The Next Generation:
Innovating to Improve Indigenous Access to Finance in Canada

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Executive summary

A well-functioning Indigenous-controlled and led financial system is essential to restoring Indigenous economic prosperity to promote investment, economic development and raise living standards in Indigenous communities. Much has been accomplished in recent decades to increase Indigenous access to finance, primarily by Indigenous-led financial institutions, but a new generation of institutions is needed to achieve the scale and coverage necessary to help attain economic reconciliation and self-determination, consistent with the recommendations of the *Truth and Reconciliation Commission of Canada* (TRC) and the *United Nations Declaration on the Rights of Indigenous Peoples* (UNDRIP).

The current shortfalls of physical capital in Indigenous communities are staggering, amounting to hundreds of billions of dollars. The lack of physical capital, especially in infrastructure and housing, directly contribute to a poor quality of life in many Indigenous communities. This enormous capital gap cannot be closed by governments or by intermediation by the largely non-Indigenous financial system in Canada.

Consequently, a new generation of Indigenous-led financial institutions has been proposed by the National Indigenous Economic Development Board (NIEDB), the First Nations Financial Management Board (FNFMB) and the National Aboriginal Capital Corporations Association (NACCA) Indigenous Financial Institutions: an Indigenous Development Bank, an Indigenous Investment Commission and the *Yänonhchia'* Indigenous Housing Finance Network. These institutions would achieve the scale and coverage necessary to address the obstacles limiting Indigenous access to finance and significantly reduce three major gaps:

- the lack of finance for medium-to-larger enterprises and major projects;
- the Indigenous intermediation gap arising from the absence of a large-scale Indigenous financial institution to invest growing financial wealth in Indigenous communities and help meet Indigenous capital financing needs; and
- the lack of access to housing finance for Indigenous communities for private homeownership and community-owned social housing.

This new generation of Indigenous financial institutions would significantly increase access to finance by Indigenous communities and help achieve the goals of Indigenous economic prosperity and self-determination, with positive benefits for the rest of Canada. These institutions would eventually be self-sustaining and not reliant on government support.

Introduction

A well-functioning Indigenous financial system is essential to restoring Indigenous economic prosperity. It is needed to help intermediate tens of billions of dollars of investment into physical capital for infrastructure, housing and economic development. While much has been accomplished in recent decades to increase Indigenous access to credit and financial services, much more needs to be done to achieve economic reconciliation and self-determination, consistent with the recommendations of the *Truth and Reconciliation Commission of Canada* (TRC) and the *United Nations Declaration on the Rights of Indigenous Peoples* (UNDRIP).

In particular, estimates of the current shortfalls of physical capital in Indigenous communities are staggering, amounting to hundreds of billions of dollars. The prevailing low levels of physical capital have kept standards of living in Indigenous communities well below those in the rest of Canada. The lack of physical capital, especially in infrastructure and housing, directly contribute to a poor quality of life in many Indigenous communities. In addition, it increases the transactions costs of investment for economic development, thereby reducing the productivity of Indigenous businesses and workers.

The purpose of this paper is to take stock of the Indigenous financial system and assess whether it is up to the task of providing the finance needed to eliminate the physical capital shortfalls. The general answer is "No". While progress has been made to develop the Indigenous financial system and Indigenous access to financial services, a new generation of Indigenous financial institutions is needed. These institutions would achieve the scale and coverage necessary to close the gaps hindering the financial and economic inclusion of Indigenous Peoples.

A new generation of well-governed and scalable Indigenous-controlled and led financial institutions is needed because this enormous capital gap cannot be closed by grants, loans, or guarantees provided by the federal and provincial governments. The gap is too large and the level of government finance required is not politically feasible. Nor can the financing gap be closed by relying on the conventional and largely non-Indigenous financial system of banks, credit unions, and financial markets. Historically, these institutions have provided limited access to financial services to Indigenous communities, households and firms, in particular, access to credit, equity and insurance.

The reasons for this lack of financial inclusion are manifold and entrenched: legal barriers stemming from the Indian Act, notably restricting collateral and economic activity on reserves and the development of stable own-source revenue (OSR) streams; widespread ignorance about Indigenous history and culture and the resulting systemic prejudice and discrimination; and the lack of capacity and connectivity, in addition to the remoteness of many Indigenous communities. These factors not only serve to increase transactions costs associated with capital investments in these communities, but also create the misperception that Indigenous lending is inherently riskier, and thus contribute to a rationing of credit to Indigenous borrowers. Non-Indigenous financial institutions are generally risk-averse and face regulatory constraints to Indigenous lending. Consequently, they are not willing to expend the effort needed to develop strong working relationships with Indigenous borrowers or to innovate to help mitigate the transactions costs associated with such lending and accommodate their needs.

Nonetheless, entrepreneurship, income and financial wealth in Indigenous communities are increasing, albeit unevenly. Financial settlements in the tens of billions of dollars are also contributing to this rise in Indigenous financial wealth. Some of this wealth is accumulating as equity in Indigenous economic development corporations and firms. However, much of the rest is held by Canadian banks and credit unions in deposits and trusts from Indigenous communities, firms and individuals.[1] Although accurate data are not publicly available, it is unlikely that much of this Indigenous financial wealth—most of it invested with conventional financial institutions—has found its way back to Indigenous communities in the form of loans or equity investments for public infrastructure, housing or economic development. The lack of capacity (including financial literacy) within Indigenous communities has also hindered the intermediation of this growing financial wealth back to these communities.

Despite these obstacles, two components of the Indigenous financial system have made important progress over the last 30 years in providing access to finance for Indigenous communities and Indigenous entrepreneurs. The first component consists of the Indigenous-led financial institutions established by the *First Nations Fiscal Management Act* (2005)[2] (FMA), which has provided access to financial market borrowing to qualified First Nations communities for infrastructure investment and community development.

1 The Government of Canada also holds funds in trust for some First Nations under the Indian Act. This is discussed in further detail below.

2 The three institutions are the First Nations Tax Commission, the First Nations Financial Management Board and the First Nations Financial Authority. The First Nations Infrastructure Institute was established in 2023 by an amendment to the *First Nations Financial Management Act*.

Good quality public infrastructure is critical to promoting investment for economic development in these communities. The second component is the system of 58 Indigenous Financial Institutions (IFIs) under the umbrella of the National Aboriginal Capital Corporations Association (NACCA). These IFIs have developed strong relationships with entrepreneurs in these communities and supported the founding and growth of Indigenous businesses by providing relatively low-cost finance and other business services.[3] Both sets of institutions have generally been self-sustaining. While they initially received capital injections and operating funds from the federal government, they have over time expanded their capital bases through retained earnings and debt issuance.

These two components of the Indigenous financial system have increased access to finance, expanded financial capacity and improved Indigenous financial inclusion. The IFIs are well governed and have good knowledge of their borrowers and their creditworthiness. However, they are often capital constrained and lack the scale needed to make larger loans. Although these IFIs provide access to finance for all three Indigenous heritage groups, most cater to First Nations borrowers. The FMA institutions do not currently provide access to Métis and Inuit communities. In addition, the participation in these institutions has grown steadily to more than half of all First Nations, motivated by the successful examples of the early adopters. Finally, while the volume of finance provided by FMA and NACCA institutions (and other forms of innovative finance, such as joint ventures or venture capital) continues to expand, these channels of finance lack the capacity and scale to meet the enormous need for investment in physical capital in Indigenous communities.

