Recommendations Report on

Improving Access to Capital

for Indigenous Peoples in Canada

The National Aboriginal Economic Development Board

July 2017

Contents

About the Board

Established in 1990, the National Aboriginal Economic Development Board is a Governor in Council appointed board mandated to provide strategic policy advice to the federal government on issues related to Indigenous economic development. Comprised of First Nations, Inuit, and Métis business and community leaders from across Canada, the Board helps governments to respond to the unique needs and circumstances of Indigenous peoples in Canada.

Information about the NAEDB can be found online at http://www.naedb-cndea.com.

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Letter from the Interim Chair

Canada is a country with many economic advantages, including a large natural resource base and a strong democracy. However, for much of Canadian history, Indigenous peoples have been excluded from meaningful participation in the economy and have been subject to controlling and economically restrictive policies which have limited Indigenous communities' growth and economic development.

According to the Conference Board of Canada, a strong financial services sector is necessary in order to develop a successful, dynamic and resilient economy.[1] Capital is required to finance operating costs, expansion and asset purchases. When access to capital is limited, entrepreneurs cannot start, grow or expand their businesses, and economic growth is slowed. In addition to spurring economic growth, access to capital is a critical component for a community to participate in major projects impacting Indigenous rights, such as natural resource expansion.

Despite the barriers many Indigenous communities have developed strong financial and business capacities. These communities have strong and vibrant economies and many of them are the cornerstone of their regional economies. Other communities continue to face challenges in economic development. Many do not have the necessary background to navigate commercial lending systems and regulatory approval processes, further limiting opportunities for those communities.

Efforts to address disparities between Indigenous and mainstream financing have not been successful across the country, and more work must be done to ensure that Indigenous communities and businesses can access the types and amounts of financing they require to build healthy, sustainable economies.

Sincerely,

Dawn Madahbee Leach

Interim Chairperson

Executive Summary

Access to capital is an integral component of economic development, and is important for governments, businesses and households alike. Capital provides expanded options for government finance, allows businesses to start and supports business growth over time.

However, Indigenous people in Canada face barriers to accessing capital that other Canadians do not face. These include a legal and regulatory environment that is unfavorable for economic development, barriers to control over lands and resources, underinvestment in housing and infrastructure, low rates of financial literacy, higher costs of doing business, a lack of support for business growth and a complex government funding regime.

Although recommendations have been made for decades towards improving Indigenous peoples' access to capital, a pronounced gap persists. Waterstone Strategies recently produced a report for our Board, entitled *First Nations and Inuit Access to Capital for Economic Development, Business and Infrastructure: A Quantitative Assessment of the Access and the Gaps,* which measured the size and assessed the characteristics of the gap between First Nation and Inuit financing,[2] and mainstream Canadian financing.

The report found that, although First Nations and Inuit are accessing more capital, the gap between Indigenous access and access for other Canadians continues to widen. Despite the growth of capital in the First Nation and Inuit business community, an additional $83.3 billion in capital would be needed to fuel a First Nation and Inuit economy operating at the same level as mainstream Canada. This gap has led to a concentration of support for early growth, which leaves expanding businesses without necessary supports, and has limited financing options for infrastructure and housing.

If access to capital were to improve, and First Nations and Inuit were able to access a proportionately similar amount of working capital as non-Indigenous businesses in Canada, First Nations and Inuit businesses could experience substantial growth. Closing the gap in access to capital would bolster Indigenous economic development opportunities and support community well-being through enhanced housing and infrastructure investments.

Furthermore, closing the gap in access to capital has implications for the Canadian economy as a whole. According to Waterstone Strategies, a First Nation and Inuit economy operating at the same level as the Canadian economy and financed appropriately could result in a contribution of over $3.6 billion to Canada's GDP. As capital-intensive industries offer significant opportunities for growing the Canadian economy in the coming years, it will be important for Indigenous people to be able to access the types and quantities of capital required to participate in these industries.

Our Board firmly believes that closing the gap in access to capital between Indigenous communities and the rest of Canada is an issue of critical importance. That is why we are making the following recommendations to the Government of Canada:

1. That the Government of Canada continue to expand investments in and support for Aboriginal Financial Institutions.

2. That the Government of Canada make a substantive effort to renew the fiscal relationship and to make fiscal fairness and affordable borrowing a reality for Indigenous peoples and communities. This includes addressing current legal and regulatory barriers to accessing capital, as well as exploring and supporting new and alternative lending options.

3. That Indigenous and Northern Affairs Canada (INAC) continue to work with Indigenous peoples, nations and governments to expand investments in communities and to enhance the investment climate.

4. That INAC enhance the relevance, quality and availability of information to Indigenous households, businesses and communities through a commitment to transparency and openness, as well as supporting Indigenous-led research and data governance.

An Indigenous economy operating at the same level as the Canadian economy could not only improve social and economic outcomes for Indigenous peoples and communities, but could also result in positive fiscal and economic impacts for all of Canada. It is essential that the federal government work with Indigenous peoples and institutions to close the longstanding gap in access to capital.

About this Report

This paper provides background information on access to capital barriers for Indigenous peoples in Canada, and includes key findings from a report produced by Waterstone Strategies, entitled *First Nations and Inuit Access to Capital for Economic Development, Business and Infrastructure: A Quantitative Assessment of the Access and the Gaps,* as well as policy recommendations on addressing the identified deficits.

First Nations and Inuit Access to Capital for Economic Development, Business and Infrastructure provides a detailed economic analysis on the gaps in access to capital between mainstream Canada and the First Nation and Inuit population for the period between 2003 and 2013. The gap in access to capital was calculated by estimating the level of capital required to finance a First Nation and Inuit economy that was operating at the same level as the Canadian economy.

This paper concludes by presenting the National Economic Development Board's recommendations on how the gap in access to capital should be closed. While this paper and the recommendations focus on access to capital, other financial goods and services are included when relevant to the discussion.

Access to Business Financing

Indigenous peoples continue to face barriers in accessing appropriate financing. In 2016, the Canadian Council for Aboriginal Business (CCAB) found that Indigenous businesses continue to rely on personal savings to finance their businesses.[3] Waterstone Strategies' recent report *First Nations and Inuit Access to Capital for economic development, business and infrastructure* found that First Nation and Inuit businesses continue to access proportionally less capital than non-Indigenous businesses in Canada. Additionally, the report indicates a greater amount and variety in capital is required to fuel Indigenous economies and allow them to operate at the same level as the Canadian economy.

