NEVADA CONSERVATION CREDIT SYSTEM

FINANCIAL ASSURANCE GUIDANCE DOCUMENT

In order to make selecting, developing and implementing financial assurances for the Credit System as easy as possible for both the Administrator and Credit Developers, the following memo:

- provides an overview of financial assurance obligations required by the Credit System,
- outlines internal processes and roles associated to implementing financial assurances for the Credit System,
- describes the different assurance instruments and requirements of each that can be used to meet financial assurances,
- identifies and compares key features of assurance instruments and the process for verifying and documenting assurance instruments, and lastly
- provides recommendations for ongoing evaluation of new types of assurance instruments.

The content here is based on a body of research, policy guidance, and implementation experiences from U.S. Army Corps of Engineers, U.S. Environmental Protection Agency, U.S. Fish and Wildlife Services, as well as conservation programs. Until operational experience is further developed the guidance here should remain internal to working staff and teams.

Guidance in this memo is expected to be improved as the Administrator gains hands on experience developing and implementing assurance instruments, and additional assurance instruments become available.

FINANCIAL ASSURANCES OVERVIEW

Financial assurances are required by the Credit System to (1) ensure a mitigation project that receives a credit release before achieving habitat function performance standards is completed successfully, (2) ensure that funds are available for the long-term management and monitoring of each credit project, including remedial actions in the event of unintentional reversals, and (3) to promptly replace credits that have been sold but become invalidated due to intentional reversals. The financial assurance requirements can be met by a Credit Developer through the use of *Assurance Instruments.* For financial assurances requirements of the Credit System, see Section 2.4.6: Financial Assurances of the *Credit System Manual*.

Assurance Instrument

An assurance instrument can be a contract term, financial product, bond, insurance policy, or other instrument which provides the legal and fiscal process to ensure sufficient funds are available to meet the ongoing maintenance requirements of a credit project, or cover the cost of credit replacement in the event of intentional reversals.

The specific assurance instrument(s) to fulfill the financial assurance requirements of the Credit System are not prescribed by the Credit System. Rather, the Credit System encourages the Credit Developer and Administrator to identify the best assurance instruments available to fulfill the specific needs of each credit project. Further, the Credit System hopes that innovations in assurance instruments for habitat mitigation sites will be developed due to the new demand for such instruments by the Credit System and other programmatic, landscape-scale mitigation approaches that need hundreds of mitigation sites to achieve habitat and species recovery goals. Figure 1 illustrates the two financial assurance obligations required of Credit Developers, as well as example and preferred assurance instruments available for each obligation. Again, the specific assurance instrument(s) to fulfill financial assurance requirements of the Credit System are not prescribed; however, the preferred assurance instruments are preferred due identified weaknesses of some instruments related to Credit

System requirements. Therefore, the preferred instruments are just for internal purposes to ensure non-preferred instruments are vetted thoroughly.

