

Statement of
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Opportunities and Challenges for Economic
Development in Indian Country

November 10, 2011

Before the
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
Washington, DC

¹ This statement reflects my views and not necessarily those of the Board of Directors of Eagle Bank or the Confederated Salish and Kootenai Tribes of the Flathead Nation

Chairman Johnson, Ranking Member Shelby, and members of the Committee, thank you for inviting me to participate in this discussion of Opportunities and Challenges for Economic Development in Indian Country. You have asked that I comment on several topics regarding Eagle Bank's role in encouraging economic development and challenges and opportunities.

Economic development and the organization of Eagle Bank

The Confederated Salish and Kootenai Tribes of the Flathead Nation (Tribes) have been proactive in economic development for many years, investing in tribal enterprises with the intent of promoting tribal employment and generating net revenues. Tribal businesses include resort and gaming operations, electronic and component manufacturing, information technology development, energy development, and environmental restoration. The Tribes have recognized the need for developing alternative sources of revenues to support their governmental and economic development needs, and the tribal enterprises are generating welcome dividends.

The Tribes also recognized the need to support credit availability for their membership. Over 40 years ago the Tribal Credit Program was created with a modest investment to assist tribal members with small balance short-term credit needs that were not adequately addressed by traditional financial institutions, and over the years net revenues were retained to grow the fund. This program has grown into a \$45 million fund providing short-term unsecured loans, educational loans, home ownership loans and commercial loans, and as reserves have grown, the program has been able to return dividends to the Tribes.

The Tribes also have a smaller fund for small dollar loans supporting tribal member economic development – Sovereign Leasing and Financing – and have instituted a grant program patterned after the Montana Department of Commerce Montana Indian Equity Fund². The Tribes are dedicated to providing credit opportunities and grants to tribal members and their small and start-up business that may not have access to capital from traditional financial institutions.

The Tribes' desire to expand into banking was a natural extension of their economic development goals and their desire to provide financial services for under-served members. After nearly two decades of research and discussion, the Tribes organized Salish and Kootenai Bancorporation³ and chartered Eagle Bank in 2006. The bank is charged with providing the traditional financial services for all residents and businesses within the Flathead Reservation, and to provide services for the under-served population such as small dollar loan and deposit accounts and check cashing that many financial institutions no longer provide.

The role of Eagle Bank

The Flathead Reservation was established by the Hellgate Treaty of 1855 and encompasses approximately 1.3 million acres of some of the most scenic agricultural and recreational areas of Western Montana. The Reservation overlays the majority of Lake County and portions of Flathead, Missoula and Sanders Counties and was settled by several bands of the Salish, Kootenai and Pend d'Oreilles Tribes.

² The Montana Department of Commerce Indian Equity Fund provides for two \$7,000 grants to Native American owned business on each reservation in Montana and one \$7,000 at large grant.

³ Salish and Kootenai Bancorporation is the only bank holding company organized under Section 17 of the Indian Reorganization Act of 1934

During the early part of the 1910's the unallocated portions of the Reservation were opened to homesteading and, as a result, the majority of the residents within the exterior boundaries of the Reservation are not tribal members. The 2010 Census reports only 24.7% of the residents claimed American Indian/Alaska Native for their ancestry, making the Tribes the minority within their own reservation.

Land ownership also reflects the population status with the majority of the Ag and developable real estate held in fee status, rather than Trust, and the Tribes are working to re-acquire real estate holdings as they become available and budgets allow.

The influx of people following the homesteading days led to significant economic development on fee land, and banking and commerce evolved over the past century in a manner more reflective of off-reservation development. Unfortunately, trust property issues and lending to Native Americans were not addressed appropriately in the past, and the Tribes have worked hard to improve the understanding that banking and commerce need to be more inclusive and responsive to their inherent Sovereignty.

Eagle Bank is one of five banks domiciled within the Flathead Indian Reservation and the market is also served by branches of two larger out of market banks and a branch of a large out of market credit union. This is an unusually high concentration of financial institutions located within an Indian reservation, and is the direct result of the opening of the Flathead Reservation to homesteading.

