

U.S. Army Corps of Engineers (USACE) Fort Worth District



Financial Assurances Guidance Document

This document discusses the requirements for financial assurances within the USACE Regulatory Program as it relates to compensatory mitigation.

DESCRIPTION OF FINANCIAL ASSURANCES

Financial assurances are a required item in a mitigation plan for compensatory mitigation projects (including mitigation banks). Financial assurances must be sufficient to ensure a high level of confidence that a mitigation project will be successfully completed, in accordance with its performance standards. Financial assurances provide funds to undertake contingency or remedial actions in the event of technical failure or sponsor/permittee default.

From The Code of Federal Regulations, Title 33, Part 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. In cases where an alternate mechanism is available to ensure a high level of confidence that the compensatory mitigation will be provided and maintained (e.g., a formal, documented commitment from a government agency or public authority) the district engineer may determine that financial assurances are not necessary for that compensatory mitigation project.
2. 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 of the project 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. Financial assurances may be in the form of performance bonds, escrow accounts, casualty insurance, letters of credit, legislative appropriations for government sponsored projects, or other appropriate instruments, subject to the approval of the district engineer. The rationale for determining the amount of the required financial assurances must be documented in the administrative record for either the DA permit or the instrument. 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.
3. If financial assurances are required, the Department of the Army (DA) permit must include a special condition requiring the financial assurances to be in place prior to commencing the permitted activity.
4. 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. The DA permit or instrument must clearly specify the conditions under which the financial assurances are to be released to the permittee, sponsor, and/or other financial assurance provider, including, as appropriate, linkage to achievement of performance standards, adaptive management, or compliance with special conditions.
5. 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. For third-party assurance providers, this may take the form of a contractual requirement for the assurance provider to notify the district engineer at least 120 days before the assurance is revoked or terminated.

6. Financial assurances shall be payable at the direction 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.

GUIDANCE

Types of Financial Assurances

Financial assurances may be in the form of performance bonds, escrow accounts, casualty insurance, letters of credit, legislative appropriations, or other appropriate instruments, subject to the approval of the USACE. A brief description of each is presented below:

1. **Performance Bonds.** A performance bond (i.e., a type of surety bond) is an indemnity contract for a certain sum whereby a surety (e.g., a properly licensed insurance company or bank) agrees to assume the responsibilities for default on the debits or obligations of another party (i.e., the sponsor/permittee). The surety guarantees satisfactory completion of the mitigation obligations of the sponsor/permittee and agrees to assume responsibility for paying the sum of the bond in the event the sponsor/permittee fails to perform their obligations. For example, if a mitigation project does not meet the performance standards and the permittee is unable or unwilling to take corrective actions, the surety is responsible to pay the amount of the performance bond to a USACE-designated third party who will take remedial actions to ensure the mitigation obligations are met.
2. **Escrow Accounts.** An escrow account is a type of collateral bonding where a grantor (i.e., the sponsor/permittee) agrees to deposit a certain sum of cash or valuable property in an account which will transfer in ownership to a grantee (i.e., USACE-designated third party) upon some stated condition or event. An escrow agent such as a law firm, title company, commercial bank or other financial institution (i.e., the depository or trustee) is appointed to receive the cash or property into their account and to assure its transfer as specified in the escrow agreement. Legal title to the property remains with the grantor; however, after the property has been delivered to the depository, neither the grantor nor the grantee can obtain it without mutual agreement or in the absence of fulfillment of the terms of the escrow agreement. For example, if the sponsor/permittee fails to fulfill their mitigation obligations (e.g. meet performance standards), then the title to the cash or property held in escrow would pass to the USACE-designated third party for use in meeting the mitigation obligations. If, however, the sponsor/permittee fulfills their mitigation obligations, the property held in escrow would be returned to the sponsor/permittee.
3. **Casualty Insurance.** Casualty insurance is an arrangement whereby a company, in return for payment, gives a customer (e.g., sponsor/permittee) financial protection against loss or harm due to negligence or property damage. For example, the sponsor/permittee could purchase a policy from a qualified company that would provide for the payment by that company to the USACE-designated third party in the event that the mitigation performance standards are not met.
4. **Letters of Credit.** A letter of credit provides for the extension of the credit of one party, such as a commercial bank or other financial institution (the issuer), on behalf of a second party (i.e., the sponsor/permittee), to a third party (i.e., the USACE-designated third party). The issuer allows the beneficiary (i.e., USACE-designated third party) to draw up to a specified sum of money from the credit account when specific conditions are met. For example, if the sponsor/permittee fails to meet performance standards for the mitigation project, the USACE-designated third party may draw upon the letter of credit from the financial institution in order

to pay for remedial actions to meet the mitigation obligations. Letters of credit are typically stipulated to be irrevocable and issued for at least one year.