In 2013, First Nation and Inuit businesses accessed slightly more of total available capital in Canada (0.2%), less than 10% of the share that would be accessed if First Nations and Inuit were accessing capital at the same rate as the rest of Canadians. The growth of capital at work in the First Nation and Inuit business community has increased from $2.8 billion in 2003 to $5.9 billion in 2013; the share of market capital as a proportion of total business financing capital increased to 53.8% in 2013 from 39.4% in 2003. Despite the overall increase in capital at work in Canada during this period, the gap between mainstream and the First Nation/Inuit on a population adjusted basis almost doubled from $41.8 billion in 2003 to $83.3 billion in 2013.

If access to capital were to improve, and First Nations and Inuit were able to access a proportionately similar amount of working capital as non-Indigenous businesses in Canada, First Nations and Inuit businesses could experience substantial growth. The necessary pre-conditions for economic development are in place, including a solid base of experienced entrepreneurs, support services, the Aboriginal Financial Institutions (AFI) network, and locally based commercial lenders with an understanding of the regulatory constraints of the *Indian Act*. According to Waterstone Strategies, a First Nation and Inuit economy operating at the same level as the Canadian economy and financed appropriately could result in a contribution of $3.675 billion to Canada's GDP.

What kinds of capital do businesses access?

In order to thrive, businesses require access to various sources of capital, including market sources of capital, assisted-market sources of capital, and non-market sources of capital. Waterstone Strategies provided the following breakdown of the types and amounts of capital that First Nation and Inuit businesses access:

Market sources of capital include all mainstream financing instruments that operate without incentives from government or other sources. These include loans, bonds, debentures, equities and commercial paper. For every dollar of market capital accessed by Canadians in 2003 and 2013, First Nations and Inuit accessed 8 and 9 cents. In 2013, First Nation and Inuit accessed $8,429 less market capital per person than mainstream Canada, even less than the $6,093 First Nation and Inuit accessed in 2003. The share of the total capital disbursed relative to the gap to be filled was 1.8%, and has been decreasing since 2003. This means that the gap is not closing.

Assisted market sources of capital alleviate the risk or lower transaction costs to support the flow of capital into areas that exceed the risk tolerance of traditional instruments. These sources include loan guarantees, loss reserves and tax credits. Assisted market capital is accessed by First Nation and Inuit businesses to support activities for new and mature businesses. Mature businesses can access conventional sources through the Business Development Bank of Canada and loan guarantees through conventional banks; many of these businesses operate off-reserve. For new businesses, microcredit and pre-market or development loans are provided by Aboriginal Financial Institutions, with an average loan size of $98,000 and generally no more than $500,000.

For every dollar of assisted market capital accessed by Canadians in 2003 and 2013, First Nations and Inuit accessed 11 cents. In 2013, First Nation and Inuit businesses accessed $11.11 for every $100 of Assisted Market Sources accessed by mainstream businesses; this is the largest and more persistent gap of all market sources. Mainstream businesses used assisted market sources of capital to support export and expansion (56%), small medium enterprise guarantees (17%) and support in agriculture and other sectors (26%).

Non-market sources of capital provide financing where the risk/return ratio or transaction cost makes an investment unattractive for conventional lending. These include federal, provincial and municipal assistance for business, usually in the form of grants and contributions. These grants and contributions can provide financing, support for skills and training, community strategic planning, infrastructure, sectoral advisement and research.

For every $100 of non-market capital accessed by the mainstream business community, First Nation and Inuit businesses accessed $66.60 in 2003 and $48.5 in 2013. For every dollar of non-market capital accessed by Canadians in 2003 and 2013, First Nations and Inuit accessed 67 and 49 cents. $586 million in non-market sources would be required to close this gap. First Nation and Inuit businesses access primarily federal non-market sources with 67.8% of that funding supporting skills development and early growth versus the 20.6% for mainstream businesses.

When mainstream businesses access federal funding, 77.5% of that funding goes towards business financing and infrastructure supporting the business. First Nation and Inuit business use 32.2% of federal non-market sources for infrastructure. 48% of government assistance for mainstream businesses was for infrastructure to support business development compared with 8.5% for First Nation and Inuit businesses. Less than 1% of non-market sources support research and development and financial enablers for First Nation and Inuit businesses, where mainstream businesses' share was four times higher. First Nation and Inuit businesses spend most of their non-market capital on early growth and development, where mainstream businesses spend most of their non-market capital on business financing and infrastructure.

Growth Patterns in First Nation and Inuit Financing Activities

In their report, Waterstone Strategies found that most of the growth in First Nation and Inuit financing activities from 2003-2013 was the result of commercial bank loans to larger private and nation-owned businesses. These commercial loans were likely driven by large energy and resource-based ventures, resulting from duty to consult and accommodate, on the force of growing retained earnings and First Nation and Inuit own-source income. However, based on information Waterstone Strategies collected from financing experts, the cost, terms and conditions for accessing this capital were likely less favourable than for comparable mainstream businesses.

The gap in access to capital remained nearly unchanged since 2003 for the smaller and owner-operated businesses in the majority of First Nations and Inuit communities, especially with respect to working capital and growth financing needs. Growth in access to capital has been limited to a small percentage of well-endowed communities. Using own-source revenue data as an indicator of the potential revenues available to communities to raise financing, Waterstone Strategies found that the majority of borrowing activity (65%) was concentrated in just 100 First Nations (approximately 15% of communities), including most of the communities using land and financial management powers outside of the *Indian Act*. The potential to increase borrowing activity in the remaining 85% of communities is limited based on the revenues they have available to access capital.