Eagle Bank is charged with serving the general market with traditional banking services, but is also charged with providing financial services to the under-served. These services include (1) small dollar consumer loans, both secured and unsecured, (2) small dollar deposit accounts with access to debit and ATM cards, (3) check cashing for non-customers who reside within the Reservation, (4) trust property loans, and (5) providing “coaching” on deposit accounts and access to credit. Eagle Bank would like to expand its “coaching” to a more formal program of financial literacy, and will do so when limited staff and resources permit.

Eagle Bank also works with Tribal and other funding programs to leverage credit for small and start-up businesses, and serves as an advisor/grant reviewer for the Montana Department of Commerce Montana Indian Equity Fund, the Tribes grant program and the Tribes economic development committee.

Eagle Bank model

Eagle Bank opened at arguably the worst time, and continues to struggle with profitability during the most severe economic conditions since the Great Depression. The historic low interest rates are a major detriment to profitability because volatile tribal deposits⁴ require maintenance of excessive short-term/overnight funds that provide no margin. In a more “normal” interest rate environment, the bank would be able to realize positive margins on liquidity and an improved profitability.

⁴ Overnight funds average in excess of 25% of assets, and deposit swings in excess of 40% of assets have occurred

The tribally owned bank model may have limited usefulness on many reservations because of the regulatory limitations on banks and their dealings with affiliates and operational limitations. In the case of Eagle Bank, the Flathead Reservation market offers a broad range of customers, tribal and non-tribal, to support both deposits and loans, but the potential customer base on other reservations may not be broad enough to support a commercial bank.

Regulatory limitations on dealings with affiliates have evolved over the years to address insider abuses of the past, but do not reflect the unique relationship between a tribe and a tribally owned bank. The tribe is the dominate economic driver on most reservations, and for the tribe and its bank to be successful, the bank needs the ability to work with the tribe and the affiliated entities on a scale that is not allowed under current regulations.

The primary operational limitation is the dependence upon tribal deposit accounts and the manner in which they can be held. Many tribes compact for services with the BIA and under the terms of many of those compacts, the deposits associated with the services must be both interest bearing and secured. Temporary FDIC coverage of interest bearing transaction accounts (with restrictions on rate paid) during 2010 provided relief, but the elimination of that coverage has increased the difficulty of providing tribal accounts.

If the majority of the deposits are tribal and volatile, it is very difficult to provide adequate coverage by pledging securities and maintain adequate levels of liquidity. Additionally, current yields on securities have been too low to cover FDIC assessments and fixed costs to maintain the deposits.

The temporary unlimited FDIC coverage on non-interest bearing transaction accounts has provided significant relief in maintaining deposit accounts for the Tribes, and I hope this temporary coverage will be made permanent, not only for Eagle Bank's somewhat unique requirements, but also for all smaller community bank's ability to compete with the perceived too big to fail institutions.

I would also hope the FDIC would consider unlimited coverage on interest bearing deposits on a fee basis for those willing to participate. The elimination of privately offered excess deposit bond coverage during the economic crises has placed additional burdens on community banks in general and Eagle Bank in particular.

Lacking improved FDIC coverage or the return of excess deposit bond coverage, the majority of a tribally owned bank's earning assets may be required to be invested in securities to secure those deposits, restricting funds available for lending. There are a couple of third party providers working on multi-bank sweep accounts designed to increase FDIC coverage for excess deposits and it will be interesting to see how successful these products will be.

If the potential deposit mix of a reservation is not broad enough to allow a tribally owned bank to have a diversified deposit base, it may be more appropriate for a tribe to partner with an existing bank to provide services on the reservation or to sponsor a credit union to promote access to financial services for its membership. Partnering may provide some return on a tribal investment, but there would be no return on sponsoring a credit union, and there would be

additional regulatory restrictions on what services a credit union could provide the tribe and its business affiliates.