5. **Legislative Appropriations.** A legislative appropriation is funding set aside for government sponsored projects. For example, a state legislature may provide funding for an agency to complete a project that includes a contingency amount for remedial actions.
6. **Other Appropriate Instruments.** Other appropriate instruments are subject to approval by the USACE. These may include a mitigation trust fund at a federally insured depository, a security interest in property, or self bonding.
 - a. A trust is an arrangement enabling property, real or personal, to be held by one party (i.e., trustee/financial institution) for the benefit of another party (i.e., USACE-designated third party). A trust is a right of property; the trustee becomes the legal owner of the trust property, although the beneficiary has an equitable interest in it. The trust agreement could be structured as an indemnity contract to stipulate that the trust must be devoted to a particular purpose (i.e., the mitigation obligation of the sponsor/permittee) in the event that it is not fulfilled, whereas it is returned in kind to the sponsor/permittee if the mitigation obligation is fulfilled. Trust funds may also be used to provide long-term management of a mitigation area.
 - b. A security interest in property may be provided directly by a sponsor/permittee to the USACE-designated third party through an indemnity contract structured as a "pledge". The necessary conditions for a contract to constitute a pledge include: 1) possession of the pledged property must pass from the sponsor/permittee to the third party (though it may only be constructive), 2) legal title to the property must remain with the sponsor/permittee, and 3) the third party must have a lien on the property for the performance of the mitigation obligation by the sponsor/permittee. In the event the sponsor/permittee defaults on the obligation, the property would be sold and the third party would receive only so much of the proceeds that are necessary to perform the sponsor's/permittee's obligation. This type of instrument may be practicable when the securities can be held by a financial institution without necessitating the establishment of an escrow account.
 - c. Self bonding is an indemnity agreement for a certain sum executed by the sponsor/permittee (with or without a corporate guarantor such as a parent company) and made payable to the USACE-designated third party. Unlike other financial assurances, self bonds are not supported by the guarantee of a licensed surety nor by security interest. In the event that the sponsor/permittee defaulted on the mitigation obligations, they or their guarantor would be liable to fulfill the terms of the indemnity agreement, either through the performance of the obligations or through the payment of a specified sum of money to a USACE-designated third party to take remedial actions to meet the mitigation obligations. Self bonding should only be used when the sponsor/permittee or its guarantor meets certain financial tests. The USACE must determine that the self bonding entity is financially sound in order for this type of financial assurance to be approved.

Third Party Beneficiary

The Miscellaneous Receipts Statute requires that certain Federal funds (e.g., money from a financial assurances agreement) be returned to the U.S. Treasury in lieu of being used to augment a Federal agency's appropriations for specific projects. Thus, the USACE cannot receive money from a financial assurances agreement and use that money for a specific project (e.g., remedial action at a mitigation area). In order to avoid the Miscellaneous Receipts Statute, the USACE may designate a third party to receive funds from the financial assurances agreement who will take remedial action to meet the mitigation obligations. If the sponsor/permittee were ever to default on their mitigation obligations, the third party (e.g., an interested, qualified, trustworthy, and financially secure group) would collect

the funds from the financial assurances agreement and be responsible to complete the mitigation work in a manner that meets the performance standards.

The USACE may also specify that the financial assurances be paid to a standby trust agreement. A standby trust agreement is a contract whereby an independent third party becomes a trustee with responsibility to distribute the funds in the trust according to the USACE's instructions. The standby trust agreement is a legal and enduring document which defines the relationship of the sponsor/permittee and third party trustee, as well as the requirements of the third party for managing the funds and following the instructions of the USACE.

Amount of Financial Assurances

The amount of the required financial assurances must be determined by the USACE, in consultation with the sponsor/permittee, and must be based on the size and complexity of the compensatory mitigation project, the degree of completion of the project at the time of project approval, the likelihood of success, the past performance of the sponsor/permittee, and any other factors the USACE deems appropriate (e.g., risk factors, temporal impacts, resource sensitivity). The amount should be sufficient to complete all aspects of the mitigation project's planning, construction, planting, maintenance, and monitoring. Since mitigation projects vary in type and complexity, the amount of financial assurances should be determined on a case-by-case basis. The amount may be based on the worst-case assumption of cost. The cost of long-term maintenance should be included in the amount of financial assurance, but the estimates for financial assurance can be separated into the initial eight- to ten-year period (i.e., construction, planting, and remedial actions) and long-term (i.e. monitoring, maintenance, and minor management after performance standards met).

One way of estimating the amount of financial assurances required is for the sponsor/permittee to obtain quotes from independent contractors (even if the sponsor/permittee intends to perform the work themselves) for the work to be completed until the mitigation project meets the performance standards. A contingency amount should be added to these quotes based on a risk assessment review.