As a result of the aforementioned obstacles that are limiting access to the non-Indigenous market finance, three important financing gaps stand out. The first is the lack of finance for medium-to-larger enterprises, major projects and for developmental lending to new Indigenous enterprises. Although the NACCA IFI network has supported the creation of thousands of Indigenous firms, many IFIs remain capital-constrained and unable to provide the size of loans needed to promote further growth in Indigenous businesses.

The second is the absence of one or more large-scale Indigenous financial institutions with the capacity to intermediate efficiently the growing accumulation of financial wealth in Indigenous communities, through savings and settlements with the government on land claims and on claims for other wrongdoings. This increasing financial wealth is not being intermediated back into Indigenous communities, creating a gap between

3 The IFIs are similar to credit unions because they work closely with their clients, including by providing financial education, but they lack a deposit base and are owned by their communities, not by their members.

accumulating Indigenous wealth and on-reserve capital financing needs. This wealth should be invested to maximize expected return subject to risk, and also to promote Indigenous economic development and prosperity.

The third is lack of access to housing finance for Indigenous communities for private homeownership and community-owned social housing. Like public infrastructure, adequate housing is critical for facilitating economic development by retaining and attracting community members who can make important contributions as entrepreneurs, professionals and skilled tradespeople.

A new generation of Indigenous-led financial institutions has been proposed in recent reports by the National Indigenous Economic Development Board (NIEDB), the First Nations Financial Management Board (FNFMB) and the NACCA IFIs to achieve the scale and coverage necessary to close these gaps, and address the different needs of the three heritage groups.[4] These new institutions are: an Indigenous Development Bank, an Indigenous Investment Commission and the Yänonhchia' Indigenous Housing Finance Network. Once again, the intent is that these proposed institutions would evenutally become self-sustaining and not reliant on ongoing government support. In addition, for these institutions to have their desired impact they would need to be complemented with other reforms, most notably expanded jurisdiction and fiscal powers in order to enhance OSR streams and build capacity within Indigenous communities in terms of financial governance and management.

This new generation of Indigenous financial institutions would over time significantly increase access to finance by Indigenous communities, helping them to develop economically and raise living standards for Indigenous Peoples. Increased access to finance would help achieve the goals of economic reconciliation and Indigenous self-determination, and it would have positive benefits for the rest of Canada. Not only would a more prosperous and self-reliant Indigenous economy create demand for goods and services produced in the rest of Canada, but it would reduce the need for ever-growing transfers from federal and provincial governments and help end the colonial legacy of Indigenous dependence.

The next section of the paper reviews the size and distribution of the physical capital shortfalls in Indigenous communities in terms of public infrastructure, housing and business investment.

The following section examines the obstacles that limit Indigenous access to market finance (namely to credit). Market finance is normally provided by chartered banks, credit unions, financial trusts, other asset managers, as well as by financial markets.

4 Note that the proposals for these new Indigenous financial institutions were developed in consultation with the three heritage groups. Representatives of the three groups are included in NACCA and NIEDB, and the FNFMB reached out to these groups in developing *The RoadMap Project* (2022).

Within the conventional financial system, there are Indigenous-controlled financial institutions: Peace Hills Trust, the First Nations Bank of Canada and a handful of credit unions/caisses populaires. Crown financial corporations, most notably the Business Development Bank of Canada (BDC), have tried to address this shortfall by increasing credit access to Indigenous entrepreneurs.[5]

The subsequent section analyses the Indigenous financial system and the existing channels of credit intermediation including the FMA institutions and the NACCA IFI network. The paper gauges the volume of finance coming through these various channels to Indigenous communities, relative to the needs.[6] The analysis includes an assessment of the efficiency and cost of this financial intermediation to Indigenous communities and of the existing barriers to access to finance.

The last section analyses the proposed next generation of Indigenous financial institutions to address the three access-to-finance gaps mentioned earlier: lending to medium-to-large enterprises, including for major projects; the intermediation of Indigenous financial wealth towards Indigenous borrowers; and housing finance in Indigenous communities. Although the focus is on access to credit, some attention is also given to equity investment.

5 In 2021, BDC, Export Development Canada (EDC) and Farm Credit Canada (FCC) all contributed to the establishment of NACCA's Indigenous Growth Fund. BDC provides term loans to Indigenous entrepreneurs of up to $350,000 and in 2021 had provided credit to 900 Indigenous firms totalling almost half a billion dollars, roughly $50-$60 thousand per business.

6 This would primarily consist of First Nations reserves, Métis settlements and Inuit communities. Data for Indigenous borrowers living elsewhere are difficult to obtain.

Physical capital gaps in Indigenous communities

The most acute impact of Indigenous Peoples' limited access to market finance is the severe lack of physical capital in Indigenous communities. These shortfalls include:

- Public infrastructure: roads, bridges and other transportation facilities; water and sewage treatment; schools, health centres and other community buildings; and communications, including broad-band internet access;
- Housing: community and individually owned single and multi-unit dwellings; and
- Capital for economic development: community and privately owned commercial and industrial buildings, as well as machinery and equipment.

Because investments in these forms of capital involve a large upfront outlay and earn returns over many years, they are normally financed by borrowing. Indigenous communities, firms and households have, however, faced numerous unique barriers to accessing credit, most notably:

- Legal barriers in the Indian Act that restrict available collateral on reserves (Section 89) and until recently prevented the development of own-source revenue by limiting the sale of agricultural goods (the permit system) and the collection of property tax and other forms of tax revenue;
- Ignorance about Indigenous history and culture, along with systemic prejudice and discrimination; and
- The remoteness, low density and lack of capacity and connectivity in Indigenous communities.[7]

The legal restrictions on collateral and own-source revenue, as well as other factors, have led to higher investment transaction costs.[8] Consequently, Indigenous borrowing is misperceived as inherently riskier and thus, is either charged a sizable risk premium or

7 Chernoff and Cheung (2023) provide more information about the barriers to Indigenous access to finance.

8 Tulo Centre of Indigenous Economics (2014) provides a thoughtful analysis of these transactions costs and examines how they can be alleviated to improve the investment climate in Indigenous communities.

avoided all together. This rationing of credit to Indigenous borrowers is a market failure because conventional commercial lenders do not have accurate information about the risk characteristics of these borrowers.[9] Consequently, this lack of access to reasonably priced finance has created an enormous deficiency of physical capital. This capital shortfall has, in turn, stunted economic development, severely limited employment opportunities and driven members out of their communities to seek a better life for them and their families. The resulting poverty trap in some of these communities has led to a myriad of social problems and wreaked needless suffering on those who remain.

