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A Survey of Mitigation Banker Perceptions and Experiences

Under the 2008 Federal Mitigation Regulations

The 2008 compensatory mitigation rule established new guidelines designed to improve the quality and success of mitigation projects. The authors surveyed mitigation bankers and consultants to gauge the banking community's take on the rule's impact thus far.

By Todd BenDor, J. Adam Riggsbee, and George Howard

In April 2008, the U.S. Army Corps of Engineers (the Corps) and the U.S. Environmental Protection Agency issued regulations (the Rule; 33 C.F.R. Parts 325 and 332; 40 C.F.R. Part 230) governing compensatory mitigation for aquatic resource damages. The Rule was designed to improve the quality and success of compensatory mitigation projects by (among other things): (1) establishing equivalent ecological, financial, and monitoring standards across different methods of compensatory mitigation, including mitigation banking (see Appendix for definitions of mitigation-related terms), in-lieu fee (ILF) programs, and permittee-responsible mitigation (PRM); (2) making the process of creating a mitigation bank more predictable by establishing disciplined time lines for the review of bank proposals; and (3) establishing preference for mitigation bank credits over other compensation methods, since, according to the Rule, mitigation banks "reduce some of the risks and uncertainties associated with compensatory mitigation."

The Rule's potential to transform the compensatory mitigation industry raises questions regarding mitigation markets and mitigation banking in particular. During its first year, did the Rule begin to make its intended impact? How has the Rule changed the process of establishing and operating a mitigation bank, such as time lines for bank approval, geographic service areas, etc.? How has the Rule affected the risk experienced by mitigation bankers?

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National Bankers Survey

During April-May 2009, we conducted a confidential, web-based survey of members of the National Mitigation Banking Association and attendees of National Mitigation and Ecosystem Banking Conferences approximately one year after the Rule's implementation date (June 9, 2008). We designed survey questions to elicit banker and mitigation consultant perceptions of: (1) the bank approval process; (2) competition among compensation practices (equivalent standards); (3) regulator preferences; and (4) demand for mitigation credits. We should note that no previous, national studies have assessed the mitigation industry's behavior and/or attitudes toward regulations. This makes it difficult to establish baseline conditions, from which we could rigorously assess the effects of changing regulations. As a result, this survey only assesses compensation providers' *perceptions* of changes brought on by the Rule.

The survey was distributed to 327 individuals during April-May 2009. A total of 156 completed responses were received (47.7 percent response rate) from individuals in 30 of 38 Corps regulatory districts (Figure 1). Survey responses revealed a wide array of experiences with the Rule among firms and Corps districts.

Equivalent Standards for ILF and PRM

ILFs have up to five years to modify their instruments for compliance purposes (ILF compliance is discretionary to Corps districts during 2010-2013). As a result, we did not expect complete compliance. In light of this, however, respondents felt that one year after Rule implementation, most ILF programs do not yet conform to the Rule's requirements. With regards to current ILF conformance status, 59 percent of respondents believed that limits had not been

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Humbug Marsh, part of the Detroit River International Wildlife Refuge, became only the 27th American Wetland of International Importance under the Ramsar Convention. Read more on the back cover.

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placed on ILF advance credit sales, 43.5 percent claimed that ILF programs had not established mandatory program accounts, 59.8 percent of respondents believed that public and regulatory review and oversight processes were not equivalent to those of mitigation banks, and 56.5 percent believed that ILF programs were not developing mitigation plans equivalent to those required of banks.

Respondent perceptions of ILF programs reflected frustration with Corps districts that: (1) did not believe that the Rule's ILF provisions applied to operating ILF programs; (2) had no desire to comply with certain ILF provisions or actively sought to disregard the Rule in certain cases; (3) were in conflict (or created complex relationships) with state regulations that interfere with the Rule's ILF provisions; or 4) place heavy preferences on nonprofits and government agencies running ILF programs. An example of a common view, one participant noted that "[a]t this point, [our district] views the Rule as a 'soft preference'. . . they are not likely to feel there is a need to limit advanced credit sales." Another noted that "[t]he Corps may feel that the in-lieu fee is more capable than mitigation banks. Furthermore, banks are made to make profits, and this may conflict with some peoples' view of . . . duty to the environment." Moreover, "some Corps staff members like to work with local community groups and land trusts, [which] are not set up to develop rigorous mitigation plans. Additionally, it appears that standards for compensation are relaxed if a group proposes a popular acquisition of land."