Government Finance

The responsibilities for the provision of various public goods and services in Canada are divided between the federal, provincial and municipal governments. Over the past 150 years, Canada's fiscal policies have increasingly sought to redistribute resources to achieve fiscal fairness and equality between regions and provinces.[4] Federal transfers to provincial and territorial governments are a major source of funding for public services, such as housing, health care, infrastructure improvements and post-secondary education. In 2008, the four major transfers to provinces and territories accounted for 19% of total federal expenses.[5]

However, the fiscal fairness Canada has increasingly pursued throughout the past 150 years has not necessarily extended to Indigenous peoples, as investments per capita have been measurably lower and as the federal government has placed restrictions on Indigenous peoples ability to access and leverage funds. In particular, the 2% cap on increases to funding transfers to Indigenous communities has long been described as discriminatory and unjust.

First Nations in particular have been subject to stringent reporting and budgeting requirements which provinces and municipalities do not experience. For example, while cost-sharing programs require provinces to report their expenses to the federal government, provinces are not required to report the details of all their expenditures to the federal government and are not accountable to the federal government for all federal transfers. The rationale for the equalization transfer to certain provinces is to enable less-prosperous provinces to provide public services comparable to other provinces.

Indigenous peoples continue to heal from the effects of colonial, assimilative policies, which have left some communities focused solely on basic needs and unable to engage in long-term planning. The National Collaborating Centre for Aboriginal Health (NCCAH) has argued that the legacies of colonization—including poverty, loss of culture, low educational attainment and poor socio-economic outcomes—have contributed to a diminished capacity to benefit from economic development opportunities, increasing environmental and social costs and cutting communities off from the indirect health benefits which stem from economic development.[6]

The insufficient access to capital creates challenges for First Nations and Inuit communities wishing to attract business and investment. This is further reinforced by obstacles, such as remoteness, lengthy approval times, limited collateral assets, and the absence of regulatory harmonization on- and off-reserve. The reduced potential of leveraging investments in First Nations communities is a result of the costs of investment facilitation on First Nation lands being four to six times higher on average than on non-First Nation lands.[7] Mainstream communities, even those located in remote areas, do not face such obstacles.

For example, the typical Canadian community can leverage $1 million of annual revenues to finance $6 million in infrastructure spending or attract $5 million in investment. For a First Nation, the same $1 million could only finance a third ($2 million) in infrastructure spending or nearly a quarter ($1.5 million) in investment.

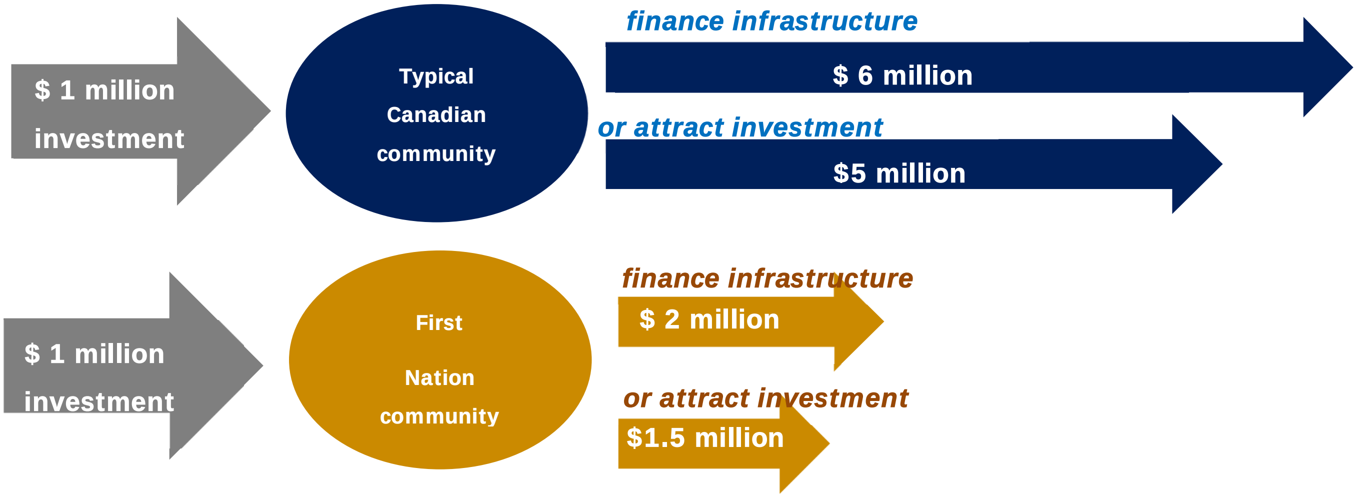

Figure 1: Comparing the investment climate on- and off-reserve. *Adapted from the Tulo Centre of Indigenous Economics, Building a Competitive First Nation Investment Climate (2014).*

It should be noted that in the case of Indigenous governments, a greater amount of capital than mainstream Canada may be needed to address the gaps in socio-economic outcomes, poverty, as well as housing and infrastructure deficits. In the case of Indigenous businesses and entrepreneurs, Indigenous governments must be enabled to support their citizens, and AFIs must be enabled to provide necessary supports.

Financing infrastructure

Infrastructure investment and development stimulates economies and can improve access to capital by providing the reliable transportation, utilities and communications networks that attract private investment. Investments in housing can have a particularly strong impact on increasing business activities and providing equity for small and medium enterprises.

First Nations are currently grappling with an infrastructure and housing deficit on-reserve, which must be addressed to enhance economic development, growing both Indigenous and Canadian economies. The cause of this deficit is most often attributed to funding restrictions and factors related to remoteness and higher costs. Improved infrastructure investment in First Nations and Inuit communities could increase access to capital by enhancing the efficiency of commercial and public operations and by providing the required transportation, utilities and communication networks to attract private sector participants.

Many First Nations and Inuit communities are rural and/or remote, which increases the cost of infrastructure. Mainstream rural and remote communities can leverage infrastructure investments from federal, provincial and municipal sources, while First Nation and Inuit communities generally access federal funding. Mainstream government borrowing can be secured by long term bonds, guaranteed by a provincial or municipal government, lowering the cost of borrowing. Until 2014 with the First Nations Finance Authority bonds, First Nation and Inuit communities were unable to access a comparable borrowing mechanism, leaving short term and high cost mechanisms for infrastructure development. Most First Nations are limited to long-term borrowing through senior government grants to finance major infrastructure expenditures. This is due to the fact that many of the infrastructure financing tools available for other communities, such as fees, public-private partnerships, short-term borrowing, frontage tax and general taxation, are tied to a regulatory framework that does not exist on reserves.