Recently, the Assembly of First Nations (AFN) has estimated this gap to be roughly $350 billion on First Nations reserves, with deficits in housing, public infrastructure and economic development structures each in excess of $100 billion.[10] While First Nations are the largest of the three Indigenous heritage groups, this amount would be substantially larger when Métis and Inuit communities are also considered, likely closer to $500 billion.[11]

While governments have tried to fill this huge gap by providing grants, loans, and loan guarantees, this effort has failed as the gap continues to increase. Indigenous leaders and the Royal Commission of Aboriginal Peoples foresaw this growing problem decades earlier. They recognized that governments could not directly solve the problem. They made the case for more Indigenous control of their resources (especially their land), and for more fiscal powers to generate own-source revenue. They also recommended actions needed to develop an Indigenous-controlled and led financial system to spur Indigenous investment and economic development.[12]

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9 Stiglitz and Weiss (1981) explain credit rationing as an equilibrium outcome in a credit market characterized by adverse selection, owing to asymmetric information about the risk characteristics of borrowers. Such rationing is a market failure because the interest rate price mechanism does not adjust to bring the market into equilibrium. Credit rationing can be exacerbated by discrimination in which lenders ascribe inaccurate risk characteristics to borrowers. For example, Cavalluzzo et al (2002) find evidence of credit rationing towards black small business owners in US credit markets and that this rationing is the most severe in the least competitive markets, as Becker (1957) had predicted. Although similar research has not been done in Canada, the likelihood of such rationing cannot be ruled out given the high degree of concentration of the Canadian banking system in which five institutions control roughly 80 percent of the assets.

10 This $350 billion gap estimate comes from a forthcoming report prepared jointly by the Assembly of First Nations and Indigenous Services Canada, and cited by Daniels (2023). It is based on an engineering study conducted the BTY Group (www.bty.com), an international engineering consulting firm. This estimate is significantly larger than previous estimates and has not been subject to public scrutiny. For a survey of infrastructure gap estimates see FNFMB (2022).

11 A recent estimate for Inuit communities is $75 billion (Davis, 2023).

12 For example, the Royal Commission of Aboriginal Peoples (1996) recommended measures to promote economic development and opportunity for Indigenous peoples, including the establishment of an Aboriginal Development Bank, because it was best way to reduce poverty and raise living standards.

Limited Indigenous access to conventional sources of finance

The conventional sources of credit for non-Indigenous governments, business and household borrowers consist primarily of banks, credit unions (or caisses populaires in Quebec and New Brunswick) and Crown financial corporations (EDC, BDC and FCC). Larger governments and firms can also borrow directly from domestic and global capital markets because they borrow at the scale needed to cover the cost of issuing syndicated debt.

Indigenous borrowers, however, have largely been excluded from these sources for the reasons explained earlier, namely: legal barriers, systemic discrimination, and the perceived higher risk of Indigenous borrowing. The implication of this lack of financial inclusion is that Indigenous communities have much less access to market finance than the rest of Canada. In 2013, on a per capita basis, the stock of Indigenous market finance was less than one-tenth of the rest of Canada.[13] Consequently, most of the finance for Indigenous housing and business comes from personal savings and much of the rest from Indigenous sources (including the NACCA IFI network or via the First Nations Financial Authority), and not from the conventional market sources.

As noted earlier, legal barriers (namely Section 89 of the *Indian Act*) prohibits confiscation of Indigenous property on reserves (legal title to reserve land is held by the Crown) by non-Indigenous lenders and thus precludes its use as collateral for Indigenous borrowing. Similarly, for Indigenous communities not governed by the Indian Act, because the land is owned collectively by the community, it cannot be pledged as collateral for Indigenous loans since it cannot be seized in the event of default.

The earlier versions of the *Indian Act* also severely limited economic activity in Indigenous communities. The *Act* restricted off-reserve sales of livestock and other agricultural products, the use of reserve land for commercial purposes and the collection of property and other taxes. All of these economic activities initially required government approval. While these constraints have been eased or removed over time, the legacy of their adverse impact on Indigenous economic development remains.

13 Waterstone Strategies (2017).

Property rights on reserves—and in Indigenous communities more generally—are very complicated because of collective control by the community, and in most cases, legal ownership belonging to the Crown (Flanagan and Alcantara, 2002). Nonetheless, some progress has been made trying to work around the barrier created by the lack of fee simple land title to access finance from conventional sources. The least successful are Ministerial Loan Guarantees, in conjunction with the use of Certificates of Possession, and the First Nations Market Housing Fund.[14] In both cases, these vehicles require the band council to complete much paperwork to guarantee each housing loan and they may take months, if not years, to obtain final approval.[15]

More effective vehicles for accessing finance have emerged from self-governing agreements, modern treaties, and the adoption of the *Framework Agreement on First Nations Land Management Act* (FA) for First Nations still under the *Indian Act*. They give Indigenous communities jurisdiction over their lands and permit them to develop their own land codes and land registries that provide for stronger legal title to property within the community. While the land is still collectively owned, such title permits, for example, the use of long-term leases that can be pledged as marketable collateral.[16]

Some charted banks and credit unions are willing to provide housing and other loans to Indigenous borrowers using these vehicles, but comprehensive data on the volume of this lending are not available. Therefore, it is difficult to evaluate Indigenous access to this source of finance. Moreover, many other conventional lenders are not willing to innovate or to provide lending with this collateral because they feel the expected return is not high enough to compensate for the perceived higher risk.[17]

14 The First Nations Market Housing Fund (FNMHF) was created in 2008 by the federal government with an initial capitalization of $300 million. Its purpose was to provide a loss backstop on housing loans made by chartered banks and other traditional lenders to borrowers on First Nations reserves. The FNFMF is managed by a board of trustees composed of First Nations members. The secretariat was initially provided by the Canadian Mortgage and Housing Corporation (CMHC), but is now under greater Indigenous control. From 2008 through to 2021 (latest year of data) only 550 housing loans have been issued and the capital base has grown to about $400 million, the majority of which is invested in money market instruments, including Government of Canada treasury bills and bonds. Proposals are now being considered to change the terms of reference of the FNMHF to make better use of its capital to support Indigenous housing and Indigenous financial literacy.

15 Note that these housing loans cannot be called “mortgages” for regulatory purposes; they are not based on fee simple property title.

16 The lease is typically paid upfront using the proceeds from a housing loan and pledged as collateral for the loan. In the event of a default, the lender obtains ownership of the lease which can be sold to recoup the amount owing on the housing loan.

17 Indigenous lending is constrained by regulatory capital requirements. Such loans would carry greater weights in their required capital holdings because of their assessed higher risk.

Larger private Indigenous firms and community economic development corporations with a track record of own-source revenue and other collateral—such as large machinery, which could be re-possessed in case of default—have also been able to obtain loans from banks and other conventional lenders. Collin and Rice (2019) estimate that in 2013 Indigenous businesses had $3.4 billion outstanding in loans from chartered banks and $2.4 billion in finance from owner equity and retained earnings.

As noted, some banks and credit unions are willing to engage in Indigenous lending, but only a few are forthcoming about the volume of this lending. Nonetheless, the available evidence indicates that the amount of lending remains small relative to the need.