Several respondents also perceived conflicts of interest by government agencies, including the Corps, Interagency Review Teams

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(IRTs), and various state agencies, that both regulate impact permits and run ILF programs. Example of a conflict of interest: "To my knowledge, no IRT has reviewed any of the proposed [ILF compensation] sites in the field to establish ecological values. The [state agency] who implements the plan also approves the [state] department of transportation's impact permits." Several respondents also blamed limited ILF provision enforcement on a lack of standardized policy for ILFs and nonexistent examples on which to build compliant ILF programs. Lax enforcement was also attributed to regulators that view government agencies and nonprofit organizations as more financially responsible than private entities. If bankers' perceptions are accurate, whereby ILF programs are not held to the same standards as mitigation banks (i.e., mitigation plans, regulatory review, public review, and limits on advanced credit sales), then the integrity of ILFs in some districts are understandably questioned. Better oversight and documentation will greatly improve ILF transparency, which is in the best interests of the environment, the public, ILF programs, and regulatory agencies.

Although a much higher fraction of respondents declined to respond to PRM questions (approximately 40 percent; presumably due to unfamiliarity with local PRM practices), only 23.4 percent believed that the Rule was responsible for substantial changes in PRM financial assurance requirements. Additionally, 21.1 percent of respondents saw changes in the implementation of the watershed approach for PRM under the Rule, primarily through increases of in-kind mitigation and additional attention toward watershed-scale concerns. Finally, 21.1 percent and 20.3 percent of respondents believed the Rule was responsible for changes in ecological performance and monitoring standards, respectively. Similar to mitigation banking standards, respondents primarily referenced stricter and more tightly defined ecological standards for PRM in the wake of the Rule.

Mitigation Banking

Among the most unexpected results of the survey was the common perception that the Rule has produced or reenforced barriers to mitigation banking, including conflicts between the Rule and existing state and local law, conflicts of interest between regulators and ILF programs, and interagency confusion and conflict (IRT members that interpret the Rule differently).

Respondents described extensive intergovernmental conflicts among the federal agencies interpreting the Rule as a major source of difficulty. One respondent noted that "[o]nce the Rule has been interpreted jointly by the IRT members, I feel as if it will make things run in much the same way as it did prior to the Rule." Another added that "[t]he regulations seem to have created a moving target that changes from district to district. [There is a] huge learning curve for IRT members [and] other agencies are not bound to Rule."

Bankers primarily attacked the inconsistent implementation of time lines associated with the bank permitting and approval process, continuing the historically distrustful relationship often seen between bankers and regulators. "Some of the [Corps'] project managers are trying to come up with ways to circumvent the Rule and keep control of the process in the hands of a very few . . . as it was before the Rule . . . no oversight by higher management at [our district]." While 44.2 percent of respondents saw no change in time lines for bank approval due to the rule, 35.7 percent of respondents indicated that the Rule had had at least some effect. Explanations were wide-ranging, with many respondents describing timely review of bank prospectuses, and others experiencing slowing due to IRT confusion and staff reorganization. An example of improvement, one respondent wrote, "[the Rule] has significantly shortened the time required to reach milestones . . . Accountability in the form of established timelines generates quicker responses from both [the Corps] and the IRT." Another highlighted a continued challenge, where there is now "[l]onger review time by legal staff to ensure compliance with the Rule. However, there was massive personnel reorganization at the same time."

"Not all bankers found fault with extended permitting time lines: 'Made them a bit longer, and more rigorous. It appears that it will make the process for obtaining an approval for a proposed bank harder, which should be a good thing.'"

Not all bankers found fault with extended permitting time lines: "Made them a bit longer, and more rigorous. It appears that it will make the process for obtaining an approval for a proposed bank harder, which should be a good thing." Usually in the form of increased requirements, 41.1 percent of respondents saw changes in financial assurances required for banks under the Rule. One person offered this description: "IRT requires performance bonding, short-term maintenance escrow that is refundable, and long-term maintenance escrow (endowment)."

Only 34.9 percent saw changes in their district's implementation of a watershed approach for mitigation banks (45.7 percent did not), primarily through changes in the size of bank service areas. Confusion as to the interpretation of watershed approach continues among many bankers. One example of improvements was that "[b]anking instruments and the prospectus has to describe [how a new bank fits within] this approach, which previous bankers have not done adequately." Another respondent pointed to problems with the watershed approach:

> [Our district] has worked closely with [state regulators] to base wetland mitigation banks on an understanding of watershed processes from an ecological perspective. This is appropriate ecologically, and an area in which the state and district excel; these [watershed approach-related] boundaries do not always match the state-defined [service areas], which has created some confusion in the public's mind.

