Native CDFI Network White Paper Series

March 2022 | No. 2022-01

Native CDFI Participation in Tribal State Small Business Credit Initiative (SSBCI) Programs

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Developed by Quarles & Brady LLP for the Native CDFI Network[1]

SUPPORTED IN PART BY

Introduction to the State Small Business Credit Initiative (SSBCI) Program

Background of the SSBCI Program

In September 2010, Congress enacted the State Small Business Credit Initiative Act (SSBCI Act), PL 111-240. The two primary purposes of the SSBCI Act were to provide federal support to states for small business credit support and small business job creation. Coming out of the Great Recession, the SSBCI Act provided for almost $1.5 billion to states to help fund capital access programs, collateral support programs, loan guarantees, and venture capital support programs for small businesses and manufacturers.

Additional policy considerations of the SSBCI Act included to give states the flexibility to design and implement small business credit support programs that met the states' market conditions, business environment, and economic development goals. Recognizing that national credit support programs – such as the Small Business Administration's loan guarantee programs, or USDA Rural Development loan and loan guarantee programs – with a one-size fits all approach to credit support did not provide the needed flexibility or targeting requirements for a particular state's economic development efforts.

In March 2021, Congress, as part of the American Rescue Plan Act, amended the SSBCI Act in two key ways:

- It added tribes to the definition of "State," thereby including tribal governments in the SSBCI Act; and
- It increased the funding to $10 billion in total, with a tribal government set-aside of $500 million, a "very small business" set-aside of $500 million, a set-aside of $1.5 billion for "socially and economically disadvantaged (SEDI) businesses," an incentive program of $1 billion to support SEDI businesses, and $500 million in funding for small business technical assistance.

Summary of Program Requirements

While tribes were added to the SSBCI Act, and funding was increased tenfold, the statutory requirements for program design, implementation, and administration remained substantially the same. A tribe must submit an application for approval to participate, and the proposed programs must meet the statutory requirements.

1. Application and Approval: To receive SSBCI funding, a tribe (or tribes) must submit an application to the Secretary of Treasury to approve the tribe's (tribes') participation. The Secretary must approve the application if:

- The tribe has designated a specific department, agency, or subdivision to implement the tribe's SSBCI programs;
- The tribe has taken any legal action necessary to implement the proposed programs;
- The tribe's proposed programs meet the statutory requirements; and
- The tribe executes an allocation agreement

2. Program Statutory Requirements: The SSBCI Act creates two categories of credit support programs: Capital Access Program and Other Credit Support Programs.[2] To implement an Other Credit Support Program, a tribe must be able to show that the programs meet the following requirements:

- can demonstrate that a minimum of $1 in private investment will result from $1 in public (SSBCI) investment (typically referred to as the 1:1 leverage ratio requirement);
- can show a reasonable expectation that overall tribal programs will result in small business lending amounts at least 10 times the SSBCI amount (typically referred to as the 10:1 leverage ratio);
- participating lenders have a substantial amount of their own capital at risk;

[1] This White Paper is produced on behalf of the Native CDFI Network. This document provides information of a general nature. None of the information contained herein is intended as legal advice or opinion relative to specific matters, facts, situations or issues. Additional facts and information or future developments may affect the subjects addressed in this document. You should consult with a lawyer about your particular circumstances before acting on any of this information because it may not be applicable to you or your situation.

[2] Because most tribes and tribal enterprises have been most interested in the Other Credit Support Programs, this white paper will focus on those.

- targets an average small business size of 500 employees or less, but no more than 750 employees; and
- targets an average loan or investment size of $5 million, but not more than $20 million.

The Secretary is also supposed to take the following into consideration[3] when determining whether to approve a tribe's SSBCI programs:

- The anticipated benefits to the tribe, its members, and small businesses, including the number of loans/investments made, expanded economic development benefits, and tax revenues increases;
- The operational capacity, skills, and experience of the tribe's management team;
- Its capacity to manage the increase in small business loan volumes;
- Internal accounting and administrative controls;
- The soundness of the program design and implementation plan; and
- Lenders/investors' experience and capacity, including experience with small business or commercial lending.