For example, an active Indigenous lender is the First Nations Bank of Canada, which received its charter in 1996. It is the only Indigenous majority-owned bank in Canada and operates branches in several provinces and territories. It started with $150 million in assets which have grown to $1.2 billion over almost 30 years, including about $600 million in outstanding loans (both Indigenous and non-Indigenous). Despite this growth, these figures are less than 0.1 percent of the totals for the entire Canadian banking system.[18]

Me-Dian Credit Union in Manitoba is the only Indigenous-owned credit union in Canada outside of Quebec. Since its founding in 1993, it has steadily grown to $80 million in assets. Within the Desjardins Group in Quebec, there are four Indigenous-owned and led caisses populaires on reserves: Caisse Eenou Eeyou (Cree) near Mistissini; Caisse de Wendake (Wendat/Huron); Caisse du Pekuakami (Innu/Montaignais) near Lac St. Jean; and Caisse populaire Kahnawake (Mohawk) in Kahnawake. Caisse de Wendake is the oldest, founded in 1965, while Caisse populaire Kahnawake is the largest with over $600 million in assets. While all provide valuable financial services to their communities, they are all relatively small.

There is a puzzle as to why there are not more Indigenous-owned and led credit unions in Canada since the community-oriented spirit of these financial cooperatives resonates well with the traditional Indigenous value attached to community well-being. Such cooperatives could play a larger role in Indigenous financial intermediation by collecting growing financial wealth in Indigenous communities in the form of deposits and recycling them back to Indigenous borrowers. The Indigenous caisses populaires in Quebec have been very successful in this role and they benefitted from the scale and efficiency of being members of the larger Desjardins Group.

18 Peace Hills Trust is Canada's largest and oldest First Nations-owned and federally regulated financial institution. It was founded in 1980 and has $2.5 billion assets under administration, including about $650 million outstanding loans (both Indigenous and non-Indigenous).

Other credit unions within the Canadian system, most notably Assiniboine Credit Union in Winnipeg and Vancity Credit Union in the Lower Mainland of British Columbia, have made exemplary efforts to provide financial services and financial literacy training to underserved Indigenous communities by establishing branches near reserves or near urban Indigenous populations. [19]

However, in terms of access to financial services, recent research by the Bank of Canada has found that remoteness and deficient infrastructure have contributed to limited access to cash and other financial services.[20] This access has likely become more limited over time as many banks and credit unions have closed branches and relied more on electronic banking, which would be difficult to access in communities lacking high-speed internet service.

With respect to Indigenous access to finance from global capital markets, a few larger Indigenous businesses or economic development corporations have been able to obtain financing by issuing credit instruments such as debentures, directly to these markets, but they are rare (Collin and Rice, 2019).

The limited data available indicate that the amount of credit being provided by conventional financial institutions to select Indigenous borrowers has increased over time. Nonetheless, there is stronger evidence of a growing Indigenous intermediation gap. Indigenous financial wealth is flowing into these institutions in the form of increasing deposits available to lend and larger trust funds to manage and invest. Yet it seems that much less is flowing out from these institutions to finance Indigenous economic development. The rising trust fund investments reflect large claim settlements by the federal government and provincial governments. In 2013, the National Aboriginal Trust Officers Association estimated that there were roughly $20 billion of trust assets and investments being managed on behalf of Indigenous communities. Since then, claim settlements have exceeded $20 billion, suggesting that this Indigenous intermediation gap is likely in the range of tens of billions of dollars, and growing. Moreover, if a fraction of the Indigenous assets held by these institutions were mobilized, they could have a material impact on the physical capital gap discussed in the previous section.

19 Martin (2012) describes the shared values that typically lead to successful partnerships between Indigenous communities and credit unions. However, several of the non-Indigenous credit unions described by Martin (2012) have since become less active in Indigenous communities. The exceptions are Vancity and Assiniboine.

20 See Chen et al (2021, 2022) for more information.

Indigenous-controlled and led institutions including the First Nations Bank of Canada, Peace Hills Trust, Me-Dian Credit Union and four Indigenous Caisse populaires in Quebec, which operate within the Desjardins Group, have made some progress in closing this intermediation gap. Their overall contribution, however, is small because they lack size and coverage, especially relative to other comparable institutions in the Canadian financial system. To lower costs, expand reach, and leverage new technology to operate efficiently they need to operate at a larger scale.

Innovative Indigenous institutions have increased access to finance

Because access to finance from conventional sources by Indigenous borrowers in Canada is limited, innovative and unique-to-Canada Indigenous-led financial institutions have been developed. These institutions aim to overcome the many systemic barriers to conventional finance faced by Indigenous borrowers. The objective is to give Indigenous communities and entrepreneurs the same access to finance as enjoyed by their non-Indigenous counterparts. The two most important innovations are the financial institutions established in 2005 under the *First Nations Fiscal Management Act* (FMA) and the network of Indigenous Financial Institutions (IFIs) that began in the 1980s and 1990s and eventually came under the NACCA umbrella.

The FMA framework was designed by First Nations leaders to enhance the local revenue-raising powers of their communities and provide access to capital markets to obtain long-term finance to fund needed infrastructure and other community projects.[21]

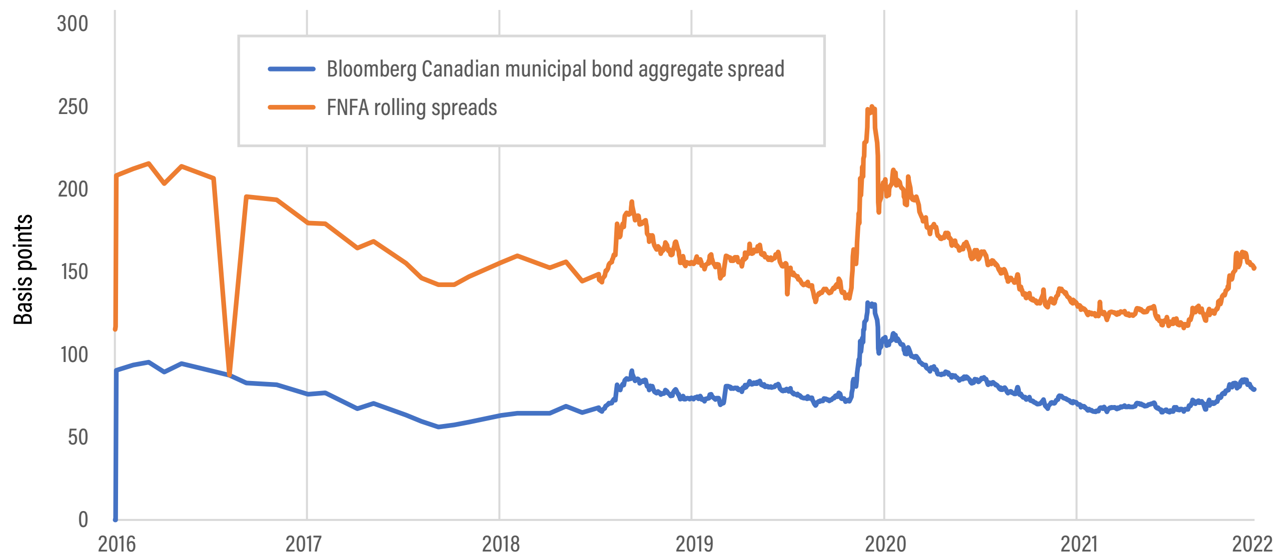
The FMA framework comprises four complementary institutions that work together to enhance the capacity of First Nations to access lower-cost capital market finance and develop a stronger climate for investment in First Nations communities. The First Nations Tax Commission helps First Nations governments increase the flow of own-source revenue by establishing tax jurisdiction and efficient tax and expenditure policies. The First Nations Financial Management Board helps First Nations adopt sound financial management and governance practices based on international standards and produce reliable financial information that can be used to assess their capacity to borrow and service debt. The third institution, the First Nations Infrastructure Institute, was established in 2023 to achieve better infrastructure investment outcomes on First Nations reserves by providing the necessary expertise and support to plan and execute such projects. The existing FMA institutions lacked this specialized expertise and so its establishment will be complementary and beneficial. Finally, the fourth institution, the First Nations Finance Authority (FNFA),