Cost estimation by the sponsor/permittee should consider the cost of the following elements as if these items were to be performed by an entity other than the Mitigation Bank Sponsor or Permittee. These items include replacement mitigation, including land acquisition, planning/design/engineering, construction (including mobilization, earthwork, burning, shredding, clearing, planting, or non-native species control), legal fees, monitoring, and long-term management, including full funding of the long-term endowment. Estimates for land acquisition would be based on a per acre price for a similarly situated site and the size of the mitigation area. The cost for planning and/or engineering should consider the fee for an engineer or planner's time to design the various elements (e.g., grading, water control structures, berms, stream channel restoration, wetland creation, etc) of a mitigation project. Construction costs would include the necessary materials (e.g., tree seedlings, native herbaceous plants/seed, erosion control blankets, rock, topsoil, fertilizer, fencing, herbicide, etc.), equipment (e.g. bulldozer, tractor, back-hoe, planter, etc.) with fuel, and man-hours (multiplied by labor rate). The cost of legal fees would include the hours multiplied by hourly rate for attorneys to prepare or review legal documents. Monitoring costs include the equipment and man-hours to evaluate the mitigation area for meeting performance standards and reporting the results to the USACE until the mitigation requirements are met and no additional reporting is required by the USACE. The long-term maintenance and monitoring (i.e., in perpetuity after performance standards are met) cost may be estimated by contacting a land trust or similar non-profit organization who would take responsibility of these tasks in return for a certain amount of funding. The costs of long-term management would generally include the materials and man-hours to maintain the proper functioning condition of the mitigation area. This may include mending fences, controlling non-native plant species, managing

wildlife, repairing minor erosion, or other activities. The risk factors associated with each item should be evaluated to determine a contingency amount included in the estimated cost.

The amount of financial assurances should reflect whether the proposed replacement work would be located on- or off-site. Replacement mitigation is presumed to proceed at the existing project site unless there are concerns with the quality of the site and surrounding landscape, site ownership and access issues, or willingness of a suitable third party to complete work at the site. For on-site replacement work, the cost estimate would include all the components to fully implement the mitigation project and meet performance standards. For off-site replacement work, the cost estimate must include the price of land acquisition in addition to the other mitigation components. Financial assurances may also reflect information for comparable mitigation projects in an area, if available.

Risk Assessment

The risk associated with a mitigation project influences the amount of financial assurances that would be required. A higher amount of financial assurances may be required for high-risk mitigation banks/projects and lower amounts for those with greater likelihood of success.

Risk is associated with several components of the mitigation project. There is risk that the design of stream channel restoration or wetland creation will fail. There is also risk that trees or other plantings will not survive. Due to their landscape position, mitigation areas are typically subject to flooding. If flooding is of a catastrophic nature, or the mitigation project was not adequately designed or constructed, there is risk of failure.

In order to plan for the amount of financial assurance that needs to accompany different levels of risk, it is necessary to assess the risk associated with each mitigation project. In general, projects that require more engineered structures and earthwork will be at higher risk of failure than those that restore natural processes. In addition, projects that rely on the establishment of hydrology, rather than utilizing existing hydrology, may be at greater risk for failure. Projects that include large numbers of plantings/seeding may also have higher risk for failure due to mortality of plant stock. Restoration of aquatic resources is generally considered more likely to succeed than establishment (i.e., creation) due to the more limited manipulation necessary to return natural/historic functions to a former or degraded aquatic resource.

Financial assurances should include a contingency amount to hedge against the risk associated with the mitigation project. The contingency amount can be used for adaptive management in the event that remedial measures become necessary to ensure the mitigation meets the performance standards. Remedial measures may include but are not limited to repair or re-design of any structural features, planting of additional native vegetation, trapping of nuisance wildlife, manipulations of vegetation not inconsistent with the plan, repair of additional erosion, and removal of accumulated debris and/or trash.

Release of Financial Assurances

Financial assurances would be phased out once the compensatory mitigation project has been determined by the USACE to be successful in accordance with its performance standards. The USACE permit or mitigation banking instrument should clearly specify the conditions under which the financial assurances are to be released to the sponsor/permittee or other financial assurance provider, including, as appropriate, linkage to achievement of performance standards, adaptive management, or compliance with special conditions.

As the sponsor/permittee achieves the performance standards set forth in the appropriate mitigation document, the amount of financial assurances required would be reduced if approved by the USACE. However, a permanent financial assurance must be maintained in perpetuity to ensure the long-term maintenance and monitoring of the mitigation project even after all performance standards have been met.

One way to phase out the financial assurances is a stepped reduction. A stepped reduction of the financial assurances would occur over a step period. Each reduction in the Financial Assurance amount will require prior approval by the USACE and will be based on the degree to which certain work elements have been successfully performed and have achieved established performance standards. For example, financial assurances may be reduced by 50 percent once the USACE determines that 50 percent of the performance standards are met. The phase out of financial assurances could also take into account the cost of each performance standard as a percentage of the financial assurance. For example, if tree plantings accounted for 20 percent of the mitigation cost, then a commensurate amount would be released from the financial assurances when the performance standard for tree plantings is met.

Other Resources

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