The Waterstone Strategies report found that from 2003 to 2013 mainstream community infrastructure investment doubled, while First Nation and Inuit community infrastructure investment increased by only 43%. Not only are there differences in the volume of community infrastructure investment, but differences have been identified in the types of infrastructure investment.

The current model of infrastructure funding for First Nation and Inuit infrastructure spending relies on federal transfers that are largely disbursed as infrastructure is being built. While mainstream infrastructure spending for most Canadian communities is primarily devoted to roads, water and sewer and electrification (80%), First Nation and Inuit communities tend to spend less available funds to such expenditures (45%). First Nation and Inuit communities tend to devote more infrastructure spending to public buildings and educational infrastructure (50%) while mainstream communities spend less on these types of expenditures (20%).

In addition to the gaps and barriers noted for First Nation and Inuit communities, the Canadian Centre for the Study of Living Standards has identified housing infrastructure for the Métis as being below the standard enjoyed by non-Indigenous Canadians.[8]

Infrastructure investments targeted at stimulating the housing sector could have a particularly strong impact on increasing business activities and access to capital as a result of its impact on other associated economic areas. Infrastructure investments in housing provide related business opportunities for local small and medium size enterprises and are a potential source of equity to leverage debt for private entrepreneurs. They also have the benefit of strengthening the local entrepreneurial and financial management capacity that is needed to absorb and channel increased access to capital.

What are the benefits of access to capital and financial services?

Government borrowing is a cornerstone for financing large expenditures, including infrastructure, such as roads, hospitals and schools. Additionally, communities and governments with better access to capital are more likely to expand their Own-Source Revenues (OSR), to exercise greater control over lands and resources, and to have greater business growth and entrepreneurship rates.

Access to capital is particularly important for those industries which are characterized as capital-intensive, including mining, oil and gas, aquaculture, utilities and telecommunniciations.[9] In particular, greater access to capital and financing enhances the ability of Indigenous communities to have equity positions in natural resource development.

In addition to the benefits to Indigenous peoples, Canada's economy as a whole would benefit from enhanced access to capital for Indigenous peoples. As Canada's Advisory Council on Economic Growth has noted, Canada is facing the economic challenges of an aging population coupled with low productivity.[10] Capital-intensive industries, such as the agrifoods industry and the natural resources sector, offer significant opportunities for growth in Canada's economy. Given the young and growing Indigenous population and current underrepresentation in capital-intensive industries, Indigenous participation in these sectors has potential to increase substantially in the near future. Access to appropriate types and levels of capital will be necessary to ensure sustainable business expansion and job creation for Indigenous peoples.

While the economic benefits of increased access to capital appear obvious, the social benefits of access to capital are less apparent. The Indian Business Corporation, an Alberta-based AFI, surveyed their clientele in 2015 and found that 74% reported a positive impact on their families since becoming a client, 58% reported an improvement in life satisfaction, 58% reported that the Indian Business Corporation has made a difference in their community, 83% reported very good mental health, and 39% reported improved mental health.[11]

It is clear that the shared future and shared prosperity of Indigenous and non-Indigenous Canadians will only be enhanced by Indigenous households, communities and businesses better enabled to participate in Canada's economy.

What are the barriers?

There are many barriers Indigenous peoples face when accessing financial services in Canada, including physical barriers caused by remoteness, and other barriers caused by the legal and regulatory environment, credit history, and low financial literacy rates. Many of the barriers frequently noted apply exclusively to First Nations on-reserve. However, the Inuit and Métis also face barriers in accessing financial services.

Legal and regulatory environment

The *Indian Act* has frequently been noted as one of the largest hurdles First Nation businesses and communities face when leveraging funds. The *Indian Act*, which applies to most reserves in Canada, regulates the majority of factors influencing community life, including education, property ownership, band membership, governance, lands, resources and financial management. This legislation and its legacy have repeatedly been identified as a hindrance to economic development and nation re-building.

For example, Section 89 of the *Indian Act* has deterred mainstream lenders from providing financial services to First Nations on-reserve, as the *Act* prevents property on-reserve from being used as collateral for loans:

> ***89. (1)*** *Subject to this Act, the real and personal property of an Indian or a band situated on a reserve is not subject to charge, pledge, mortgage, attachment, levy, seizure, distress or execution in favour or at the instance of any person other than an Indian or a band.*

The *Indian Act* creates additional barriers in accessing capital, deters investment and forces many First Nation businesses to operate on a cash basis.

As the Board has stated in previous reports, the *Indian Act* was never designed to accommodate the economic aspirations of First Nations. As a result, the tools available to manage business on-reserve are inappropriate for economic development. Specifically with regard to access to capital and financial services, the *Indian Act* limits property ownership that would otherwise be required to access financing from mainstream financial institutions, in addition to creating an environment of uncertainty for investors. *Indian Act* restrictions make it difficult to take and register conventional forms of security/collateral on loans. For example, banks are often unable to seize property on-reserve, which increases the risk of lending on-reserve and makes such dealings undesirable for mainstream lenders. Conventional risk-measurement and value assessment instruments have limited applicability on-reserve, especially with regards to land and real-estate value.

Although efforts have been made over the years to amend the *Indian Act* through the introduction of remedial opt-in legislation, the *Act* remains a barrier to access to capital, economic development and well-being for many First Nations.

Lack of control over lands and resources

Indigenous governments face barriers in exercising control over lands and resources, which stem from a variety of causes, including lack of consultation, economic marginalization, and exclusion from participating in major resource projects. This exclusion decreases potential Own-Source Revenues which could be used to secure additional financing.

Limited ability to use revenues to leverage financing

The *Financing Secured by Other Revenues Regulations* limits the revenues First Nations may use to leverage financing. For example, First Nations are unable to use the First Nations Goods and Services Tax to leverage other sources of finance.

Underinvestment in housing and infrastructure

For the Inuit, historic underinvestment in housing and infrastructure, coupled with the high costs of doing business in the North make access to capital particularly challenging. As previously noted in this report, increased investment in housing and infrastructure could bolster Indigenous peoples' economic development opportunities and ability to access capital.

