

## Community Investments Vol. 10, Issue 2 Sovereign Lending: One Step Closer in the Northwest

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*During January and February 1998, the Federal Reserve Bank of San Francisco sponsored four workshops to discuss and advance issues of credit need and access in Washington State and Northern Idaho Indian country. Titled "Sovereign Lending," the workshops were co-sponsored by Affiliated Tribes of Northwest Indians' Economic Development Corporation, Federal Deposit Insurance Corporation, and Freddie Mac. Nearly three hundred participants attended, including tribal leaders, bank officials, and representatives of non-profit organizations and public agencies. The four workshops collectively focused on the issues of over 30 Northwest-based tribes. The following is a synopsis of the key findings and issues that were defined at these gatherings.*

It's no secret that many Indian reservations suffer from high unemployment rates and widespread poverty. The reasons for these conditions are as numerous and unique as the tribes who suffer them, but it's a safe bet that the lack of credit availability hasn't helped the situation. There are a number of real and perceived barriers that continue to make lending on reservations a challenge, if not downright difficult. Among these barriers are issues associated with deficient or ineffective educational efforts, marketing/outreach, and underwriting standards.

## **Educational Efforts**

There are hundreds, if not thousands, of articles, publications and seminars devoted to the subject of Indian culture and access to credit on tribal lands. Nevertheless, there remains a lack of understanding around a number of tribal issues, all of which stress the need for the ongoing education of lenders and other private entities seeking to conduct business on tribal lands.

An important starting point is an understanding that tribal governments vary from tribe to tribe. Each tribe represents a separate sovereign nation and has its own set of laws and regulations. Tribal government leaders can change, just as U.S. government leaders do, and this can affect how tribal laws are enforced. Why do lenders need to know this? Lyndi Wells, a partner with the firm Dorsey & Whitney LLP, explains, "Prior to entering into a transaction with a tribal enterprise, it is essential that lenders understand the government organization of the tribe. The method of a tribe's organization affects how powers are distributed, who can act for the tribe, and what, if any, approvals may be necessary to carry out a transaction." Beyond an understanding of a tribe's government structure, Sovereign Lending a training program for tribal entities (such as the housing authority) on how to pre-qualify loan applicants. participants identified several educational needs in which financial institutions I could participate. These include the provision of:

- small business technical assistance for reservation business owners;
- financial planning and budgeting in tribal area schools;
- job training and entrepreneurship classes for tribal members; and,
- a full-time mortgage and small business credit counselor for each tribe.

In addition to the exchange of technical expertise, a greater understanding of cultural differences will be necessary to foster more productive

negotiations and the expedient resolution of conflicts. Forums such as the *Sovereign Lending* workshops provide tribal members and others the opportunity to discuss cultural differences in a structured environment. The informal networking that occurs is an added, but important, benefit.

### **Marketing And Outreach**

Lenders attempting outreach to tribal reservations cite remote locations and uncertainty about effective advertising methods as the primary barriers for successful marketing efforts. To address these concerns, workshop developed a list of options that lenders could pursue to enhance their marketing efforts. Suggestions include the establishment of:

- customer call programs;
- direct mail advertising to promote products and services;
- ATM's and mobile branches to provide physical access to banking services; and,
- a training program for tribal entities (such as the housing authority) on how to pre-qualify loan applicants

Whatever the methodology, it is imperative that marketing and outreach efforts consider and include the unique characteristics of the "targeted" tribe. Careful analysis of a tribe's credit needs and governmental structure will vastly improve a marketing program's chances for success.

### **Underwriting Standards**

Underwriting loans on Indian reservations may cause lenders to feel caught in a quagmire of concerns: different Universal Commercial Codes, jurisdictional concerns, income verification difficulties, and land ownership issues.

Raynell Diehl, Banking and Finance Coordinator for Associated Tribes of Northwest Indians, states, "A majority of tribes across the nation do not

have tribal laws that adopt versions of the Universal Commercial Code (UCC). In addition, most tribes have not adopted judicial interpretations or regulatory law governing basic business licensing of an operation, contract law, or corporate operations that would protect legitimate creditor, investor and consumer interests. The absence of such laws weakens creditor and investor confidence in their ability to pursue a range of remedies pertaining to judgments including appeals, garnishments, attachments, foreclosure sales and repossessions."

To alleviate issues of creditor confidence, a tribe may adopt a "Tribal UCC," or portions of the state code, to separate tribal politics from its business activities. For example, while tribes are immune from lawsuits arising from contracts or other causes of action, tribes may waive immunity from lawsuits by adopting a "sue or be sued provision" in a corporate charter established under its constitution or bylaws. These kinds of provisions help satisfy a lender's need for clear foreclosure remedies.

Although several states have jurisdiction over American Indian civil and criminal matters, most tribal courts have jurisdiction over civil matters concerning tribal members. Therefore, if a tribal member defaults on a loan, collection procedures usually occur in tribal courts. Perceiving a disadvantage in tribal courts, lenders are less likely to make loans to tribal members who reside on a reservation. To overcome these perceived disadvantages, lenders can educate themselves about the distinct judicial system of each tribe, and any effect on ability to enforce contracts.

Indian lands held in trust may not be conveyed, taxed, or mortgaged without the permission of the U.S. government. Consequently, Indian lands cannot be pledged as collateral because legal title rests with the U.S. government. In other words, Indian lands are not subject to foreclosure. American Indians and tribes are, therefore, less likely to qualify for loans. Why? Because lenders perceive these loans to be high risk. And, because

resources unencumbered for collateral purposes are severely limited by the trust status of Indian lands. Furthermore, the Bureau of Indian Affairs' (BIA) lengthy processing-time for dispute resolution seems to have discouraged lending activity. Lenders are hopeful that the BIA's current system will be reevaluated soon to deliver speedier decisions.

Tribes and tribal members receive trust income from the sale or lease of land, minerals, timber, water or other investments, but they are not required to pay taxes on income derived from trust assets. Since lenders typically rely on tax returns to substantiate income, trust income is not usually taken into account when lenders determine likelihood of repayment. In addition, some tribal members involved in seasonal or agricultural professions, like the fishing industry, do not have the standard employment and income documentation generally required by lenders to underwrite a loan. In response to these concerns, workshop participants suggested that lenders consider requesting information about trust income and begin accepting alternative income verification documentation such as fish tickets and receipts of leasehold interest income.

### **In Conclusion**

The advancement of many strategies to address the complex issues raised at the Sovereign Lending workshops left most participants feeling optimistic. Recommendations to promote credit availability, such as marketing programs, access to a credit banker, and training on cultural differences will become more tangible when organized task forces analyze the issues and structure a game-plan. As each barrier disappears, access to credit will become increasingly commonplace for current and future generations of Native Americans.

*For more information on the results of the Sovereign Lending Workshops, more of which are planned for June and July 1998, please contact Craig Nolte at the Fed's Seattle Branch at (206) 343-3761.*

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## **About the Author**

**Craig Nolte** serves as a Community Affairs Advisor at the Seattle Branch of the Federal Reserve Bank of San Francisco. In this role, Mr. Nolte works with the Community Affairs Unit in San Francisco to assist financial institutions in boosting their CRA performance. In addition, he works with the Public Information Department in Seattle. Mr. Nolte is also a commissioned Federal Reserve Bank examiner.

Prior to his career at the Federal Reserve Bank, Mr. Nolte worked for 14 years at the Office of Thrift Supervision in the area of corporate applications and examinations. He also served as a compliance examiner for several years. His credentials include an MBA from City University of Seattle and an undergraduate degree in Finance from Seattle Pacific University.