

# FINANCIAL ASSURANCES

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# PURPOSE

- To provide an overview of the requirement for financial assurances to ensure success of compensatory mitigation projects.



# Financial Assurance Requirement

- 33 CFR 332.3(n)(1):

“The district engineer shall require sufficient financial assurances *to ensure a high level of confidence that the compensatory mitigation project will be successfully completed, in accordance with applicable performance standards.*” [italics added]



# Purpose of Financial Assurances

- Mechanism for ensuring resources are available to provide required mitigation if the responsible party proves unable or unwilling to do so
- Allow permit issuance using permittee-responsible mitigation prior to successful mitigation implementation
- Allow initial credit release for third party mitigation before successful mitigation implementation
  - ▶ Facilitates the economic viability of commercial mitigation banking
- Endowments to provide any needed funds for long-term management of mitigation projects is different (although it can employ similar types of assurance forms, e.g. escrow accounts)



# What Must the Financial Assurances Cover?

- Construction
- Project success in accordance with performance standards
- Long-term operation and maintenance





# When Must the Financial Assurances be in Place?

- Permittee-Responsible Projects
  - ▶ *“If financial assurances are required, the DA permit must include a special condition requiring the financial assurances be in place prior to commencing the permitted activity.” [CFR 332.3(n)(3)].*
- Mitigation Bank Projects
  - ▶ *“The mitigation banking instrument may allow for an initial debiting of a percentage of the total credits projected at mitigation bank maturity, provided the following conditions are satisfied: the mitigation banking instrument and mitigation bank plan have been approved, the mitigation bank site has been secured, appropriate financial assurances have been established...” [CFR 332.8(m)].*
- ILF Programs
  - ▶ *“The cost per unit credit must also take into account contingency costs appropriate to the stage of project planning, including uncertainties in construction and real estate expenses. The cost per unit of credit must also take into account the resources necessary for the long-term management and protection of the in-lieu fee project. In addition, the cost per unit credit must include financial assurances that are necessary to ensure successful completion of in-lieu fee projects.” [CFR 332.8(o)(5)(ii)]*



# How is the Dollar Amount of Financial Assurances Determined?

- *“The amount of the required financial assurances must be determined by the district engineer, in consultation with the project sponsor, and must be based on the size and complexity of the compensatory mitigation project, the degree of completion at the time of project approval, the likelihood of success, the past performance of the project sponsor, and any other factors the district engineer deems appropriate ... In determining the assurance amount, the district engineer shall consider the cost of providing replacement mitigation, including costs for land acquisition, planning and engineering, legal fees, mobilization, construction, and monitoring.” [33 CFR 332.3(n)(2)]*



# How is the Dollar Amount of Financial Assurances Determined?

- Assurance amounts should reflect where replacement mitigation work would occur
  - ▶ Quality of the site and surrounding landscape
  - ▶ Site ownership/access/protection issues
  - ▶ Willingness of a suitable third-party entity to complete work at the site
- ILF
- Mitigation Bank





# When Can the Financial Assurances be Released?

- Project Success

- ▶ *“Financial assurances shall be phased out once the compensatory mitigation project has been determined by the district engineer to be successful in accordance with its performance standards.” [CFR 332.3(n)(4)]*
- ▶ Permit or instrument must specify the conditions under which the financial assurances may be released
- ▶ Assurances can be phased-out in stages as certain project milestones or interim performance standards are met

- Notice

- ▶ *“A financial assurance must be in a form that ensures that the district engineer will receive notification at least 120 days in advance of any termination or revocation.” [CFR 332.3(n)(5)]*



# Calling on a Financial Assurance

- *“Financial assurances shall be payable at the discretion of the district engineer to his designee or to a standby trust agreement. When a standby trust is used (e.g. with performance bonds or letters of credit) all amounts paid by the financial assurance provider shall be deposited directly into the standby trust fund for distribution by the trustee in accordance with the district engineer’s instructions.” [33 CFR 332.3(n)(6)].*
- *“The compensatory mitigation project must comply with all applicable federal, state, and local laws. The DA permit, mitigation banking instrument, or in-lieu fee program must not require participation by the Corps or any other federal agency in project management, including receipt or management of financial assurances or long-term financing mechanisms, except as determined by the Corps or other agency to be consistent with its statutory authority, mission, and priorities.” [33 CFR 332.3(o)]*



# Miscellaneous Receipts Statute

- 31 USC 3302(b)
- Requires that money collected by Federal agencies be placed into the U.S. Treasury upon receipt.
- Once deposited into the Treasury, a new appropriation is required before the funds can be used.
- Specific statutory authority is needed to collect money into our local appropriations.



# Standby Trust Agreement

- Independent third party trustee with fiduciary responsibility to the beneficiary
- The Corps does not receive the funds but does determine how and to whom the funds are to be disbursed to ensure completion of mitigation requirements
- Standby Trust is not funded unless the financial assurances are called



# Types of Financial Assurances

*“...Financial assurances may be in the form of performance bonds, escrow accounts, casualty insurance, letters of credit, legislative appropriation for government sponsored projects, or other appropriate instruments, subject to the approval of the district engineer...” [33 CFR 332.3(n)(2)]*



# Performance Bond

- Contract in sum certain (penal sum) between project sponsor & surety (e.g., insurance company) whereby surety guarantees performance of mitigation requirements or payment of penal sum
- Project sponsor pays approximately 1.5 -5 % of penal sum to the surety and also enters into an indemnity agreement with surety that includes collateral
- Issues: Limited availability without high collateral; limits on coverage and term; performance disputes





# Letter of Credit

- A letter of credit is a document issued by a financial institution on behalf of a mitigation provider that provides for payment of the mitigation provider's obligations to another party (or beneficiary) approved by the Corps who is willing to accept responsibility for completing or replacing the mitigation project
- Cost varies but mitigation provider may pay 1.5 – 3% of credit limit each year and also enters into loan agreement with surety that typically requires collateral
- Issues: Limited availability without high collateral; limits on term; provides funds but not performance



# Escrow Account

- Sponsor deposits entire amount of required assurance into an escrow account at a financial institution that serves as escrow agent
- Escrow agent disburses funds to a third party approved by the Corps
- Issues: High opportunity costs to sponsor; provides funds but not performance



# Casualty Insurance

- Casualty insurance is an agreement between an insurance company (the insurer) and a mitigation provider (the insured) whereby the insurer agrees to fulfill the mitigation obligation of the insured, up to a specified dollar limit within a specified period of time
- Sponsor pays insurer one-time premium of 2 - 4% insurance policy amount for the period over which sponsor is required to meet success criteria
- Claim can only be made by the identified regulatory body



# Casualty Insurance--continued

- Can allow for claims over as much as a 10 year time period required to achieve mitigation success
- The policy specifies that the insurer will satisfy a claim (up to the dollar limit of liability) by remediating the failed mitigation project, providing replacement mitigation, or making payment to a third party approved by the Corps
- Issues: coverage; reductions in dollar limit over time



# Legislative Appropriations

- Specific to governmental bodies
- Government appropriation of funds to guarantee that the mitigation responsibilities of a government agency are met for a specific period of time
- Appropriation may be a line item in a government budget, such as a capital improvement budget



# SUMMARY

- Few hard and fast rules for establishing financial assurances for mitigation project success
- Financial assurances serve to limit, not eliminate, the risk that mitigation projects will not meet success criteria
- [http://www.iwr.usace.army.mil/Portals/70/docs/iwrreports/Financial\\_Assurance.pdf](http://www.iwr.usace.army.mil/Portals/70/docs/iwrreports/Financial_Assurance.pdf)