21 The First Nations Financial Management Act also established a fourth institution, the First Nations Statistical Institute, which was closed in 2012.

builds upon the first two elements to help secure low-cost financing by monetizing[22] or collateralizing community revenue streams (following the municipal model) and issuing highly rated debentures to the market.[23]

From 2014 to 2022, the FNFA has issued nine debentures totaling $1.63 billion with a high investment grade credit rating because of no defaults and thus no need to draw upon federal government guarantees.[24] In fact, the FNFA's impressive track record has enabled 154 qualified First Nations governments to borrow at rates that are comparable to Canadian municipalities to fund their public infrastructure, as shown in Figure 1.

Figure 1: Recent FNFA bond spreads are comparable with Canadian municipal bonds
Spread over sovereign benchmark



Source: Bloomberg

22 Daniels (2023)

23 The Tulo Centre of Indigenous Economics was established in 2008 to provide university-accredited courses to build the expertise necessary on First Nations to take advantage of the services offered by the FMA institutions as well as those offered by Lands Advisory Board established to help First Nations implement the Framework Agreement on First Nations Land Management. This agreement with the federal government was first signed in 1996 and amended in 2022 and allows the 165 First Nation signatories to opt out of the land management sections of the Indian Act and adopt their own Land Code and Land Registry.

24 In 2022, FNFA debentures were rated A+ and Moody's rated them Aa3. Moody's Investor Service (Moody's) rated the first issue in 2014 A3. By comparison, Winnipeg's debt was rated AA+ and Aa2, respectively. Note that the Government of Canada does not guarantee this debt, but only provides a backstop to the FNFA five percent Debt Reserve Fund (DRF).

Consequently, over 342 First Nations (well over half of the 630 First Nations) have opted to join this innovative, well-governed and effective FMA framework.[25] And the number of signatories to the FMA have been growing steadily at an average of 21 per year. Therefore, a growing number of Indigenous communities have committed to putting in place robust financial governance and management practices to increase their access to finance. They have been motivated, in part, by the success of the First Nations who took early and full advantage of the FMA institutions. [26]

One of the best examples of the success of the FMA framework is the acquisition by the Mi'kmaq Coalition—a grouping of seven Mi'kmaq communities in the Atlantic provinces—of 50 percent of Clearwater Seafoods for $500 million. It was partly financed by a debenture issued by the FNFA ($250 million) and it represents the single largest Indigenous investment in the seafood industry.

This FMA framework has helped First Nations communities obtain access to capital market finance on better terms in order to fund much needed infrastructure and community development projects. However, to meet the immense needs for finance of Indigenous communities, these FMA institutions will have to scale up with more members and more issuance as well as allow the two other heritage groups to participate.

The FMA framework, while successful in providing finance for First Nations communities (including their economic development corporations), it does not provide access to development finance for small and medium enterprises, owned by individual Indigenous entrepreneurs or their communities. This is where NACCA comes in. The 58 Indigenous Financial Institutions (IFIs) located in First Nations, Métis and Inuit communities that are part of the NACCA network have made great strides in mitigating many of the historical obstacles to finance for such firms. As community-based organizations, they pride themselves on knowing and supporting their clients by providing hands-on and tailored business services as well as access to finance.

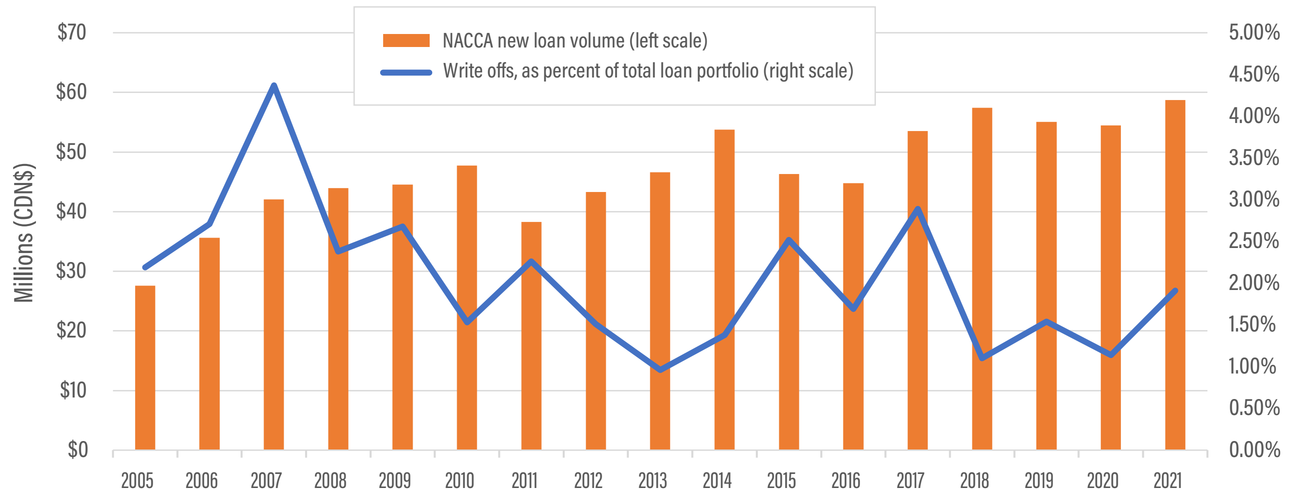
Since the first IFIs were founded some 40 years ago, the NACCA network has been remarkably successful. By building trust and capacity within their communities, the NACCA IFI network has supported the development of 50,000 small and medium-sized

25 It is noteworthy that 270 of these First Nations have been certified by the FNFMB as having good governance and finance practices in their law, 224 have been certified as having implemented this law in their policies and procedures and 61 have been certified as having achieved the highest standard in terms of financial and property management.

26 LeDressay (2023, forthcoming) shows that the First Nations that were full signatories to the FNFNA financial framework and to the Framework Agreement on First Nations Land Management have experienced the greatest increase in own-source revenue.

enterprises and provided $3 billion in loans. Annual loan volumes have more than doubled since 2005 while keeping loss rates very low (Figure 2).