Challenges to access to capital

Access to capital on reservations has been an ongoing problem for Native Americans, and I have observed three primary challenges limiting access (1) uncertainty created by tribal governments' willingness to support access to capital, (2) uncertainty created by lack of consistency in secured transactions, and (3) financial literacy.

Tribal government uncertainty - One major impediment to accessing credit from financial institutions is the uncertainty in lending within the jurisdiction of a Sovereign entity. Each federally recognized tribe is a sovereign government and is responsible for developing its own governing laws, statutes and court systems. Some tribes are very proactive in developing statutes that support lending and have consistent enforcement through their tribal courts, and other tribes continue to maintain a more protective environment for their membership.

Banks are reluctant to lend in an environment that is not governed by a strong, consistent court system that will allow collection of debt, and bank regulators have been increasing critical of loan administration not based upon solid, well documented credit administration and collection practices.

This creates a difficult environment for banks – there is a perception banks are discriminating against Native Americans by not lending on reservations, but if secured credit is extended on

some reservations, there is the very real potential that the bank will have no recourse in the case of default. Within the past year, Eagle Bank was not successful in civil actions in 2 of the 3 courts approached – a Washington tribal court refused to schedule a hearing, and a Montana tribal court scheduled a hearing, but when Eagle Bank appeared as scheduled, no one else appeared, not even the judge.

I believe this to be more of an educational issue rather than a jurisdictional issue between sovereign tribal governments and financial institutions organized under either state or federal charters. The Confederated Salish and Kootenai tribal court is an example of an unbiased court that is consistent in its treatment of collection actions. Creditors can be confident that a collection action filed with this court will receive a fair hearing, and the court will rule on the merits of the case.

Tribal governments need to understand that for capital to be made available within reservations, those receiving the benefit of the capital must be accountable for repaying their debts and the tribal governments must take responsibility to assure lenders have a clear, consistent recourse in the case of a default through an independent and unbiased tribal court system.

Lack of consistency in regulating secured transactions - In addition to a consistent and unbiased court system, it is necessary to develop and adopt uniformity in regulating transactions secured by real and personal property. Trust property issues vary from reservation to reservation, and even though there are established procedures in place for perfecting mortgages on individually owned trust property and assignment of leasehold interests in tribal trust

property, the ability to sell foreclosed real estate is often limited on some reservations. Credit underwriting must take into consideration the ability to sell foreclosed real estate, and this may have an adverse impact on the ability of a Native American to borrow.

The inability to adequately record and search liens on non-titled personal property creates nearly as much uncertainty in lending as an unresponsive or inconsistent court system. Susan Woodrow's testimony today will address the ongoing efforts to develop a uniform tribal secured transaction code and I strongly support this effort.

Financial literacy and technical assistance - Financial literacy continues to be a challenge accessing capital and is not limited to Indian Country. There is a significant population that does not have the basic financial understanding and/or training to successfully manage deposit accounts, complete loan applications or understand the importance of credit ratings. Many banks have taken the approach, and perhaps rightfully so from a profitability and litigation point of view, that if a potential borrower does not have the ability to complete a loan application and does not have a predetermined credit score, the application will be rejected.

Many Native Americans do not understand the significance of credit scores and the impact low scores have on their ability to not only borrow money but their cost of insurance and other credit dependent services. A primary negative factor for many Native American's credit score is medical collections. Many tribal members assume the IHS or the tribal health services are responsible for their health care, but often medical payments are not processed timely and the bills are not paid in their entirety. Medical providers routinely submit these unpaid bills to

collection agencies, and because the tribal member assumes they are not responsible for payment, they do not respond to the collection activities. I routinely see credit scores in 500 range with medical collections the primary derogatory items.

With no established banking relationship and low credit scores, many people fall prey to predatory lenders and check cashers. Once this pattern of borrowing and check cashing is established, it is very difficult for the individual to break free of a very expensive credit environment.