Higher costs of doing business

Many Indigenous communities in Canada (particularly First Nations and Inuit) face higher costs of doing business, which can deter investment. The above-listed factors require more time-intensive interactions driving up the transaction costs for all but the larger, more urban businesses with more conventional lending profiles. Additionally, the unconventional and fragmented nature of the lending environment for First Nations and Inuit can create additional legal costs associated with multiple and changing legal, land management and regulatory circumstances. Some of the challenges include:

- The limited applicability of conventional risk-measurement and value assessment instruments especially with regards to land and real estate value;
- The absence of reliable credit documentation and registration instruments;
- The limited applicability on reserves of mainstream loan guarantee programs.

Lack of support for business growth

There are additional barriers created by insufficiently formed markets (otherwise known as market failure). As the Waterstone Strategies report finds, a large number of small businesses in the early stages of development are supported, while mid-size businesses receive less support as they grow. This broken business life-cycle development pays less attention to growing the mid-size business base with identifiable sectoral strengths to attract private capital. This is partly the result of lack of access to government supported capital (such as financial enablers, credit enhancement and risk mitigation supports, guarantees, and tax credits).

Complex government funding regime

In a 2016 survey of Indigenous businesses in Canada, 51% of survey respondents identified locating potential sources of funding as a barrier to business development and growth, due to the “patchwork nature of funding” and the large number of government programs.[12]

Financial literacy and credit scores

The physical availability of supports and access to financial services is lacking, as most Indigenous communities do not have a bank within their boundaries. Due to low rates of internet connectivity for rural and remote Indigenous communities, there is a lack of access to digital and technological solutions which could fill this gap. In combination, these factors lead to low rates of financial literacy for many Indigenous communities, which increases the likelihood of an Indigenous person having a poor credit score.

Previous Recommendations

Over the past 20 years, a number of recommendations have been made to the federal government on how to address the barriers in access to capital for Indigenous peoples in Canada. These recommendations have generally targeted a need for increased support for AFIs, as well as changes to the *Indian Act* and a need for the federal government to transform the fiscal relationship with Indigenous peoples (and First Nations in particular).

The Royal Commission on Aboriginal Peoples

In 1996, the Royal Commission on Aboriginal Peoples (RCAP) noted the gap in access to capital, and recommended that Indigenous financial institutions be supported in expanding their role, in addition to financial arrangements supporting Indigenous autonomy. Furthermore, the Commission recommended a renewed fiscal relationship among federal, provincial and Indigenous governments, governed by a framework to restore balance in the relationship.

The Standing Senate Committee on Aboriginal Peoples

In 2007, the Standing Senate Committee on Aboriginal Peoples made a series of recommendations to improve Indigenous access to capital, citing a lack of access to capital as a key and primary barrier for Indigenous economic development.[13] In particular, the Senate Committee identified Section 89 of the *Indian Act* as one of the primary barriers to on-reserve development.

In 2015, the Standing Senate Committee on Aboriginal Peoples made various recommendations on improving infrastructure and housing on-reserve, targeted at improving financing options. Their recommendations included changes to the Ministerial Loan Guarantee program for housing, the creation of a Ministerial Loan Guarantee program for infrastructure, amendments to the First Nations Land Management regime, and opt-in legislation to render Section 89 of the *Indian Act* inapplicable. The Committee has also proposed a series of innovative approaches to funding/financing infrastructure on-reserve, including the creation of tax regimes, leveraging Own-Source Revenues and property taxes through the bond market, public-private partnerships on-reserve, cost-sharing and using INAC funding streams to leverage financing. The Ministerial Loan Guarantee permits First Nations to obtain loans for funding on-reserve, as the federal government backs the loan, and eligibility requires sound financial management. The First Nations Market Housing Fund (FNMH) offers an alternative to Ministerial Loan Guarantees for First Nations wanting to obtain mortgages on reserve.

In 2015, The Standing Senate Committee on Aboriginal Peoples recommended that Ministerial Loan Guarantees be streamlined and improved by INAC in consultation with First Nations. Additionally, the FNMH was criticized by the Committee for failing to meet its objectives since it was established in 2008. The Committee on Aboriginal Peoples recommended that the CMHC commission a value for money evaluation of the FNMH and propose expanded uses for the fund.

In 2016, the Standing Senate Committee on Aboriginal Peoples also argued that Section 89 of the *Indian Act*, coupled with the lack of stable Own-Source Revenue streams means new financing options are required for housing and infrastructure on-reserve.[14]

Aboriginal Financial Institutions (AFIs)

In 2015, the Indian Business Corporation (IBC) recommended that governments aim their programs to support AFIs in engaging private capital, and support best practices in developmental lending. The Indian Business Corporation also encouraged corporations to increase local content in their supply chain, and to challenge their thinking on corporate social responsibility.[15]

In February 2017, the National Aboriginal Capital Corporations Association (NACCA) released a three-volume report detailing barriers specific to Indigenous small enterprise financing, noting limited growth potential in the current financing environment. Much like the Waterstone Strategies report we have recently released, NACCA found that the current environment supports the early stages of business, but does not support long-term, sustainable growth for businesses in later stages. NACCA recommended simplifying access to financing, improving financial literacy and strengthening financial capabilities, enhancing micro-loans and supporting efforts to overcome the financial barriers of the *Indian Act*.

Roundtable discussions

In 2015, the First Nations Financial Management Board (FNFMB) and the Government of Canada partnered to produce a series of recommendations for closing the gap in access to capital for First Nations. Recommendations included modernizing the fiscal relationship, investing in education and training, strengthening financial institutions, and improving financial literacy.

Past recommendations from the Board

Our Board has also made recommendations on improving Indigenous access to capital. Over the past eight years, these recommendations have included:

- strengthening the capacity of financial institutions,
- reviewing government funding regimes to ensure fiscal fairness,
- providing long-term, multi-year funding to AFIs,
- using a single-window approach to funding agreements,
- supporting the generation of Own-Source Revenue (OSR), and
- developing a loan guarantee instrument to facilitate equity participation in natural resource projects.

We have also urged the federal government to develop a modern approach to financing First Nation infrastructure, which would focus on increased access to alternative financing options, strengthened capacity to leverage different sources of financing, and comprehensive community planning to support sustainable and long-term planning for capital assets.