Figure 2: NACCA has increased its lending while keeping loan loss rates very low



Source: National Aboriginal Capital Corporations Association

The effectiveness of NACCA and the IFI network clearly stems from how well these financial institutions know their clients, and thus, can more accurately assess the lending risks. Working closely to support their clients in the early stages of developing their businesses has helped them build strong relationships and a solid understanding of their needs and financial capacity.[27]

While among the IFIs there are many individual success stories, the Aboriginal Savings Corporation of Canada (ABSCAN), based in Quebec, stands out. It not only provides loans to small and medium-sized businesses, but also finance for individual houses and multi-unit dwellings on First Nations reserves. In addition, it provides savings products to First Nations clients, helping reduce the Indigenous intermediation gap, and has successfully issued debentures in the past to raise funds for its lending activities.

While the IFIs have been able to grow their capital bases for lending from relatively small amounts injected by the federal government upon inception through the accumulation of retained earnings, they are often capital constrained. There are more

27 IFIs in Canada operate much like microfinance institutions in other jurisdictions because in addition to providing small loans to buy equipment, they provide other forms of business support to new entrepreneurs. See Cull et al (2009) and OECD (2020) for useful surveys.

opportunities to lend then the resources they have on hand. Unlike ABSCAN, most IFIs are exclusively lending institutions and cannot easily expand their lending capacity. This represents an important challenge to the network.

To address this challenge, NACCA established the new Indigenous Growth Fund (IGF) in 2021 with $150 million investment from the Government of Canada and the three Crown financial corporations. The funds will be allocated to individual IFIs to finance a portfolio of projects.[28] The IGF will reduce the capital shortages that the IFIs face, thereby enabling them to make larger loans to clients keen to expand their operations. The IGF will also be able to attract investment from other sources. These include Indigenous trusts and other public and private sector funds looking to contribute to Indigenous economic reconciliation.[29] By attracting funds from Indigenous trusts, the IGF will help close the Indigenous intermediation gap. The evergreen nature of the IGF implies that it will serve as a revolving credit facility, aiming to provide $75 million in loans to about 500 Indigenous firms on an annual basis.

Both the FMA financial framework and NACCA IFI network have increased Indigenous access to finance, and funded both public and private capital investment, while remaining largely self-reliant and self-sustaining. Thus, they have stimulated economic development and activity in Indigenous communities with positive spillovers to the rest of Canada. Furthermore, federal and provincial governments have been relieved of providing the resources needed for these investments.

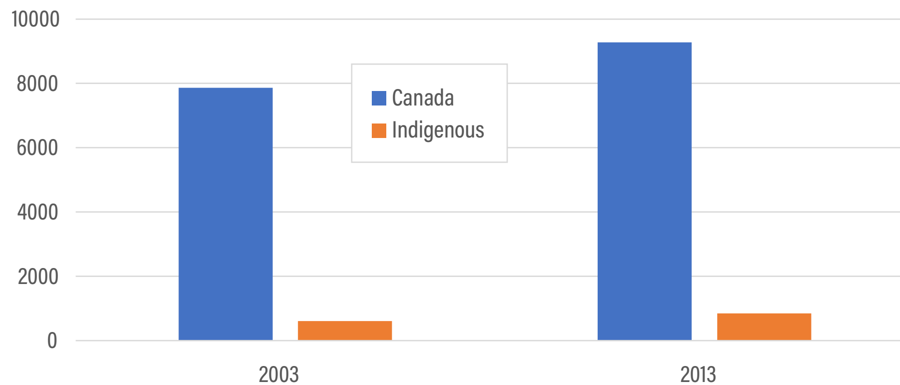
However, the need for increased access to finance is great and further innovative steps should be taken. To assess this need, a comprehensive study of the sources of credit and equity finance to First Nations and Inuit businesses[30] was conducted by Dominque Collin and Michael Rice (Waterstone Strategies, 2017, and Collin and Rice, 2019). Their first important finding is that while Indigenous businesses' access to market finance increased over the period 2003 to 2013 (the stock of capital grew from $2.8B to $5.9B), the gap with non-Indigenous businesses grew as their access increased by even more. Figure 3 shows that on a per-capita basis in constant dollars that this gap has increased.

28 $10 million has already been allocated to Tale'awtxw Aboriginal Capital Corporation (TACC), a prominent IFI in British Columbia,

29 The IGF in 2022 received a $3 million investment from Block Inc., a U.S. technology company with a focus on broadening access to financial services.

30 Comparably comprehensive data on sources of finance for Métis communities and businesses were not available.

Figure 3: 2003-2013 Per capita access to market finance (2013 constant dollars)

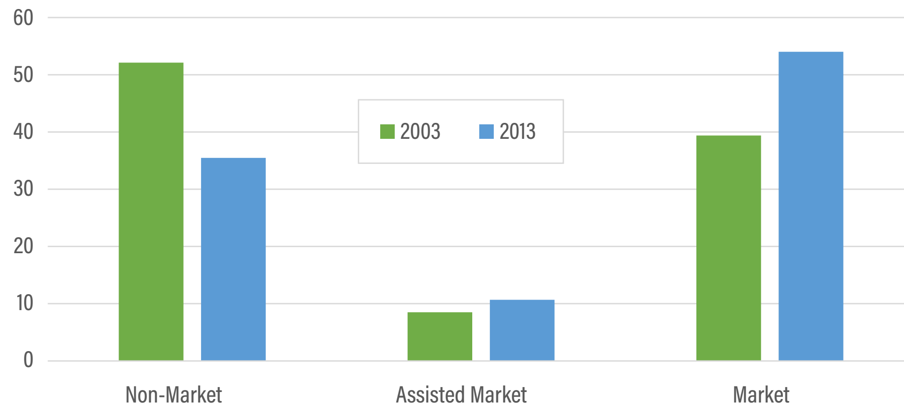


Note: Indigenous includes First Nations and Inuit only
Source: Waterstone Strategies (2017)

They attribute this growing disparity to a number of factors already discussed, and in particular, that Indigenous businesses are largely micro-enterprises in the developmental phase that most Canadian non-Indigenous businesses were in after the Second World War. This generational lag means that Indigenous businesses do not receive the same degree of support from government programs as was given and then wound down for similar non-Indigenous businesses. They therefore argue that for the gap to be closed access to financial services, financial literacy, and financial and credit reporting need to be improved.

They divided sources of finance into three categories: market, assisted market and non-market. Market sources were commercial sources that operated on a risk-return basis and included debt and equity market issuance, chartered bank loans and retained earnings. Assisted market sources were primarily chartered bank loans, developmental loans from IFIs, and other forms of credit that carried a government guarantee or credit enhancement. While non-market sources are primarily grants or transfers from governments and charitable foundations. A second important finding is that for the first time in 2013 the stock of market-based sources of finance to Indigenous businesses exceeded that of government transfers ($5.9 billion versus $3.6 billion) (Figure 4). In 2013, 60 percent of the stock of market capital was in the form of chartered bank loans, while 40 percent was owner's equity and retained earnings. For non-Indigenous businesses, bank loans represented only 10 percent of capital.