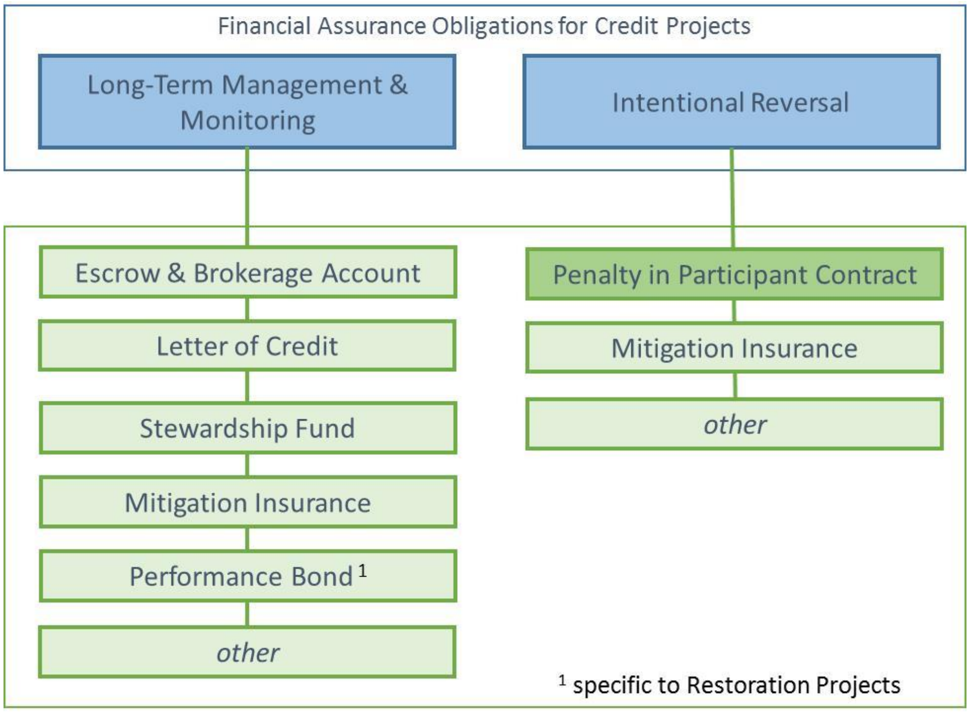

Figure 1: Financial assurance obligations and example assurance instruments

As shown in Figure 2 and 3 in the next section, the Administrator and Credit Developer will work together to define assurance instruments that are mutually acceptable. After receiving initial guidance, the Credit Developer will work with financial institutions to select and develop assurance instruments that the Administrator will then review and provide approval of if all requirements are met. The specific assurance instruments used can be a combination of various instruments that ensure sufficient funds are available to meet the needs listed below.

LONG-TERM MANAGEMENT AND MONITORING REQUIREMENTS

The objective of this financial assurance is to ensure funding is available for the long-term management and monitoring of each credit project, including remedial actions in the event of unintentional reversals. Any assurance instrument used to meet this financial assurance must ensure,

- The principal amount deposited in the assurance instrument is sufficient so that
    - Annual payments are able to
        - Cover all anticipated costs expected to perform maintenance and monitoring of the project as defined in the Management Plan for the duration of the contract.
        - Ensure an ongoing financial incentive that is greater than the anticipated cost to maintain and monitor the project.
    - Contingency funds are able to
        - Address periodic unanticipated project-related costs that are likely to occur; these funds are released with approved remedial action plans, and unused contingency funds are released at the end of the contract period.

- The principal amount and interest earned is invested with the objective of achieving a rate of return sufficient to account for inflation, interest, and administrative fees, while not putting the required annual payments at significant risk.
- Credit Developers can access up to a pre-defined maximum annual withdrawal amount as determined in the Management Plan.
- Administrator can access entire remaining balance at any point in the case that the credits are intentionally or unintentionally invalidated.

To cover credits sold that were released prior to achieving performance standards above baseline habitat function (not to exceed 33% of total credits), any assurance instrument used to meet this financial assurance must also ensure,

- The default is funds are available to cover at least 15% of the value of the credits released before habitat function is above baseline habitat function. However, the specific value of the financial assurance must be aligned with the expected risk of the habitat restoration project, which for planting sagebrush is high relative to wetland banking for example. The value of the letter of credit will likely be less than the value of the credits released. Note that 10-15% is the standard in mitigation and conservation banking, and is believe to provide plenty of an incentive for the Credit Developer to achieve the performance standards associated with the credits released before habitat function is above baseline habitat function.

INTENTIONAL REVERSAL REQUIREMENTS

The objective of this financial assurance is to ensure funding is available to the Administrator and Credit System for replacing credits that have been sold, but become invalidated due to an intentional reversal. In most cases a contract term providing access to adequate funding in the *Participant Contract* provides a sufficient guarantee against intentional reversals. Any assurance instrument used to meet this financial assurance must ensure,

- Administrator can access funds to do the following, at any time for the duration of the credit project:
  - Cover the monetary costs of acquiring new credits to replace all invalidated credits; and
  - Ensure that the additional effort incurred by the Administrator to secure new credits is fully funded.

REVIEWING FINANCIAL ASSURANCES, ROLES & SPECIFIC GUIDANCE

OVERVIEW OF PROCESSES TO IMPLEMENT FINANCIAL ASSURANCES

The process to develop financial assurances that fulfill the requirements related to long-term management and monitoring is illustrated in Figure 2.