Program Guidance

In November 2021, Treasury issued its policy guidance for implementing the SSBCI program and its amendments. The guidance covers key aspects of the statutory requirements, and especially those that give discretion to the Secretary for implementing and approving tribal programs. In addition, there were several provisions in the guidance unique to tribal governments and tribal enterprises. Critical guidance most relevant to Native CDFI participation in SSBCI programs includes:

1. Lender or Equity Investor Capital at Risk: Lenders and investors must have "meaningful capital" at risk. For lenders, this is defined as at least 20% of risk of loan loss. For equity investors, this is defined as being junior or subordinate to the SSBCI investment. For equity funds, the fund manager must have its own resources at risk, consistent with industry standards.

2. Loan or Investment Purpose and Prohibitions: Lenders and investors must provide assurances that the borrower or investee are not using the proceeds for an impermissible purpose and that the borrower or investee are a permissible borrower or investee. For example, a loan cannot be made to an illegal business, such as a cannabis business. Nor can a loan or investment be made to an enterprise that has more than 30% of its revenue from gaming activities (unless the enterprise will use the funds for non-gaming related purposes).

3. Operational Experience and Capacity: If a Native CDFI wants to participate as an administrator for a tribe's SSBCI program, it has to show that its management team has significant credit underwriting or risk management experience with lending and financial institutions; experience operating credit support programs; and adoption of industry best practices. Native CDFIs can hire or contract with people who have the necessary skills and experience.

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4. Capacity to Manage Increases: A Native CDFI should be able to show it has the financial strength, resources, and capacity to support staffing increases, infrastructure improvements, and has the systems, policies, and procedures to handle increased loan transactions.

5. Accounting and Administrative Controls: The Native CDFI should also show it has internal accounting, auditing, and other controls in place to create a reasonable assurance that the SSBCI funds are safeguarded against waste, loss, unauthorized use, or misappropriation. Regular internal and independent audit policies and processes should be instituted.

6. Program Design and Implementation Plan: If a Native CDFI is working closely with a tribal government to design and implement the SSBCI program, then those programs should incorporate the use of business models and strategies for managing the risks associated with the SSBCI programs.

[3] The Treasury Guidance, issued in November 2021, expands on these considerations.

Types of SSBCI Programs

Based on the original SSBCI Act, states designed and implemented several "Other Credit Support Programs." The most prevalent programs are described below.

Loan Guarantee

A standard loan guarantee program provides a repayment guarantee to a lender for a portion of the loan made to a small business. The guarantee is paid out if the borrower defaults and after collection or collateral recovery efforts fail. The loan guarantee percentage can range from 30% to 80% of the loan amount.

Another type of guarantee program that was developed by New York was a surety bond guarantee program. Like a loan guarantee, this program provided a bond repayment guarantee on a portion of a surety performance bond for small business construction companies. The New York program focused on women and minority owned companies that were seeking construction contracts with the state or local governments.

Loan Participation

A typical loan participation program allows the tribe to provide additional loan amounts – as either subordinated debt or as pari-passu (side by side, equal footing) debt – to allow for higher loan amounts for a small business borrower. The participation can occur at the time of loan closing (i.e., two loans are made to the borrower), or the tribe can buy back a portion of the loan made. Another option is for the tribe to co-fund the loan. In any event, the lender typically services the loan(s).

Direct Loan/Relending

A tribe can contract with a CDFI to administer a direct loan program, using SSBCI funds matched by CDFI and/or other investor funds. Alternatively, a tribe can lend SSBCI funds to CDFIs either directly from the tribe or through the tribe's lending network. In either event, the CDFI can then use the SSBCI funds to make loans to small businesses.

Collateral Support

Program funds are used to provide additional "cash collateral" for borrowers when the lender requires collateral to secure a loan, but the borrower lacks sufficient collateral. This kind of program can be especially helpful for tribal members who live on trust lands and cannot mortgage their house or other collateral.