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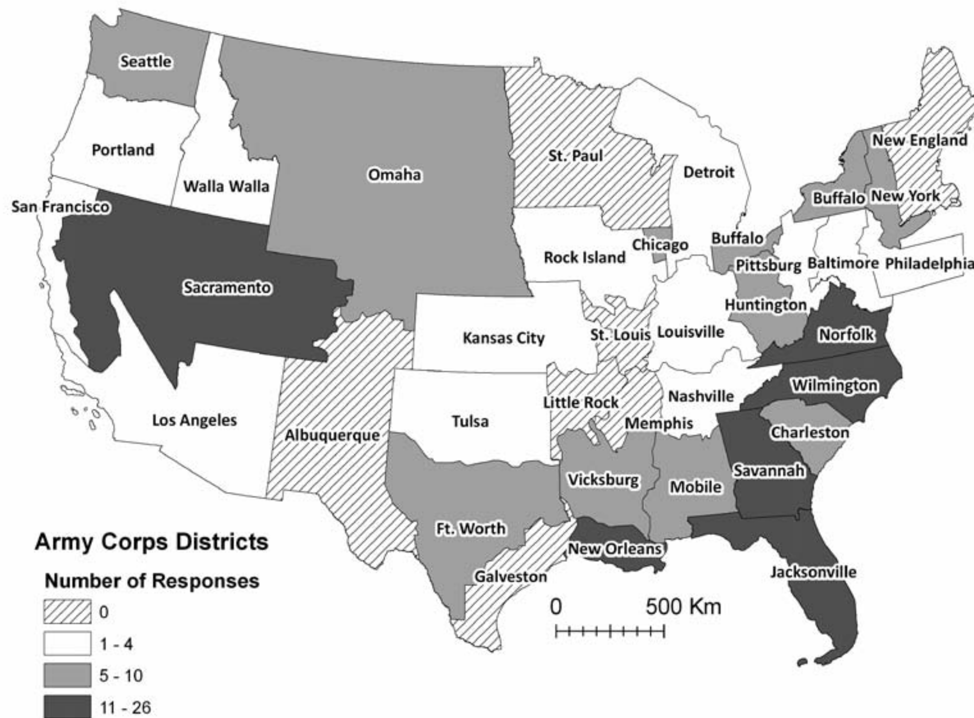

Figure 1: Corps Districts and Response Frequencies

For ecological performance and monitoring standards, only 31 percent and 29.5 percent of respondents, respectively, believed the Rule had affected changes, usually through increased standards that were more strictly enforced and better defined. In several cases, monitoring periods had not been defined or enforced prior to the Rule. One respondent commented: "[There has been an] increase in use of functional assessment models and focus on performance metrics tied to measurable increase in function. [This] facilitates standardization rather than arbitrarily developed performance standards based on opinion rather than science." However, respondents also indicated the need for guidance relating to these standards, particularly given extensive interagency conflicts, slowing of credit releases, and altered incentive structures. One respondent noted, "I don't think the IRT agencies have yet determined what they want as a group." Another stated that "[g]uidance on this would be helpful . . . Instead of playing the 'bring me a bigger rock' game, it would be easier . . . if they provided guidance. . . ."

Regulatory Preference

The Rule established a preference hierarchy through which mitigation banks were given regulatory preference over ILF sites and PRM. The Rule explores possible conditions where the stated preference structure may not be appropriate, formally authorizing each Corps district to make the final determination. Responses reveal that the banking community largely perceives that regulators see the preference structure as soft, with many districts ignoring the guided structure put forth in the Rule, viewing it merely as a suggestion to guide district decisionmaking. One respondent commented that "[mi]tigation is left to the discretion of the district engineer. A bank may be formed, but staff can require mitigation elsewhere." Another example noted that "[t]he members of the IRT . . . include individuals that are openly biased against private environmental mitigation policies, do not trust businesses, and do not like the concept of profit in environmental restoration."