There are numerous programs available for education of first time home buyers, out-reach through the school systems and technical assistance for small businesses. The first time home buyers programs appear to have value and the out-reach programs through the schools appear to be of benefit for those students that are reached. Unfortunately many students who need the basic financial education do not take the elective courses or who do not advance far enough in the school systems to participate in the out-reach.

I am disappointed with some of the technical assistance programs I have observed. These are generally presented through a grant funded program and the TA providers are minimally paid individuals with little or no successful business experience. I am not suggesting that the providers are not very motivated and work hard to assist their clients, I am only suggesting that without personal successful business experience, it is hard to provide the financial training necessary to build a solid basis for someone attempting to start or expand a small business.

Most TA providers follow a set pattern of developing a business plan (generally from a canned program) including at least three years projections and setting up basic accounting systems with balance sheets, income statements, cash flows and break even analysis. This may be an appropriate approach for those small business owners who have a general understanding of business and bookkeeping, but for those folks who do not have a good understanding of managing a check book, this approach is not appropriate.

An example – I participate in reviewing grant applications for small Native American businesses, and recently I reviewed an application for a woodcutter. His business is to cut firewood and supply the wood to needy folks under a tribal program. He needs to understand what his fuel costs are to go to the woods, cut the firewood, and deliver it, what his costs are to maintain his equipment are make his loan payments.. Anything in excess of those costs will provide for his personal living expenses. If he understands these costs, he could keep track of them by maintaining receipts in an envelope and basic notes of loads hauled, income and expenses on the back of that same envelope. He does not need a QuickBooks accounting system providing balance sheet, income statement and cash flow information when he will most likely not even use a checking account.

His grant application included a “text book” business plan, including forecasts and cash flows, all prepared by a TA provider, and the TA provider commented that the applicant had difficulty understanding the cash flow analysis.

Unfortunately the level of technical assistance training is not well matched to the needs of the small business owner, and for the most part, the technical assistance is only given in an attempt to apply for a grant or a loan. I feel strongly that all technical assistance should be directed to the understanding and management of the business, not to apply for a loan or grant, and should be provided by trainers with successful business experience and in a manner consistent with the level of sophistication of the business they are advising. Perhaps a partnership with a minority financial institution that would assist with funding financial literacy in local communities would be an option. As noted above, Eagle Bank is charged with providing financial literacy, but limited resources and staffing have prevented development of a more formal program.

Opportunities

There are many opportunities for banks to assist with credit needs in Indian Country, and as federal funding becomes more difficult, commercial lending can, and should, step up to fill the gap. Housing is a prime example.

Many reservations have limited individual home ownership and the tribal housing authority owns and rents most units. The HUD 184 loan program offers an alternative to rental units, can increase the amount of housing available, and free limited tribal resources for other pressing needs. Robert Gauthier⁵ is a strong advocate for the HUD 184 loan program, and in his opinion that freeing tribal housing resources by increasing homeownership must begin with educating

⁵ Robert Gauthier is the Chairman of Eagle Bank and was instrumental in the development of the HUD 184 guaranteed loan program. He has been involved in Native American housing issues for nearly 30 years and consults on Native American housing and infrastructure issues.

tribal governments of the value of home ownership before attempting to educate the potential homeowners and the financial institutions that could serve those homeowners.

This is an educational issue that does not appear to be addressed in the current technical assistance programs. Perhaps some level of support could be directed to this specific need, recognizing that educating tribal governments is a very unique challenge and may not be adequately addressed by conventional contract providers. Without educating tribal governments, expansion of individual homeownership or small business development on many reservations will continue to be very slow.

In conclusion, I believe there are opportunities for economic development in Indian Country, but significant challenges remain. The Confederates Salish and Kootenai Tribes approach, including chartering Eagle Bank, is making a difference on the Flathead Reservation, but chartering or purchasing a bank may not be appropriate for many tribes.

The primary challenges limiting access to capital have not changed significantly during the nearly 30 years I have worked on the Flathead Reservation, but I am optimistic progress is being made.

I thank you for the opportunity to provide my comments this morning. I look forward to answering any questions that you may have.