Venture Capital Support

This program is primarily an equity investment program, using SSBCI funds to provide an equity investment in eligible small businesses. The investment program can be run directly by the tribe or a third-party investment fund. While the typical goal of VCP programs is to provide needed financing for start-up or early-stage businesses, investments can also be made in mature businesses for expansion or asset acquisitions.

Models for CDFI Participation/ Programs

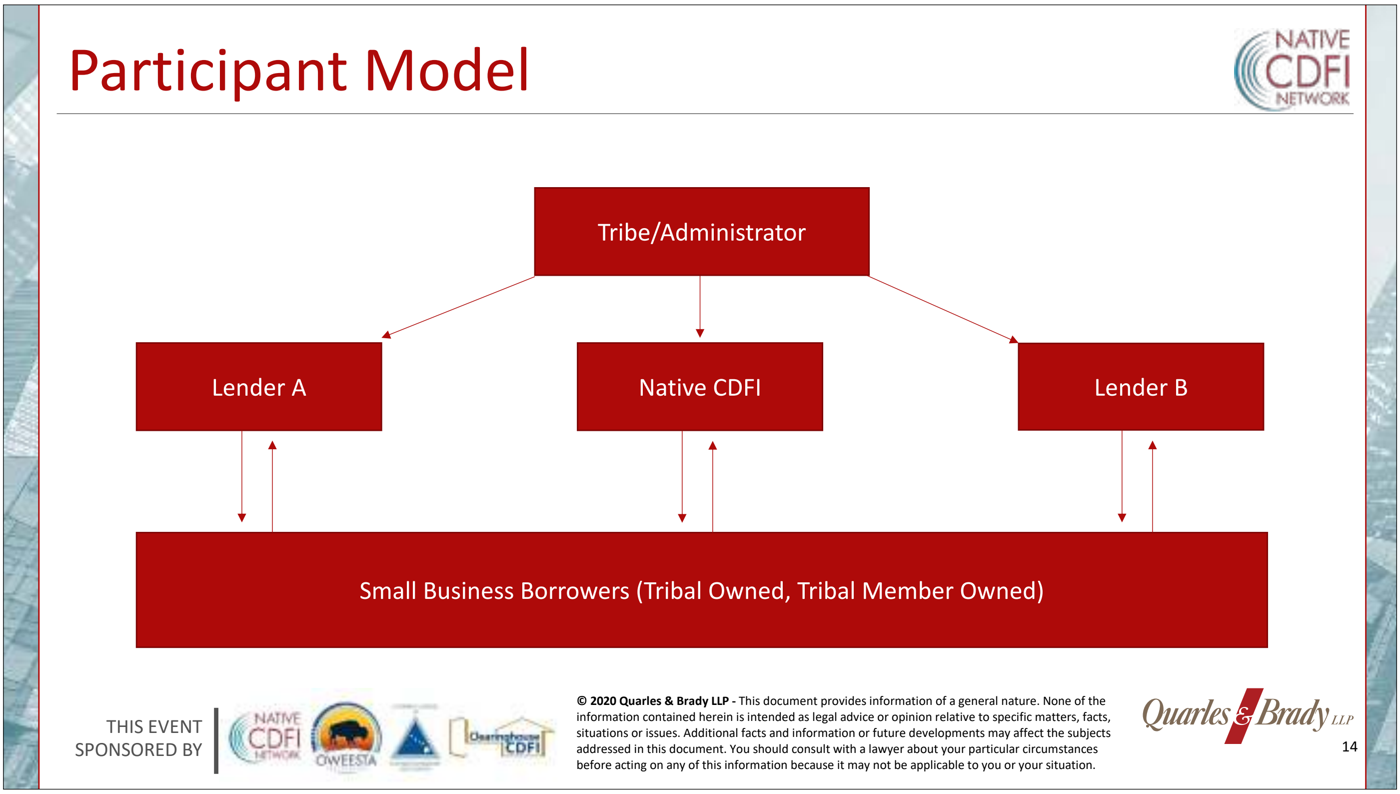
There are several models implemented by the states that involved CDFIs in the state's SSBCI programs. These models, described below, provide examples and road maps for how Native CDFIs can partner with tribes to implement tribal SSBCI programs.