In 2015, our Board released a report entitled *Enhancing Aboriginal Financial Readiness for Major Resource Development Opportunities*. This report highlighted the importance of a community's ability to effectively use financial management tools, having expertise in business, and access to the necessary resources to make informed decisions about resource development opportunities.

Current Status

What is the federal government doing to address the gap in access to financing?

Over the past several years, the Government of Canada has demonstrated ongoing support for Indigenous business development by investing in economic development programming and supporting the development of Aboriginal Financial Institutions (AFIs).

To address some of the challenges created by Section 89 of the *Indian Act*, two measures were introduced to support private home ownership options on-reserve. However, these options are not available to all communities, and access to capital and financing for infrastructure development on-reserve continues to be a challenge for many First Nations.[16]

Despite support for AFIs through funding and government programs, progress must be made in addressing many of the barriers in access to capital, including addressing the challenges created by the *Indian Act*.

What are Indigenous communities and Aboriginal Financial Institutions doing to address the gap?

Indigenous governments continue to explore the advantages of private home ownership to determine if this may be a viable solution for members of their community. While Aboriginal Financial Institutions (AFIs) provide lending assistance and financial supports, they also fill an important gap in providing a broad range of services to support Indigenous business development, youth employment, and the amelioration of social conditions. Many AFIs have created innovative lending options which allow clients to build credit histories.

For example, TRICORP, a British Columbia AFI, delivers the Aboriginal Youth Initiative Program, where Indigenous youth (15-30) receive training and career placement, including a conference highlighting success stories and role models for youth. TRICORP also provides a program to assist individuals at risk through peer mentorship, designed to assist those facing employment obstacles due to socio-economic status and their personal history.[17]

The Yukon Micro Loan is another example of local-level innovation. The program is not based on a client's credit history, and offers entrepreneurs the opportunity to establish or improve their credit history. Approvals are instead based on personal characteristics and traits determined through an alternative assessment.

In 2015, the Indian Business Corporation in Alberta provided a Developmental Loan Fund to Siksika First Nation. This loan, created through a six-year agreement, has supported access to capital for the Nation, and has created the "next generation of entrepreneurs" for Siksika. Siksika invests Band trust monies into the Indian Business Corporation in order to create a "revolving loan fund" which is directed at their community. The provincial government was identified as a key driver of this process, contributing $700,000 to the $2.7M fund. As loans are repaid, the money is re-invested in the fund and re-loaned within the Nation. Over the six-year term, the First Nation will earn a blended return of the financial and social outcomes on their investment. This loan is the first of its kind in Canada, and benefits are already being identified. [18]

Although AFIs are certainly demonstrating local pockets of success and innovation, many AFIs are struggling and/or experiencing challenges which the federal government should be aware of, and could help to address. The Nunavut Business Credit Corporation, which provides financing alternatives for northern SMEs, has seen a decrease in client performance over the past year, with over 40% of clients unable to maintain their commitments to loan repayments due to current economic challenges.[19]

Locally and regionally, institutions have demonstrated flexibility and responsiveness; however, they will require continued support to provide capital and support services to bridge the gap.

Summary of Key Findings

A small number of First Nation and Inuit communities are accessing a high level of capital

Using Own-Source Revenue (OSR) as a proxy for access to capital, it is estimated that a small number of well-developed communities operating at a higher capacity than others are accessing most of the available capital. Waterstone Strategies estimates that only 100 communities are accessing 65% of available capital.

Coincidentally, many of the characteristics of a sound investment environment and increased access to capital are also consistent with higher community well-being. A recently released statistical study has identified a number of First Nations who rank highly on the Community Well-Being (CWB) index as having the following characteristics and/or opportunities available: (a) pursuing alternatives to *Indian Act* management, (b) running stable and fiscally prudent governments, (c) capitalizing on the value of property rights, (d) the presence of local economic opportunities, and (e) the possibility of partnerships with and investments from non-Indigenous communities and companies.[20] Those communities which meet the criteria identified in the study[21] are by virtue of those characteristics more likely to be able to access greater amounts and more variety of capital. This demonstrates an indirect link between community well-being and access to capital. Although there has not been an empirical study linking higher levels of community well-being and access to capital or financial services, it is clear that the ability to access adequate and appropriate types and levels of financing contributes to Indigenous economic development, including the associated benefits.

The gap in access to capital is widening

Despite the growth of capital in the First Nation and Inuit business community, an additional $83.3 billion in capital would be needed to fuel a First Nation and Inuit economy operating at the same level as mainstream Canada. The Waterstone Strategies report suggests that the widening gap between mainstream and First Nations and Inuit access to capital is likely to persist, as the proportion of market capital disbursed each year to this outstanding gap has been steadily decreasing. In 2003, First Nations and Inuit accessed 2.37% of available capital and 1.86% in 2013. Improving access to capital means expanding both the amount and types of capital available; ensuring a variety of capital is available to meet different needs.

Government contributions are not fully supporting business growth

Government contributions as a share of total First Nation and Inuit business equity have been estimated to have declined rapidly from 31% in 2003 to 18% in 2013, as the increasing injection of Own-Source Revenues has likely been the largest source of this equity, followed by retained earnings.

Government assistance for First Nations and Inuit has focused more on “early growth” activities such as skills and training and community planning, and less on categories that support increased access to market capital including financial enablers that contribute to economic success by creating the right conditions for growth, such as business financing and infrastructure development support.

Since 2003, training and skills development has remained the main investment for First Nations and Inuit, while the share from categories that support increased access to market capital have declined. The move away from "early" enablers to "later" enablers, such as financing support, research and sector expertise, and infrastructure observed for mainstream Canada, has not yet materialized for First Nations and Inuit.

Based on available data and evidence, mainstream lending tools and revenue-raising methods have proved insufficient for Métis business development. Métis Capital Corporations provide an important bridge in the gap between mainstream financial services and the needs of Métis communities, businesses and households.

Financing options for First Nation and Inuit housing and infrastructure are limited

Indigenous peoples currently have limited financing options for key expenditures, such as infrastructure and housing, and federal solutions to the issue have not been successful to date. As a result of historic policies of dispossession, disenfranchisement and underinvestment, housing and infrastructure appears to be an issue for First Nations and Inuit in particular.

