A New insurance Product Against Risk of Invalid RINs

Although most instances of Renewable Identification Number (RIN) fraud occurred in the early years of the Renewable Fuel Standard (RFS) program, credit buyers have long memories.

The highly publicized fraud cases have created a continued wariness in the RIN market that -- combined with EPA's "buyer beware" approach which holds obligated parties liable for invalid credits -- has led some credit buyers to deal only with long-standing and trusted sellers. And that, some market sources said, has worked to reduce liquidity in RINs trading and put smaller renewable fuel producers at a disadvantage.

Parhelion Underwriting, a company that focuses on addressing investment risk in clean energy and environmental commodity markets, says it has a solution that can allow market participants to buy RINs free of any fraud and invalidation risk. And that, it says, should help inject more liquidity into RIN trade.

The company, whose policy is backed by Lloyds of London, began writing insurance policies for the Kyoto and European carbon cap and trade markets and about five years ago expanded to California's Carbon Offsets market, where it offers two types of policies that promise to pay the cost of replacing any invalidated credits for buyers and sellers.

Starting in January, Parhelion began offering similar insurance coverage to RIN buyers and sellers.

In a recent interview, Parhelion Chief Operating Officer Michael Newman said the emergence of carbon trading markets are often marked by a level of uncertainty over the potential that credits can be invalidated for a variety of issues.

"If you are holding one of those credits and it's invalidated, your investment is worthless, and worse still it exposes the compliance entity to civil fines and penalties." he said. That risk, he added, is a concern of market participants and functions as "sand in the oil" of the market, reducing liquidity. "Insurance can take that risk away."

Newman said the company saw similar opportunities in the RINs market, where there continues to be concern that "something along the chain can go wrong,"
resulting in a party "holding the bag" for worthless credits.

In the RINs market, he said many refiners simply don't want to do business with smaller biofuel producers without "pretty solid assurances" that the credits are valid.

While EPA has attempted to address the issue of bogus RINs in 2014 when it established its Quality Assurance Program (QAP), which allows for third-party validation of credits, Newman said the market use of the program has been limited, because the process can be expensive and because it does not fully remove the risk.

As a result, only about 12% of all RINs are so-called "Q-RINs" and many parties have opted instead to trade only with well-known parties, implement their own verification programs or buy only ethanol RINs. "It's nice, but it's not enough," he said of the QAP "and managing an in-house verification program requires significant management time and expertise.

Newman said the company's "Platinum-RIN" is a risk-free credit that can be bought by any market participants and applied to any RIN type. It can complement QRINs by removing the residual risk or it can wrap non-Q RINs. It also can remove the need for expensive in-house procurement protocols, he said.
Further, it can enable biofuel producers to increase the number of buyers to whom they can sell and permit marketers that assume RIN invalidation risk in sales contracts to offer clear title.

For obligated parties like refiners, the company said the insurance can support their due diligence program -- which Newman described as a "belt and braces" approach -- at a "relatively small additional expense."

The cost of the insurance varies depending on the category of RIN, for example Parhelion would charge a 2% of the credit value for D6 RINs (1.5% for Q-D6) and as much as 4% for a D4 RIN (2% for a Q-D4). All of EPA's documented cases of RINs fraud have involved D4 or biomass-based diesel credits.

Newman said his company has discussed the Platinum-RIN program with EPA officials, adding that while the agency is required to be "agnostic on anything commercial, it was supportive of the idea, recognized the usefulness of the program" and discussed how it has worked in California with state officials.

He said Parhelion also has discussed the program with refiners, biofuel producers and traders and found a lot of interest. "We only introduced it the first of the year and we know from our experience in the cap-and-trade market that it takes a while to get the word out and that there's a herd instinct, with parties waiting to see who the first mover will be."

In addition, Newman said Parhelion has been eyeing offering insurance for California's Low Carbon Fuel Standard (LCFS) program for some time, but has yet to act because the extent of liability for invalidated credits is still "fuzzy."

But that may be changing. The California Air Resources Board, Newman said, "didn't want to be seen coming out of the gate with a punitive LCFS program, but that is starting to tighten up now as regulatory changes made last year started to bring more clarity to who is liable" for bad credits.

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