Intelligence MEMOS

From: Glen Hodgson and Diana Smallridge

To: Reconciliation Observers

Date: January 17, 2024

Re: **UNLOCKING INDIGENOUS FINANCING: ARE LOAN GUARANTEES THE ANSWER?**

The federal government's recent Fall Economic Statement included a commitment to establish a loan guarantee program to foster Indigenous equity ownership in major natural resource sector projects. This offers clear recognition that significant amounts of Indigenous financing will be required for economic reconciliation.

The specific idea of a loan guarantee program was promoted by the First Nations Major Projects Coalition, with the support of Indigenous and business organizations like the Business Council of Canada. Next steps are to be announced in Budget 2024, so the federal government has some homework to do to define the program parameters.

A loan guarantee is not a free good; it essentially transfers risk from private lenders to government and taxpayers. We have been advisors to many development and trade finance organizations and their supporting governments around the world and understand well the importance of well-designed and well-managed guarantee programs to maximize benefits and minimize fiscal costs.

Loan guarantees are most effective when they address a clear market gap and help to mobilize net additional financing from the private sector. Specifically, meaningful additional resources are mobilized when a government guarantee covers a relatively small share of the loan's value. A high share, in contrast, reduces the leveraging of private sector financing and even prompts questions about why a risk-transfer guarantee is being used, rather than providing a direct government loan.

It should also be recognized that the proposed loan guarantee program is to be used to backstop equity investment, which has inherent risks. This means a guarantee fee – a risk premium on the loan's interest rate – that reflects the transaction's risks and potential losses ought to be paid by the guaranteed party. A budgetary backstop for the federal government such as a loss provision would be beneficial.

Other questions will need to be addressed before the program can be launched. Program coverage is a central issue. The fall statement mentions Indigenous investment in projects in the natural resource sector. Would that include investment in energy resources with high GHG emissions such as oil, gas or even coal? The energy sector is obviously in transition toward lower or no net GHG emissions, and the economic life of non-renewable energy projects may end up less than currently expected. If traditional energy projects are to be included, it would be reasonable to require the project to include abatement of emissions, such as through carbon capture. And what about Indigenous investment in infrastructure related to the resource sector? It would seem reasonable to make that eligible too.

Next, program management: Prima facie, the federal government will be taking the financial risk, so it is reasonable to expect an Indigenous loan guarantee program to be managed by federal officials.Yet Indigenous nations and peoples increasingly expect to direct their own affairs as per the UN Declaration on the Rights of Indigenous Peoples (UNDRIP – Articles 5 and 23), including how they choose to invest in resource development. This suggests that, at a minimum, Indigenous leaders should be fully engaged in setting the strategic priorities of the guarantee program and in the selection of projects and related private sector financing partners. If this program is to succeed, it will thus be critical to strike the right balance between federal and Indigenous interests in its governance.

More fundamentally, while a federal loan guarantee program will be a useful tool in unlocking financing for Indigenous ownership and engagement in major projects, it is only a partial solution to the large financing gaps within the overall Indigenous economy in Canada. Not surprisingly, recent Bank of Canada research confirms levels of economic development within Indigenous communities are significantly lower than within non-Indigenous populations and that people from Indigenous communities face greater barriers to accessing finance.

We recently undertook analysis for the First Nations Financial Management Board, which identified many other financing gaps, including financing for Indigenous business ventures of all sizes, Indigenous nations, governments and communities, infrastructure, and housing. Existing Crown financial institutions and other government programs have not met the demonstrated needs for Indigenous financing; other approaches will be required to meet the broad spectrum of financing needs of the Indigenous economy. We will offer advice in a future Memo on how best to address all of these financing needs and continue to build towards economic reconciliation.

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