Although gaps, issues and barriers persist, innovative solutions are being pursued at the local level

For Indigenous people, businesses and governments to thrive, urgent changes must be made to the highly centralized and controlling financing regime created by the *Indian Act* and the legacy of colonial policies and practices in Canada. However, the current legal and regulatory environment is not changing with the speed and flexibility necessary to accommodate the variation in needs, strengths and goals of Indigenous communities across the country. Attempts to modify and/or remedy barriers created by the *Indian Act* have experienced concentrated successes, with no widespread benefits to Indigenous peoples across the country.

Despite these barriers, Aboriginal Financial Institutions (AFIs) can create pockets of local innovation and solutions which have been more successful for some communities than federal legislative remedies. This has been demonstrated through innovations such as the Siksika Developmental Loan Fund, the Yukon Micro Loan and the Aboriginal Youth Initiative Program previously mentioned in this report.

Recommendations to Improve Indigenous Peoples’ Access to Capital

Our Board firmly believes that closing the gap in access to capital between Indigenous communities and the rest of Canada is an issue of critical importance. An Indigenous economy operating at the same level as the Canadian economy would not only result in positive fiscal and economic impacts for all of Canada, but could improve social and economic outcomes for Indigenous peoples and communities.

Immediate and ongoing work must be undertaken to remove the barriers that restrict Indigenous businesses and communities from accessing the same financial tools as other Canadian businesses and communities. The successful implementation of the following recommendations will depend on the federal government’s ability to pursue a renewed fiscal relationship with Indigenous peoples in Canada.

1. **We recommend that the Government of Canada continue to expand investments in and support for Aboriginal Financial Institutions (AFIs).**

Aboriginal Financial Institutions (AFIs) must be able to deepen and broaden their support to businesses and entrepreneurs with products capable of supporting both early growth and diversification needs. It is recommended that the Government of Canada continue to enhance its supports to AFIs so that they can offer the full range of supports, including business readiness training, developmental lending, and business aftercare support. The Government of Canada should generate new guarantee and investment incentive programs that are of use when contribution programs are no longer needed and that support early commercial growth for larger businesses.

We recommend that the Government of Canada expand investments and supports for existing Indigenous business growth, including “late” enablers. This could mean ensuring AFIs are capitalized adequately to meet the demand for ongoing business loan support, as evidence suggests there is overrepresentation in government support for start-up business, and as the mainstream financial sector is not meeting the demand for existing Indigenous business financing needs.

2. **We recommend that the Government of Canada make a substantive effort to renew the fiscal relationship and to make fiscal fairness and affordable borrowing a reality for Indigenous peoples and communities. This includes addressing current legal and regulatory barriers to accessing capital, as well as exploring and supporting new and alternative lending options.**

In order for the Government of Canada to embark on a renewed fiscal relationship with the First Nations, Inuit and Métis peoples of Canada, Indigenous peoples must be fully included in fiscal federalism. Indigenous governments need to be enabled as planners and decision-makers, instead of simply as funding and program recipients.

The recommendations in this report should be implemented with consideration given to enhancing affordable borrowing options and lowering interest rates. Affordable borrowing is a necessary precondition to much of the regular functioning of the Canadian economy; however, First Nations and Inuit businesses and entrepreneurs have been unable to access low-interest borrowing at the same rate as non-Indigenous Canadians. This has acted as a drag on economic growth for First Nations and Inuit communities and has been a major barrier to business development, entrepreneurship, and prosperity in First Nations and Inuit communities.

We recommend that the Government of Canada remedy the harmful economic effects of outdated and discriminatory legislation and policies. We commend the Minister of Justice for her ongoing work to amend/repeal problematic legislation as it pertains to Indigenous peoples in Canada. This work could be enhanced by a specific focus on legislation constraining economic development and impacting the fiscal relationship. Therefore, we recommend the Department of Justice take immediate measures to address Section 89 of the *Indian Act* to ensure fiscal fairness, investment opportunities on-reserve and equitable access to financial services for First Nations in Canada. Any amendments must be aligned with the concept of self-determination.

We recommend that Indigenous and Northern Affairs Canada work with Indigenous governments and financial institutions to explore lending options for Indigenous governments (and First Nations in particular) which parallel those available to other levels of government. To achieve this, Indigenous and Northern Affairs Canada should increase the ability of First Nation and Inuit government institutions to use their revenue streams to access financing. This includes leveraging non-market sources of capital (such as government contributions) to attract market capital. In particular, the Government of Canada should work with First Nations to expand the permitted revenue streams in the Financing Secured by Other Revenues Regulations to enable more First Nations to secure long-term, low-interest loans through the First Nations Finance Authority. Additionally, restrictions should be lifted on revenue streams, such as the First Nations Goods and Services Tax (FNGST), to enhance borrowing.

It is recommended that Indigenous and Northern Affairs Canada play a leading role in the development of Reconciliation Action Plans. Such plans would help to ensure that partnership with Indigenous peoples a core component of government mandates, and to help achieve the economic growth and parity targets which are in every Canadian's best interest. INAC could also support mainstream financial institutions, other federal government departments, and provinces in the development of Reconciliation Action Plans.

3. **We recommend that INAC continue to work with Indigenous peoples, nations and governments to expand investments in communities and to enhance the investment climate.**

We recommend that the Government of Canada increase investments in infrastructure and housing to support economic development. In particular, it is recommended that the Government of Canada partner with other levels of government to work to improve housing and infrastructure in Inuit communities and in the North in order to support and stimulate economic development for Inuit communities and support the development of personal wealth and equity for Inuit households. Furthermore, it is recommended that a variety of sources of capital be used to finance housing (not limited to non-market sources), and that First Nations continue to explore the benefits of private property ownership.

Capital infrastructure investments could be accelerated by securitizing cash flows representing a fraction of current pay-as-you-go infrastructure budgets. Alternatively, with higher exposure to governments, guarantee instruments could be used to support increased economic development and infrastructure lending and help close the First Nations and Inuit gap in government assisted capital sources with mainstream Canada.

Indigenous and Northern Affairs Canada could support the establishment of networks and peer mentoring to support capacity development and access to financial services. This could be achieved through the establishment of regional conferences or dialogue sessions on issues and opportunities in Indigenous finance. Such sessions would also support the federal government in identifying barriers that need to be addressed at the federal level.