Approximately one-half (48.3 percent) of respondents agreed that their district was applying this preference structure, although only 30.7 percent believed that the Rule affected a change in regulatory preference structure. Of the respondents claiming that their district did not use the Rule's suggested hierarchy, 58.8 percent asserted that PRM was the most preferred choice of regulators, 42.6 percent believed that mitigation banking was the second preference, and 45.6 percent believed that ILF mitigation was the least preferred alternative. In districts where the Rule has caused a change in preference hierarchies, PRM had also previously been the clear regulator preference, followed by mitigation banking and ILF programs.

These results suggest that prior to Rule implementation PRM was the widely favored compensation method in most districts. Although the Rule recognizes PRM as the riskiest form of mitigation, PRM continues to be the preferred method where the Rule has not forced changes. Our results support documentation by the Environmental Law Institute (2007), which concluded that during fiscal year 2003, 59.8 percent of wetland mitigation and 81.5 percent of stream mitigation was completed as PRM. This suggests that while bankers have focused substantial attention over the years to the threat posed by ILFs to banking interests, PRM has been, and continues to be, a more important challenge to banking interests.

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Related to regulatory preference, several respondents believed that IRT members, and Corps districts in particular, prefer compensation provided by nonprofits and government agencies over that provided by mitigation banks. Although these concerns are not new to the mitigation banking community (Mogensen 2006, Robertson 2004), they indicate significant distrust between its private and public components. Based on the frequency and geographic extent over which they were raised in the survey, these perceptions are widespread. If accurate, these perceptions suggest entrenched ideological barriers to the implementation of a Rule that might otherwise benefit private-sector-sponsored compensation.

Financial Risk and Market Demand

The majority of respondents (75 percent) indicated that the Rule had not reduced the financial risk of establishing mitigation banks. Respondents reasoned that the new compensation hierarchy was merely a soft preference, meaning that compensation requirements and decisions were largely left to the discretion of district-level regulators, whom respondents often felt were adverse to banks and the organizations that created them. Respondents also referenced several factors that negated decreases in financial risk that they hoped would accompany the Rule, including: uncertainty in time lines and service areas; continued preference for non-bank compensation by regulators; high up-front costs due to increased financial assurances and stricter ecological requirements under the Rule; and Rule implementation problems. One respondent wrote: "Staff does not facilitate quick resolution of problems, and allows IRT members to question decisions already covered in the signed [Banking Instrument], creating uncertainty. Permittees are not routinely approved to use the bank, putting the bank at financial risk." To a lesser extent, respondents pointed to marked heterogeneity in the treatment of individual bankers by regulators in several districts. One example noted that "[t]he approval process is slanted to a specific group of bankers that have been involved with the project managers. Delay tactics still exist despite the [new time lines]. This serves certain interest[s] well, but delays others inexcusably."

Respondents who did see reductions in financial risk primarily attributed it to increasing regulatory preference for banking in their districts, consistent and predictable time lines for bank approvals and credit releases, consistency in application of the Rule, and increased certainty regarding service areas. Approximately 23 percent of respondents claimed an increase in the availability of mitigation bank credits, primarily due to increases in bank development (although this widely varied across districts), improvements in the bank approval process, increased investment in banking companies, and increases in the general acceptance of banking by regulators. However, 64.5 percent of respondents saw no effect on credit availability due to the Rule.

Many respondents claimed that no new banks had been established in their districts. Analysis of these responses did not reveal any correlation with respondent discussions of decline in market demand for compensatory mitigation due to the current economic recession. Soft preferences, continued uncertainty in time lines, perceived interference by competing ILF programs, interagency conflicts (both within the IRT and between state and federal agencies), and increased requirements for compensatory mitigation were referenced.

Implications

Although substantial changes have occurred in the short time since the issuance of the Rule in 2008, ongoing efforts to improve implementation will be important in the coming years. Elevating compensatory mitigation to more ecologically sustainable standards will be difficult unless extensive social and economic hurdles to implementing the Rule are overcome. Perceptions of conflicts of interest that breed distrust between bankers and regulators, combined with multiple sources of uncertainty in the compensatory mitigation process, continue to present barriers to realizing the full potential of the Rule. Full compliance with the Rule will require that regulators and bankers improve communication and work together to ensure transparency in standards for Rule interpretation and implementation, including regulator expectations and banker responsibilities. ■

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Resources

The entire report, A National Survey of Federal Mitigation Regulations and Their Impacts on Wetland and Stream Mitigation*, can be read at* http://www.unc.edu/~bendor/survey/MitSurveyReport_Distribute.pdf.