MODEL #1:
Participant - Lender, Investor, Borrower

Participating in any of these roles will give a Native CDFI the ability to expand its small business loan program to more small businesses or to increase loan sizes to small business borrowers.

1. Lender[4]: The Native CDFI can serve as a lender in a tribe (or tribes) network for loan credit support programs (guarantees, collateral, participation). The Native CDFI would participate just as any other lender enrolled in the tribe's SSBCI program.

[4] Alabama's loan guarantee program included CDFIs as eligible lenders.



The Native CDFI must also be able to show that it has sufficient lending experience and the financial and managerial capacity to participate. The Native CDFI also has to have a "meaningful amount" of capital at risk – which the guidance quantifies as at least 20% or more of the risk of loan loss. As the lender, though, the CDFI may have to comply with the tribe's program design, including any limitations on borrowers, loan size, interest rates, fees, and uses. However, many states created programs that deferred to the lender (i.e., the lender used standard underwriting and loan products) on loan types, amounts, etc., but the credit support program may have been used to buy up loan amounts (allowing for higher amounts) or lower interest rates. The Native CDFI will also have to assure the tribe that its loans and borrowers comply with statutory limitations and Treasury's policy guidance, as well as the tribe's representations required under the Allocation Agreement.[5]

If a CDFI is interested in participating as a lender, then the key agreements that need to be negotiated are loan guarantee agreements and/or loan participation agreements.

2. Investor: Some Native CDFIs can make equity investments in small businesses. If an existing program is in place, SSBCI funds can be leveraged to expand the equity investment amount. This program can also give needed flexibility to the tribe's SSBCI programs, by expanding the types of small businesses that get support and allowing for increased investment in small businesses through combined loan and equity investment products to support start-up or business expansion. If the Native CDFI wants to participate as an equity investor, then it must be able to show sufficient equity investment experience and have the financial and managerial capacity to participate. In addition, the Native CDFI must have its own capital at risk. Furthermore, to participate as an equity investor, the Native CDFI must structure its investment fund to meet the definition of a "venture capital fund" under SEC regulations.

If a CDFI is interested in participating as an investor or fund manager, then the key agreements that need to be negotiated will depend on how the investment fund is structured – for example, as a General Partner/Limited Partnership or as a Limited Liability Company.