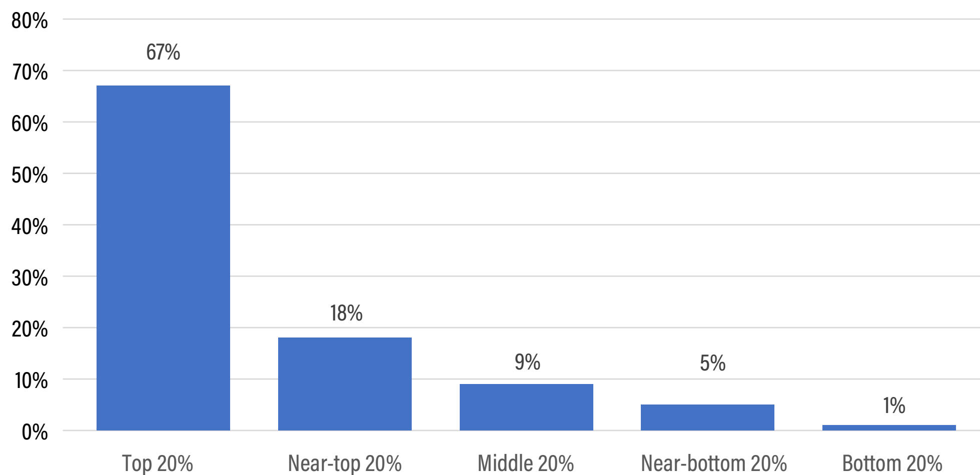
Figure 4: Share of Indigenous Finance



Note: Indigenous includes First Nations and Inuit only
Source: Waterstone Strategies (2017)

The third key finding is that own-source revenue, which is the basis for market-sourced capital, is unevenly distributed across First Nations communities in Canada as is access to capital. This reflects differences in business income as well as royalty and tax revenue. The top 20 percent of First Nations account for 67 percent of own-source revenue whereas the bottom 20 percent account for only 1 per cent (Figure 5). Much this revenue is concentrated in Alberta and British Columbia, likely reflecting income from natural resource projects or from reserves closer to urban areas.

Figure 5: Share of total First Nations own-source revenue (per capita, by income tier)



Source: Waterstone Strategies (2017)

These data indicate that increasing and stabilizing the future stream of own-source revenue will be critical for expanding access to finance for Indigenous communities. Such an OSR stream will serve as a basis for borrowing, through monetization or securitization, and attracting equity investment. An important step in this direction will be a new fiscal relationship with the federal and provincial governments. This new relationship will be based on granting stronger jurisdiction and fiscal powers to Indigenous communities. Furthermore, these governments should commit to more stable long-term funding, including a more equitable revenue-sharing arrangement for natural resource and other major projects. Indigenous communities should strive to generate their own revenue, in part, by having the power to raise property and sales taxes, as promoted by the First Nations Tax Commission.

In summary, while progress has been made to increase Indigenous financial inclusion—in particular, Indigenous access to credit and equity from both conventional sources, and more importantly, from innovative Indigenous sources—much more needs to be done to overcome ongoing barriers and close growing gaps. The evidence to date indicates that the most progress has been made via Indigenous-controlled and led financial institutions and this represents the most promising path going forward.[31] The existing Indigenous financial institutions have been able to mitigate historic barriers, lower costs, and reduce perceived risks associated with Indigenous economic development. However, they have not been able to achieve the scale and the coverage across Indigenous communities necessary to make substantial and broad progress in reducing the physical capital shortfall. To this end, the next section will consider proposals put forward by national Indigenous organizations for new Indigenous institutions with the potential to achieve sufficient scale and coverage.

31 This observation is consistent with the main finding of the Harvard Project: *"When Native nations make their own decisions about development projects to take, they consistently out-perform external decision makers…"* (www.indigenousgov.hks.harvard.edu)

Proposals to strengthen the Indigenous financial system: the next generation

In 2022, the FNFMB published *The RoadMap Project*, the NIEDB released the *National Indigenous Economic Strategy*, and the NACCA promoted the establishment of the *Yänonhchia' Indigenous Housing Finance Network* (YIHF). All brought forward innovative proposals for new Indigenous financial institutions with the scale and broader coverage needed to be efficient and materially reduce the identified gaps in Indigenous access to finance and intermediation.

Indigenous Development Bank

Both the FNFMB and the NIEDB reports call for an Indigenous Development Bank (IDB).[32] The primary purpose of the IDB would to be to provide the scale necessary to attract investment finance from global capital markets and distribute it to address existing gaps. In particular, it would provide larger loans to individual Indigenous businesses and Indigenous economic development corporations than are currently available from the IFIs (and BDC) and it could also inject capital loans into NACCA's IFI network to relieve the lending constraints they now face. It could also lend to businesses (Indigenous and non-Indigenous) wanting to invest in economic development infrastructure on reserves. Such investments could include major projects in natural resources, transportation and electric power, as well as real estate development projects (for which FNFA financing may not be available). The IDB would begin with an initial injection of capital from the federal government and its capital base could be supplemented by debt issuance to financial markets. This debt issuance would be more attractive to outside investors if promoting Indigenous economic development were to become an ESG (environmental, social and governance) standard, as social impact finance. In addition, the

32 The NIEDB's proposal called it an Indigenous Business Development Bank. Although the main purpose of both proposals is the same—to increase Indigenous access to finance—the scope would be different with the NIEDB proposal focusing on Indigenous business borrowing while the FNFMB proposal also includes lending for major projects, and economic development infrastructure.

IDB's capital base would increase over time as retained earnings accumulate or if the IDB can attract investment from Indigenous trusts, which would help close the Indigenous intermediation gap.

The IDB proposal is promising, but it does rely on government(s) providing the initial capital base (with the IDB growing it subsequently) and on the government guaranteeing, at least initially, any debt issuance to financial markets. This initial capital contribution as well as any subsequent guarantees could come with some degree of government oversight. Not only could this create another layer of bureaucratic decision-making, but these decisions could also be subject to political influence, eroding the independence of the IDB. Therefore, for the IDB to be credible and effective, its governance would have to be structured to ensure its operational independence and minimize the extent of government bureaucracy and political influence.

Another consideration is that the existing FMA institutions, which the IDB would complement, currently only provide finance to First Nations. While First Nations are the largest Indigenous heritage group and face unique legal barriers, the scope of the IDB, and perhaps also of the FMA institutions, should encompass and address the different needs of all three heritage groups to achieve sufficient scale. The IDB should promote economic development across Indigenous communities, most notably, the least affluent.

