by the PRP to establish the annuity is calculated accurately.

In sum, the use of annuities as a funding mechanism for Superfund settlements offers substantial potential benefits, but also requires careful analysis of potential drawbacks. The Superfund Reform Act would have explicitly authorized EPA to assume ownership of financial instruments (such as annuities) and to use the proceeds of such instruments to conduct or enable others to conduct response actions. To date, EPA has identified no absolute legal bars to the use of annuities under the existing statute, or to EPA ownership of the annuity contract, although a number of legal issues may need to be worked out in particular cases.

I would like your feedback in identifying additional benefits, drawbacks, and considerations for the use of annuities in settlements and for EPA ownership of annuities. Any thoughts you have on the use of other financial instruments as funding mechanisms for CERCLA settlements are also invited. I would also like to initiate several pilots to test the use of annuities on a trial basis, and I invite you to propose candidate sites.

If you would like to provide input into this project, please provide comments by three weeks after the date of this memo. Contact Dan Beckhard of my staff at 703-603-9063 (FAX: 703-603-9117; mail code 5502-G).

cc: Sandra Connors, OSRE
Earl Salo, OGC
Carol Cowgill, OGC
Barry Korb, OPPE
CERCLA Settlement Lead Region Workgroup
Superfund Branch Chiefs, Regions I - X
Regional Counsel Branch Chiefs, Regions I - X