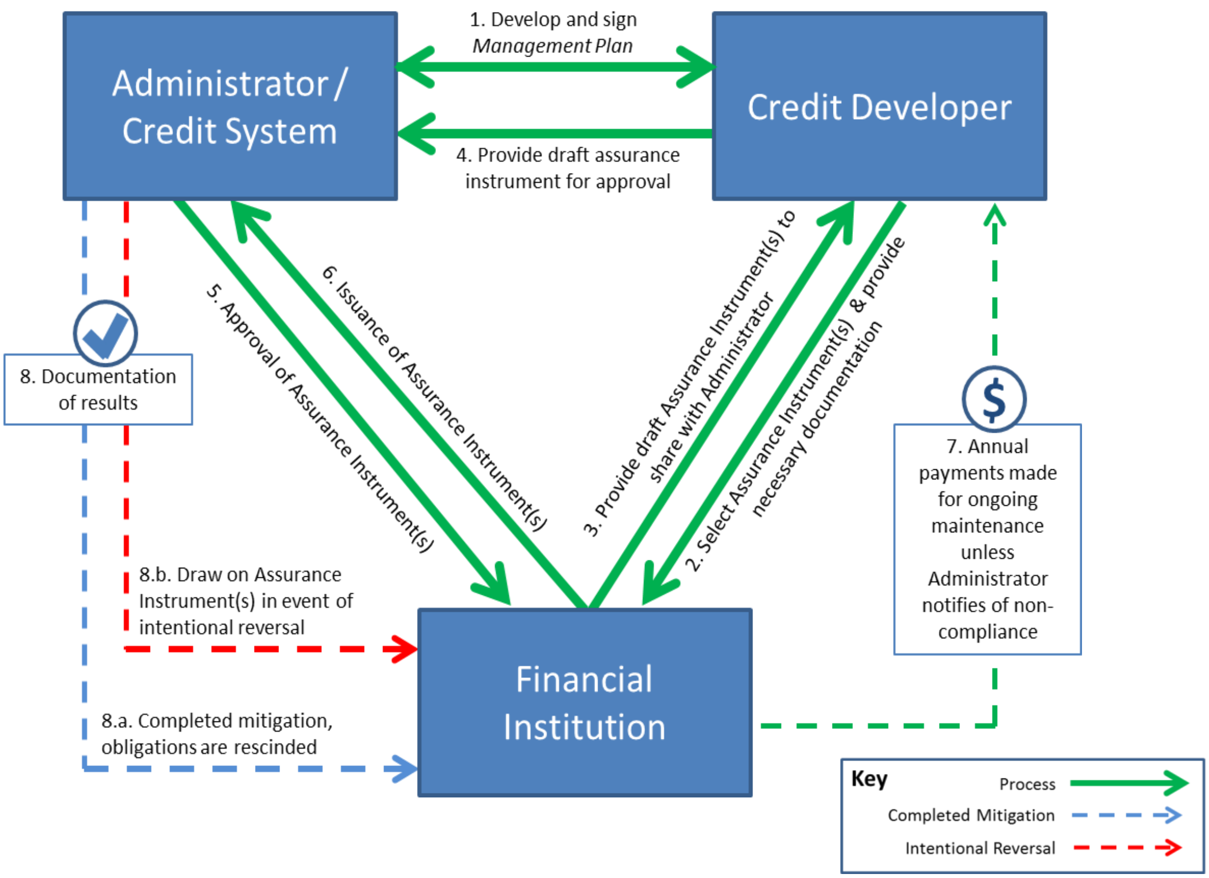

Figure 2: Long-term Management & Monitoring: Financial Assurances Process

TYPES OF ASSURANCE INSTRUMENTS

A basic description of each assurance instrument is provided over the following pages, including the necessary requirements of each depending on the financial assurance requirement of the Credit System that the instrument is used to fulfill, and Table 1 provides a comparative review of the important features of each assurance. Section *Example Assurance Instruments* of this memo provides examples and templates for each assurance instrument described in this section.

Key considerations for a Credit Developer when selecting an assurance instrument will include the amount of collateral (cash, property, other…) they can commit, the opportunity cost of that collateral, their credit worthiness to a financial institution, as well as the expected credit release schedule. Another important consideration for each assurance instrument is the relative financial strength and stability of the assuring entity itself. While requirements have been incorporated for each assurance instrument as to the assuring entities' ability to provide payment when a claim is made, there is no foolproof guarantee that all claims will be honored, therefore due diligence is needed in the review of all assurance instruments proposed by a Credit Developer.

POTENTIAL FINANCIAL ASSURANCE INSTRUMENTS - LONG-TERM MANAGEMENT & MAINTENANCE

Escrow & Brokerage Account

An *escrow account* is an agreement between the Credit Developer (the grantor) and Department of Conservation and Natural Resources (the grantee) where the Credit Developer has the authority to withdraw cash to do maintenance on the property or if the Credit Developer fails to meet obligations specified in the Management Plan the grantee can access funds. A neutral third party (Escrow Agent), such as a bank, financial institution, law office, or Certified Public Accountant receives and holds the money and agrees to invest and transfer the funds per the terms of the agreement. An escrow agreement can be established for an indefinite period or a set period outlined in the agreement. The Credit Developer will need to work with their preferred financial institution to set up an escrow account and associated brokerage account that will allow them to invest the escrow funds accordingly.