Indigenous Investment Commission

The FNFMB *RoadMap Project* also calls for the establishment of an Indigenous Investment Commission (IIC) to house and manage the accumulating financial wealth of Indigenous communities.[33] Currently over $20 billion of Indigenous financial assets held in trusts are being managed by conventional asset managers, and in some cases earning low returns and incurring high management fees. The Government of Canada holds almost $700 million in assets in trust for First Nations with a less than two percent return. In both cases, the trust agreements provide no opportunity for the First Nations owners to leverage these funds to finance public infrastructure or economic and community development projects on their reserves. In addition, financial wealth is accumulating as a result of impact benefit agreements, which are largely flowing into non-Indigenous financial institutions. Moreover, there would be opportunities in the future for the IIC

33 On this issue, the NIEDB's *National Indigenous Economic Strategy* calls for the modernization of trust agreements to ensure long-term sustainability, provide revenue streams and flexibility in decision making.

to manage the financial investments of a potential Indigenous insurance company or Indigenous pension fund.[34]

The IIC would help close the Indigenous intermediation gap if some of these funds were used to promote Indigenous economic development. Ideally, the IIC would have the standard fiduciary mandate of maximizing expected return subject to risk, and an additional mandate to support Indigenous economic development, as does, for example, the Caisse de Dépôt in Quebec.[35] The IIC could make such Indigenous investments directly by providing loans or buying equity in Indigenous businesses or projects, or indirectly, by providing equity or loans to the IDB. In particular, the IIC could help Indigenous communities finance equity stakes in major projects to achieve a larger return from such projects.

A potential vision over the longer term would be to merge the IDB and IIC into one institution, as an *Indigenous* Caisse de Dépôt, so that it could be completely self-contained within the Indigenous space, independent of any Canadian government. Although such a vision could take many years to accomplish, it would be consistent with the TRC and UNDRIP goals of Indigenous self-government and self-determination.

Yänonhchia' Indigenous Housing Finance Network

The purpose of the Yänonhchia'[36] Indigenous Housing Finance Network is to create an Indigenous network of IFIs within NACCA to finance investment in Indigenous housing, primarily on reserves, settlements, and communities where the land is communally held and fee simple mortgages are not possible.[37] The participating IFIs in the network would have to expand their capital base and operational capacity to provide housing loans, based on the ABSCAN model of a revolving credit facility. These IFIs would implement ABSCAN's approach of issuing loans to Indigenous households that have the desire and means to own their homes, and subject to rigorous underwriting standards. Ideally, the fund could be scaled up by securitizing pools of these housing loans and packaging them into Indigenous housing bonds that could be sold to financial markets. The lending

34 The IIC could establish an Indigenous impact investment fund to attract non-Indigenous finance. See, for example, Willis (2023) who discusses Longhouse Capital, which is a recently established Indigenous impact investment fund.

35 The Caisse de Dépôt de Quebec invests roughly 20 percent of its assets in Quebec-based businesses.

36 Yänonhchia is the Huron-Wendat word for "home".

37 For more detail about credit assessment and default provisions, refer to ABSCAN (2023) and Collin, Schembri and Vincent (2023).

process would be streamlined and much more efficient than the existing First Nations Market Housing Fund (FNMHF) and Ministerial Loan Guarantee processes because the loans would not require community or government approval.

The loans would be used to finance the construction or renovation of single-family or community-owned, multi-family residences. It would expand the Indigenous housing supply, which is desperately needed as young adults and families are leaving their communities due to a lack of adequate housing.[38] By promoting home ownership, Yänonhchia' would effect a change in housing culture as housing in most Indigenous communities is government-provided social housing. Early-adopting homeowners would set a good example in their communities and contribute to greater social stability. Moreover, the lifespan of the Indigenous housing stock would significantly increase because social housing lasts, on average, 8-10 years. The goal of the Yänonhchia' network would be to make housing finance available to all three heritage groups. Yänonhchia' is currently in a pilot phase as more IFIs participate and the final details are worked out.

In summary, the three innovative financial institutions proposed by national Indigenous groups have several advantages:

1. they would be scalable to meet demand and achieve an efficient scale with latest technology to lower operating and transactions costs;
2. they would have a broad national coverage to improve access to finance for all three heritage groups;
3. they would be Indigenous-controlled and led, an approach that has proved successful in the past in spawning innovation and assessing and managing risk;
4. they would help to close the remaining gaps in Indigenous finance, namely, the shortage of finance for larger Indigenous business loans and major projects, the intermediation gap between growing Indigenous financial wealth and needs for capital investment in Indigenous communities; and the lack of access to housing finance; and
5. they would eventually be self-sustaining, once they achieve an efficient scale, with no need for ongoing government financial support.

38 Such migration from Indigenous communities, often to urban areas, is likely contributing to existing shortages of affordable housing in the rest of Canada. Roughly 60 to 70 percent of those who identified as First Nations in the 2021 Census (Statistics Canada, 2022) live off reserve. See Chernoff and Cheung (2023) for more information.

Concluding Remarks

Starting from a low base 50 years ago of very little or no financial access, the Indigenous-led financial system in Canada has made remarkable progress in providing access to finance and other financial services to Indigenous communities. This success has been achieved through innovation and by building partnerships, trust and capacity, as well as strong financial governance and management practices. In addition, advances have been made accessing conventional institutions and financial markets for credit and equity finance. These sources of Indigenous finance now far outweigh that provided by direct government transfers.

Despite this progress, barriers to financial inclusion remain and gaps across many dimensions continue to grow. Consequently, disparities in investment in housing, infrastructure, and economic development in Indigenous communities—along with overall standard of living relative to the rest of Canada—remain large.

At the same time these gaps to Indigenous finance and investment are increasing, Indigenous financial wealth is growing and mainly held in conventional, non-Indigenous, financial institutions as deposits or investment trusts. This wealth, to a large extent, is not being recycled into Indigenous communities where the needs are great and expected returns to community well-being are high. Moving to close this Indigenous intermediation gap represents an excellent opportunity to boost access to finance and investment in these communities.

Therefore, there is now both the need and the opportunity to accelerate progress on Indigenous access to finance by building the next generation of innovative Indigenous financial institutions to complement the first, namely the FMA institutions and NACCA and the IFIs. The Indigenous-led financial institutions proposed by the FNFMB, NIEDB, and NACCA are: the Indigenous Development Bank; the Indigenous Investment Commission; and the Yänonhchia' Indigenous Housing Finance Network. These institutions have important advantages: they are scalable; they can achieve broad coverage across all Indigenous communities; and they can draw upon and potentially leverage the accumulating Indigenous financial wealth. Therefore, they should have a much larger and more

equitable impact on these gaps that are holding back Indigenous economic development and keeping income levels and living standards for Indigenous Peoples well below those of the rest of Canada. However, to help ensure that they have this beneficial impact, these institutions should retain the rigorous financial governance and risk management practices that have served successful Indigenous-led financial institutions well in the past. A prudential approach to their establishment and expansion would be essential.

These proposed institutions hold much promise, but they must also be accompanied by other reforms that give Indigenous communities more jurisdiction over their resources and more fiscal powers to boost own-source revenue and build capacity.

The critical point is that economic reconciliation implies creating the opportunity for Indigenous Peoples to achieve economic prosperity. Indigenous leaders recognize that Indigenous self-determination and Indigenous prosperity go hand-in-hand; one cannot be achieved without the other. Limited access to finance has been a large obstacle to Indigenous prosperity and while progress has been made to mitigate it through innovation, more needs to be done. The proposed next generation of Indigenous-owned and led financial institutions are promising because they offer a self-sustaining means to address the remaining gaps. They should be considered seriously not only because they will help achieve economic reconciliation—which most Canadians support—but also because Indigenous self-determination, self-reliance and prosperity will have positive economic benefits for the rest of Canada.

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