3. Borrower[6]: A Native CDFI that itself needs additional capital for its small business lending

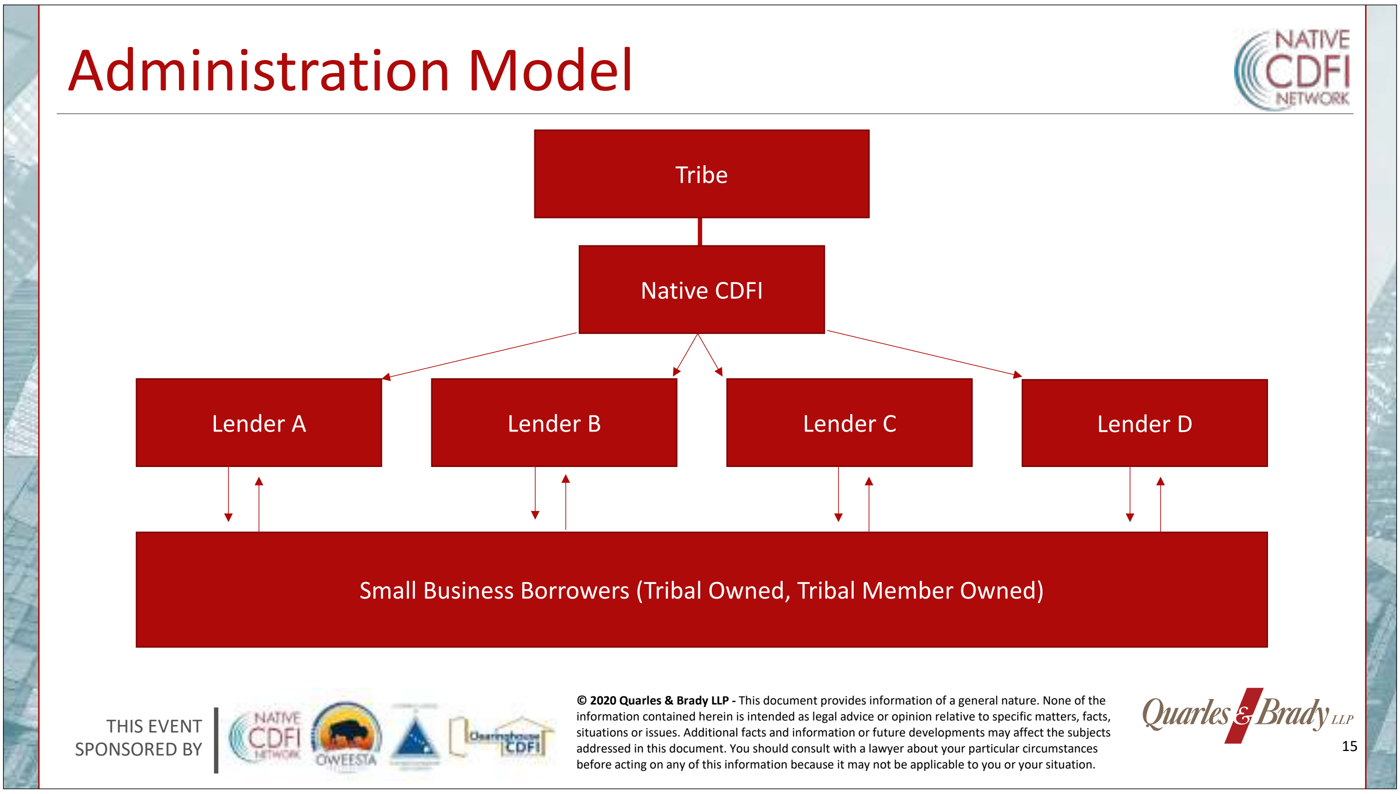
[5] Treasury has not yet published the updated version of the Allocation Agreement. In the previous version of the Allocation Agreement, Article 4 covers all the representations the tribe must make to Treasury regarding its OCSP programs.

[6] For example, in Minnesota, one aspect of the SSBCI program was to provide a zero-interest loan to several CDFIs that in turn created a revolving loan fund to make loans to small businesses.

programs can be a borrower. The tribe, or a lender, can make the loan directly to the Native CDFI under the tribe's SSBCI program. If the tribe makes the loan, it can do so interest free. This loan can then be used to re-lend to small businesses. For non-depository Native CDFIs, this could be another way to raise capital. For many Native CDFIs, this can also provide for lower cost capital.

Some states even allowed the CDFI to retain the loan capital (through a loan forgiveness or conversion to a grant), to promote future lending activities for the CDFI.

If a CDFI is interested in participating as a borrower, then the key agreement that needs to be negotiated is a loan agreement.



MODEL #2:
Administrator - Lending Programs

Several states used CDFIs to administer the state SSBCI loan credit support programs. Tribes can also contract with a Native CDFI to administer its loan credit support programs. This option provides several benefits to both the tribe and the CDFI. For example, many tribes do not have the required experience, capacity, or financial infrastructure to directly administer credit support programs. Furthermore, tribes can expand the reach of its SSBCI programs outside its immediate reservation area or outside its state. In addition, some examples of how Native CDFIs can administer a tribe's programs include:

1. Direct Loan Programs[7]: The Native CDFI could contract with the tribe to administer a direct loan program. The Native CDFI would create a separate loan fund, using SSBCI funds and the Native CDFIs own capital (remember, we need a minimum of 1:1). The Native CDFI can also combine other outside capital (such as charitable foundation or other outside partner investments) to fund the direct loan program. This can also be administered as a loan participation program. The Native CDFI would be responsible to underwrite, originate, and service the loans, but the tribe could set the loan parameters (i.e., loan size, target businesses) or defer to the Native CDFI. The Native CDFI would retain the repaid funds to continue to relend. The direct loan program must still comply with all SSBCI Treasury guidance, such as limitations on eligible uses, eligible borrowers, interest rates, and fees.