Escrow accounts are mostly likely to be used to fulfill the long-term management financial assurances, and the requirements below are aimed at the long-term management financial assurance.

Stewardship Funds

Stewardship funds also known as "mitigation endowments" are actively managed funds designed for covering long-term conservation site management costs, where a third party acts as an agent, trustee, or escrow provider for the permitting agency, and ensures funds are available to satisfy the long-term mitigation requirements specified in the applicable laws, regulations, permits, and management plans. Stewardship funds are typically used when a permit or other governmental approval requires a funding mechanism be established to provide ongoing payment for a defined set of land management or stewardship activities.

Stewardship funds can be used to fulfill long-term management financial assurance requirements.

Performance bond

A *performance bond* also known as a surety bond is an assurance contract with a specified dollar limit for a specified period of time whereby a bonding or surety company assumes the obligations of a Credit Developer (the principal) for the benefit of the Credit System (the obligee) in the event that the Credit Developer fails to fulfill their obligations. The bonding company may fulfill the Credit Developers obligations either by performing their obligations up to the specified dollar limit, or by paying an amount up to the specified dollar limit (less any costs already incurred by the bonding company) to the Credit System. To secure a performance bond, the Credit Developer must enter into an indemnity agreement with the bonding company that requires the Credit Developer to reimburse the bonding company for any loss they may incur under the performance bond, and such agreements often require the Credit Developer to post collateral with the bonding company.

POTENTIAL FINANICAL ASSURANCE INSTRUMENTS - INTENTIONAL REVERSAL

Participant Contract

The Participant Contract is the legal agreement between one or more Credit Developers and the Administrator that defines obligations of the Credit Developers, binds a participating credit site to a Management Plan, and lays out the relevant terms and conditions for the development of credits under the Credit System. In the event of an Intentional Reversal, a signed Participant Contract will act as the assurance instrument, as in most cases section 7.b.1 of the Participant Contract provides a sufficient guarantee.

If a Credit Developer was determined to be in non-compliance, the Administrator would provide documentation indicating default under the terms of the Participant Contract and Management Plan to the Credit Developer, along with notice to pay all fees required under section 7.b.1 of the Participant Contract.

Mitigation insurance

Mitigation insurance is a contract between a Credit Developer (the insured) and an insurance company (the insurer) whereby the insurer agrees to fulfill the Credit System obligations of the insured, up to a specified dollar limit within a specified period of time, if the Administrator determines that the Credit Developer has failed to meet their obligations. A claim can only be filed by the Credit System. The insurer may satisfy the claim by fulfilling the obligations of the insured or by cash payment (up to the limit of liability) to the Credit System or an appointed designee. The insured is required to repay to the insurer any insurer costs that result from a claim up to a specific deductible amount.

COMPARATIVE REVIEW OF ASSURANCE INSTRUMENTS

Table 1 adopted from (Engineers, 2011) provides a comparison of the above defined assurance instruments according to key performance characteristics and attributes including

Availability and Procurement

Relates to the general availability of the assurance instrument and the process and demands that both a Credit Developer and Administrator must go through to secure it.

Price and Opportunity Cost

Relates to the fee charged to a Credit Developer to secure the assurance instrument as well as the costs to the Credit Developer of tying up money in the assurance instrument or in any collateral that may be required by the assurance provider.

Term and Renewal

Relates to the period of assurance coverage provided by the assurance instrument as well as the renewal or cancellation process.

Claims and Performance

Relates to the process required for making and honoring a claim against an assurance instrument, and whether additional steps are needed to secure the replacement of a failed project due to unintentional or intentional reversals.

Additional Notes

Relates to any unique aspects of the assurance instrument not captured above.

Table 1 - Comparative Overview of Potential Assurance Instruments

Assurance Instrument	Availability & Procurement	Price & Opportunity Cost	Term & Renewal	Claims & Performance	Additional Notes
Escrow Account	Escrow accounts linked to brokerage accounts can be set up at many financial institutions with active and/or strong investment divisions. Additionally, all owners will need to be present at time of signing/account opening.	The financial institution will charge a minimal fee to secure the escrow & associated brokerage account. The fee will either be arranged annually, or as a one-time management fee. The main cost of establishing an escrow account relates to the opportunity cost to the Credit Developer of tying up cash in escrow, although this may be unavoidable for long-term management and monitoring assurance.	An escrow account can be setup for an indefinite amount time, so if used as an assurance instrument the term of the escrow account should match that of the Participant Contract.	In the event of non-compliance by a Credit Developer, the Administrator would provide documentation indicating default under the terms of the escrow agreement and management plan to the financial institution, specifying the amount of funds needed to repair or replace the failed project. The institution cannot contest a claim against an escrow account, so it provides a quick payment to the Credit System.	Escrow accounts should be able to provide an acceptable rate of return (3-4%) from responsible investments, such as a recognized Exchange Traded Funds (ETF). Escrow accounts can be used to fulfill both *Long-term Management* and *Intentional Reversal* financial assurances, but separate accounts would be needed for each.