Targeted investments should be made in improving internet connectivity for remote communities. Internet connectivity can make alternative financial services viable, improve financial literacy and increase networks and connections between Indigenous communities to share best practices and ensure ongoing support for governments, businesses and households looking to access various financial services. With this connectivity, new finance technology may be better positioned to break isolation, create new partnerships and adjust to niche markets.

Indigenous and Northern Affairs Canada should also ensure that Indigenous entrepreneurs are supported through financial literacy initiatives and enhanced investment in education and training. The federal government and its partners could explore program and services enhancements that pay special attention to critical non-financial enablers is needed, specifically financial literacy. Financial literacy will support growth and sustainability, and innovation in Indigenous financial services, as people become entrepreneurs and community leaders. Creating an environment for financial literacy supports good credit ratings for Indigenous communities, which makes it possible to pursue innovative and beneficial financing instruments in the future.

4. **We recommend that INAC enhance the relevance, quality and availability of information to Indigenous households, businesses and communities through a commitment to transparency and openness, as well as supporting Indigenous-led research and data governance.**

   It is recommended that the Government of Canada support additional research on barriers to accessing capital and financial services, particularly for the Métis, non-Status and urban Indigenous peoples. Additional information on the differences within and between communities, businesses, industries and types of capital is necessary to develop appropriate solutions.

   As our Board indicated in our 2015 Economic Progress Report, improved data collection is required. There are a variety of regional initiatives targeted at improving data quality and use. It is recommended that the Government of Canada fully support Indigenous-led data initiatives to ensure that communities have all the information they need to enhance good decision-making and ensure accuracy in fiscal policy at both a local and a national level.

   It is recommended that INAC work with other government departments to compile a central repository of government funding programs which provide finance to Indigenous businesses as the patchwork nature of government funding has been identified as a challenge when accessing capital.

   Due to a lack of clarity as to national progress on removing barriers in Indigenous access to financial services, we recommend that the Government of Canada release consistent updates on progress made towards improving Indigenous access to capital, as a part of annual public reporting standards.

Notes

[1] Conference Board of Canada, *An Engine for Growth: 2016 Report Card on Canada and Toronto's Financial Services Sector* (November 2016).

[2] The Metis were not included in the Waterstone Strategies study due to data and statistical challenges.

[3] Canadian Council for Aboriginal Business, *Promise and Prosperity: The 2016 Aboriginal Business Survey* (2016), https://www.ccab.com/wp-content/uploads/2016/10/CCAB-PP-Report-V2-SQ-Pages.pdf.

[4] Livio Di Matteo, "A Federal Fiscal History of Canada, 1867-2017," *The Fraser Institute* (February 2017), https://www.fraserinstitute.org/studies/a-federal-fiscal-history-canada-1867-2017.

[5] Auditor General of Canada, *Chapter 1: A Study of Federal Transfers to Provinces and Territories* (December 2008), http://www.oag-bvg.gc.ca/internet/docs/parl_oag_200812_01_e.pdf.

[6] The National Collaborating Centre for Aboriginal Health, *Economic Development as a Social Determinant of First Naitons, Inuit and Métis Health* (2010), http://www.nccah-ccnsa.ca/docs/fact%20sheets/social%20determinates/NCCAH_fs_economicdevelopment_EN.pdf.

[7] Tulo Centre of Indigenous Economics, *Building a Competitive First Nation Investment Climate* (2014).

[8] Jasmin Thomas, "Benchmarking Métis Economic and Social Development," *Centre for the Study of Living Standards* (2015), http://www.csls.ca/reports/csls2015-07.pdf.

[9] Conference Board of Canada, *An Engine for Growth: 2016 Report Card on Canada and Toronto's Financial Services Sector* (November 2016).

[10] Advisory Council on Economic Growth, "The Path to Prosperity" (February 2017), http://www.budget.gc.ca/aceg-ccce/pdf/summary-resume-2-eng.pdf.

[11] Indian Business Corporation, *2015 Report on Social and Economic Outcomes*, http://www.terrapinsf.ca/wp-content/uploads/2015/06/IBC-Report_v19_SCREEN.pdf.

[12] Canadian Council for Aboriginal Business, *Promise and Prosperity: The 2016 Aboriginal Business Survey* (2016), https://www.ccab.com/wp-content/uploads/2016/10/CCAB-PP-Report-V2-SQ-Pages.pdf.

[13] Standing Senate Committee on Aboriginal Peoples, *Sharing Canada's Prosperity : A Hand Up, not a Hand Out*(2007), https://sencanada.ca/content/sen/committee/391/abor/rep/rep06-e.pdf.

[14]Standing Sentate Committee on Aboriginal Peoples, *On-Reserve Housing and Infrastructure : Recommendations for Change* (June 2015) https://sencanada.ca/Content/SEN/Committee/412/appa/rep/rep12jun15-e.pdf.

[15] Indian Business Corporation, *2015 Report on Social and Economic Outcomes*, http://www.terrapinsf.ca/wp-content/uploads/2015/06/IBC-Report_v19_SCREEN.pdf.

[16]Standing Sentate Committee on Aboriginal Peoples, *On-Reserve Housing and Infrastructure : Recommendations for Change* (June 2015) https://sencanada.ca/Content/SEN/Committee/412/appa/rep/rep12jun15-e.pdf.

[17] TRICORP, Annual Report (2015), http://www.tricorp.ca/index.php/Information.

[18] Indian Business Corporation, *Siksika Developmental Loan Fund Report,* http://www.indianbc.ca/reports/siksikareport.pdf.

[19] Nunavut Business Credit Corporation, *Annual Report 2016-2016,* http://www.nbcc.nu.ca/sites/default/files/NBCC_2015_ANNUALREPORT_FINAL.pdf.

[20] Tom Flanagan, “Why First Nations Succeed,” *The Fraser Institute* (2016), https://www.fraserinstitute.org/sites/default/files/why-first-nations-succeed.pdf.

[21] For example, communities which are able to attract investment and local partnerships, which are able to run governments identified as “stable and fiscally prudent,” and which are able to take advantage of property tax and alternative land management regimes to the *Indian Act*.

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