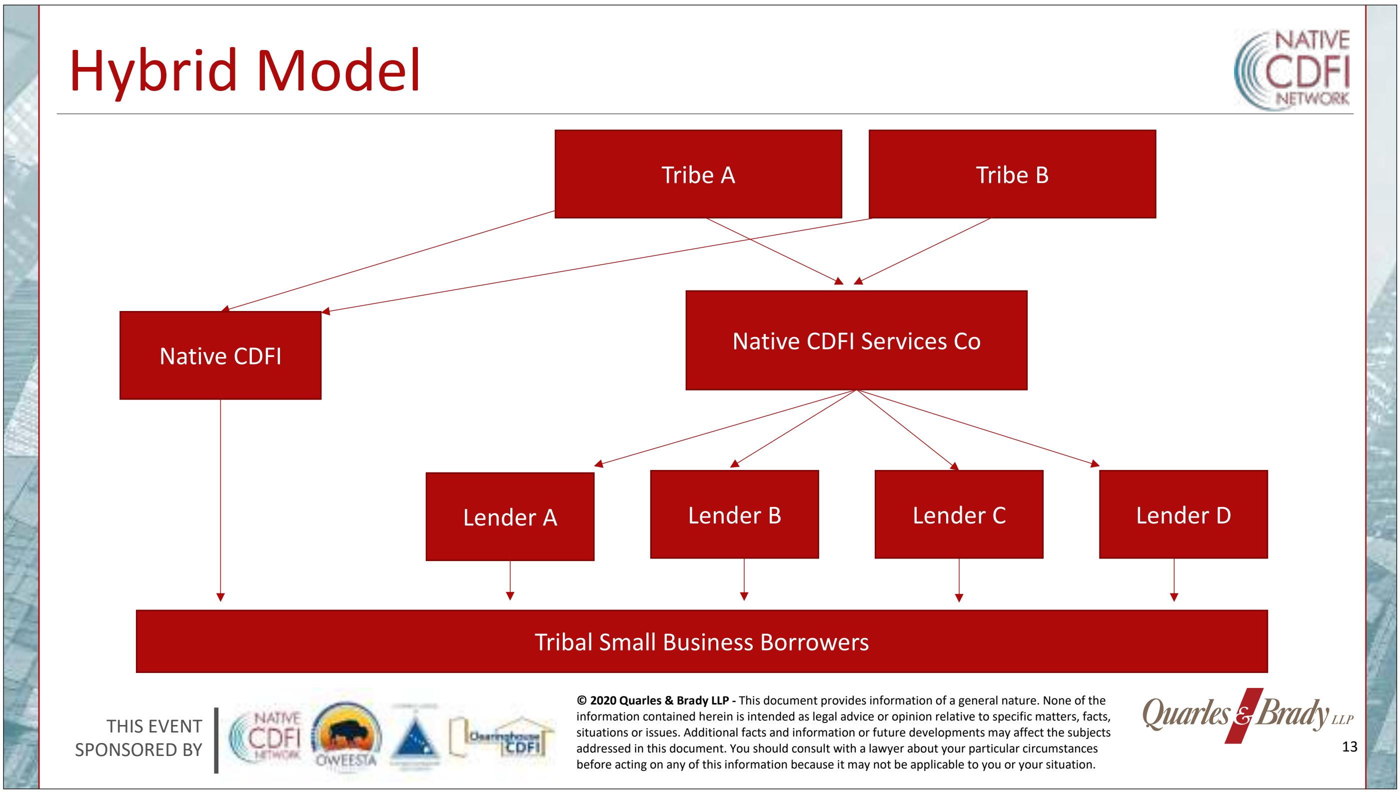
2. Loan Participation[8]: The Native CDFI can contract with the tribe to administer a loan participation program. The Native CDFI would

[7] The following states implemented this program: Washington, Minnesota, Georgia, Montana, and Pennsylvania.
[8] The following states implemented this program: Georgia and North Carolina.

establish relationships and loan participation agreements with other lenders (such as a bank, credit union, or other CDFI). The Native CDFI would then provide a companion loan or purchase a portion of the loan – using SSBCI funds – in conjunction with another lender's loan for a small business. As with the direct loan program, the tribe can still set loan parameters. But the lenders would be responsible for underwriting and servicing the loans. The Native CDFI would retain the repaid funds to continue to relend. The loan participation program must still comply with all SSBCI Treasury guidance.