Assurance Instrument	Availability & Procurement	Price & Opportunity Cost	Term & Renewal	Claims & Performance	Additional Notes
Stewardship Fund	Stewardship Funds can only be setup once there are mitigation requirements set forth in a permit or governmental approval. At present there are not many organizations willing to act as the 3rd party agent, trustee, or escrow provider of Stewardship Funds. The most viable option is the *Impact-Directed Environmental Accounts (IDEA)* program offered by the National Fish and Wildlife Foundation	The main cost of establishing an escrow account relates to the opportunity cost to the Credit Developer of tying up cash in escrow, although this may be unavoidable for long-term management and monitoring assurance.	A stewardship fund can be setup for an indefinite amount time, so if used as an assurance instrument the term of the stewardship fund should match that of the Participant Contract.	Using the past work of NFWF as an example, stewardship funds can be tailored based on investment parameters, ongoing disbursement of funds, and the governing agencies risk tolerances for the investment.	At present NFWF is the largest provider of and may also be the only viable provider of stewardship funds for the Credit System. While much of a stewardship fund can be tailored to the unique needs of a mitigation program, it does require a governmental permit or requirement for establishment.

	(NFWF)				
Participant Contract	All Credit Developers are required to sign and execute a participant contract, which will be established by the Administrator and act as the first intentional reversal assurance instrument for all Credit Developers.	While the establishment of the participant contract requires investment of Administrator and resources, it does not require the additional engagement of a financial institution or provider. Executing the Participant Contract may decrease a Credit Developers ability to secure additional lines of credit for other purposes, due to committed collateral or concerns over who would hold senior debt obligations.	The Participant Contract will extend for the project duration as defined by the Management Plan or until the Administrator releases the Credit Developer from obligations.	In the event of non-compliance by a Credit Developer, the Administrator would provide documentation indicating default under the terms of the Participant Contract and Management Plan to the Credit Developer, along with notice to pay all fee's required under section 7.b.1 of the Participant Contract. The Credit Developer may refuse to pay the Credit System per the terms of the Participant Contact, which would then necessitate legal action by the Credit System to receive payment.	The Participant Contract is the easiest assurance instrument to setup and manage, but in the event of a reversal and subsequent non-payment by a Credit Developer may prove to be the longest timeline to recoup funds.

Assurance Instrument	Availability & Procurement	Price & Opportunity Cost	Term & Renewal	Claims & Performance	Additional Notes
Casualty Insurance	In principle casualty insurance is available to any Credit Developer, but to date casualty insurance has been used in only a few mitigation projects and is offered by a handful of insurance companies, though is expected to increase in the coming years. To obtain a policy, a Credit Developer would demonstrate to the insurer they have the capacity and financing to complete their obligations. This process	The fee structure to date, has been that a Credit Developer will pay a one-time premium of about 2-4% of the dollar limit of insurance written into the policy, though this is subject to vary according to individual applications or underwriting considerations. The policy would not require a Credit Developer to post additional collateral with the insurer.	Casualty insurance can be setup for an indefinite amount time, but most providers have used a 10-year term length to date. Once a policy is setup and in force, it cannot be cancelled with the policy period unless the Credit System was to release the insurer from coverage.	In the event of non-compliance by a Credit Developer, a claim against the policy can be initiated only by the Credit System. The insurer will then respond to a claim by either, working with the Credit System to settle the claim, or pay a designee of the Credit System the claim amount that is necessary to meet the compensatory mitigation requirements as determined by the Credit System.	While a relatively new assurance product, the use of causality insurance for mitigation projects is expected to grow, as it provides a low cost option to Credit Developers, an extended period of coverage, and all with minimal administrative oversight and maintenance.

	has tended to be less exhaustive than the review for a performance bond. If accepted, the policy will include a deductible clause that requires the Credit Developer to reimburse the insurer for any costs that the insurer incurs up to the deductible amount.	The main cost of establishing casualty insurance relates to the cost to the Credit Developer of paying the initial 2-4% of the policy, which cannot be invested like an escrow account.			