3. Loan Guarantee: The Native CDFI can contract with the tribe to administer a loan guarantee program. The Native CDFI would establish relationships and loan guarantee agreements with other lenders with service areas both within and outside of the CDFI investment area. Upon receipt of a loan guarantee application from a lender, the Native CDFI would process the loan guarantee – ensuring the loan meets the tribe's program requirements and Treasury policy guidance – and the Native CDFI would charge a loan guarantee fee to cover its costs. The Native CDFI would receive the allocation of SSBCI funds for the loan guarantee amount, which would be utilized if the event of a loan loss. At the end of the program, the Native CDFI could retain any unused funds as unrestricted capital for future lending programs.

4. Administration Responsibilities: Regardless of the type of credit support program(s) a Native CDFI administers, it must show that it can meet the statutory and policy guidance requirements for operational, financial, managerial, and capacity capabilities. In addition, the Native CDFI should be prepared to assist the tribe with, among other things, marketing the program to small businesses, identifying and implementing the lender network, tracking loans and monitoring loan performance, and reporting SSBCI program results.



MODEL #3:
Hybrid – Participant and Administrator

Native CDFIs, like other CDFIs, could also play a dual role of participant and administrator. For example, the Native CDFI could participate as a lender (or borrower) to enroll in a tribal (or state) SSBCI credit support program for loans it makes to small businesses within the Native CDFI investment area. The Native CDFI could also administer a tribe's credit support program for tribal member-owned small businesses outside the Native CDFI investment area. If a Native CDFI seeks to participate in these dual roles, then it will be important to have the necessary operational, financial, accounting, and other safeguards to ensure the programs are separate.

The split between these roles can be based on relative capacities and program design. For example, if the tribe wants to extend the SSBCI program both on and off the reservation, or both within and outside its state, then leveraging a CDFI to make loans on or near the reservation while administering the program outside the CDFIs investment area may be an efficient way for the tribe to expand its program to small businesses.

MODEL #4:
Private Leverage, Incubator/Accelerator, Technical Assistance

Given the complexity of many of the SSBCI programs, as well as the lack of experience in Indian Country with the SSBCI and other credit support programs, Native CDFIs and tribes might want to strongly consider establishing partnerships with other private sector or non-profit entities to promote the SSBCI programs and support successful outcomes. Some examples of potential partnerships include (but are not limited to):

- Working with larger CDFIs, non-profit CDFI lenders, non-profit foundations, or tribal enterprises to raise additional "private investment" capital to support participation in a tribal SSBCI program. This might be more helpful for a smaller Native CDFI that doesn't have much capital to deploy but has identified a great need or demand for small business loans.
- Creating a joint program with a local or national entity that runs incubator or accelerator programs for start-up businesses. This program would combine training and technical assistance to small businesses, with access to capital – whether loans or equity investment – to start up or expand smallbusinesses. The tribe can allocate its SSBCI funds to the accelerator program investment manager (for equity investments) and to the Native CDFI for the loan programs. This could be developed as participation or administration.
- Partner with a local small business training program (through chamber of commerce, incubator, or tribal program) to provide technical assistance to small businesses who are interested in accessing an SSBCI credit support program. The Native CDFI could apply for a grant directly from Treasury to finance this technical assistance program.

Key Considerations for CDFI Participation

Any Native CDFI that wants to participate in any role in a tribal (or state) SSBCI program will have to demonstrate that it has the experience, capacity, and capital to participate. It must be able to meet the statutory and policy guidance requirements if it's going to administer SSBCI programs on behalf of a tribe. Furthermore, for smaller Native CDFIs that want to participate as lenders, they must be able to put their own resources at risk – at least 20% of the loan. If the Native CDFI lacks sufficient capital, it might consider raising additional capital, structuring its participation as a borrower – and then relending the funds – or participating as an administrator of a direct lending program.

Native CDFIs should also evaluate its business structure to determine if there are additional business models it should deploy to participate in a tribe's SSBCI program. For example, the Native CDFI may want to create a new company – using an SSBCI investment, its own capital, and outside raised capital – that will actually administer a tribal SSBCI program.[9] This might be useful to mitigate risk to the Native CDFI and the tribe.

Potential Next Steps

Program Design

One key opportunity that a Native CDFI has is working with the tribe to jointly design programs. If a Native CDFI already has loan products in place that could be built upon using SSBCI funds, then the Native CDFI might consider drafting a proposed program design for the tribe to review

[9] For example, Craft3, a CDFI in Washington, created a new business structure for its direct loan program. See Opportunity Finance Network: SSBCI Presentation, https://ofn.org/sites/default/files/resources/PDFs/Presentations/SBFF2014/SSBCI.pdf.

and consider. This information is a required component of the SSBCI application.[10] Some key attributes of loan credit support programs include:

- Lending experience, underwriting infrastructure
- Loan terms (size, use, rate, length)
- Sound underwriting standards
- Flexible guarantee/participation percentage
- Qualified lender network: Banks, CDFIs, Credit Unions
- Broad or targeted small business borrowers
- Compliance, data gathering, reporting

Tribal Sponsor Support

Only tribes can apply for the SSBCI program. Thus, if a Native CDFI wants to serve as an administrator for a tribe's (or tribes') program, the Native CDFI must work with the tribe BEFORE the application is filed to be listed as a "contracting entity" on the application.[11]

Program Agreements

There will be several program-related agreements to execute to implement SSBCI programs between tribes and Native CDFIs.[12] Those agreements will likely include:

- Loan Agreement for relending programs (between tribe and CDFI) – this agreement is relevant if the tribe decides to loan its SSBCI funds to a CDFI for a relending program (III.A.2)
- Contract to Administer SSBCI Program (between tribe and CDFI) – this agreement is relevant if the tribe decides to contract with a CDFI to administer any SSBCI programs (III.B)
- Loan Guarantee Agreement (between CDFI (as administrator) and lenders, or between tribe and CDFI) – this agreement is relevant if the tribe creates a loan guarantee program with SSBCI funds. If the CDFI is a lender, the agreement is between the tribe and the CDFI (III.A.1). If the CDFI is the administrator, then the agreement will likely be between the CDFI and lender.
- Loan Participation Agreement (between CDFI (as administrator) and lenders or between tribe and CDFI) – this agreement is relevant if the tribe creates a loan participation program with SSBCI funds. If the CDFI is a lender, the agreement is between the tribe and the CDFI (III.A.1). If the CDFI is the administrator, then the agreement will likely be between the CDFI and lender.
- Investment Agreement (between CDFI and outside investors) – this agreement is relevant if the CDFI as administrator seeks outside investors to participate in a loan fund that will fund small business loans.

Resources and References

For additional information on CDFI participation in SSBCI programs, please refer to the following:

Best Practices from Participating States: Partnering with CDFIs

https://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI%20CDFI%20Paper%202-27-15%20-%20final.pdf

Opportunity Finance Network: SSBCI Presentation

https://ofn.org/sites/default/files/resources/PDFs/Presentations/SBFF2014/SSBCI.pdf

Opportunity Finance Network: CDFI and SSBCI Status Report (Mar. 2013)

https://cdn.ofn.org/s3fs-public/OFNInterimStatusReportonCDFIsandtheStateSmallBusinessCreditInitiative.pdf

[10] See Section 8.1B for the complete list of information needed for each OCSP program: https://home.treasury.gov/system/files/256/2021-State-Small-Business-Credit-Initiative-Application-Instructions.pdf.

[11] See Section 5.2 of the SSBCI application.

[12] Consult with your legal counsel regarding the terms and conditions of these agreements. Some agreements are publicly available.