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Insurers Investing in California Communities
By Daniel Sheehy, President and CEO

Introduction

Impact Community Capital is a newly formed business enterprise whose purpose is to facilitate, indeed be an advocate for, insurance industry investments in California, especially in low-income and middle-income communities. The model we have created in Impact Community Capital will prove to be an extremely successful vehicle for making innovative, effective and sound investments in all of California's diverse communities.

As you may be aware, the insurance industry has come under increasing pressure in California and elsewhere to increase the investments it makes in under-served communities. These pressures have taken the form of legislative proposals that would require or mandate investments in economically targeted communities.

The insurance industry already makes substantial investments in California's communities and these investments are vital to this state and its residents. However, regulations that limit the kind of acceptable investments insurers can make often inhibit what individual companies can do. Those obstacles cannot be overcome by mandatory investments. In fact, mandates in this area are counter productive. Because Impact is voluntary and tailored to suit the circumstances of California's insurers, I believe it is a far superior approach than legislation requiring economically targeted investments.

That is why Impact was formed. It is the insurance industry's focused, encompassing solution to achieving the economic benefits of increased investments in low-income and middle-income communities

Background

My initial experience in this area began when I held several positions at the Federal Reserve Bank of New York and the Fed's Board of Governors in Washington, D.C. I later served as an executive vice president of a major commercial bank and as a general partner in a major Wall Street investment banking and securities trading firm.

From 1987 until 1997, I was Senior Vice President of the State of New York Mortgage Agency, commonly known as SONY MA. SONY MA is one of the nation's largest originators of residential mortgages for affordable housing with a portfolio in excess of $4 billion. At SONY MA, I managed the Mortgage Insurance Fund and developed it into a highly rated mortgage insurer and credit enhancer with an insurance portfolio of more than $2.5 billion of community development type mortgage loans. It is the largest and most successful entity of its kind in the country.
I have served as a financial advisor to the Florida Housing Finance Corporation and the Housing Finance Authority of Hillsborough County, Florida. And I have been involved in two consulting firms that have provided advisory and consulting services in the area of housing finance programs and credit enhancement structures to state and local governments throughout the United States, in Guam, and the Caribbean.

Current Obstacles to Community Investments

On a drive through any major city or Central Valley farm community in California, one is struck by the significant need for investment in affordable and special needs housing, health and child care centers for low or moderate income families, community facilities and small business development.

California's insurers have amply demonstrated a willingness and commitment to invest in California communities when those investments meet their unique investment needs. Insurance companies currently invest billions of dollars in municipal bonds that are used to build housing, infrastructure, schools and a wide range of other public purpose projects. Why? Because municipal bonds are properly structured securities, many of which have been rated by one or more of the nationally recognized credit rating agencies; they are generally liquid investments which can be bought and sold in the capital markets, and are issued and traded in denominations large enough to be economically and efficiently handled by institutional investors like insurers.

Insurance and pension fund investments are closely regulated. Insurers must be responsive to regulators, their policyholders and their owners. Some of the socially targeted investments that insurers are being encouraged to make frequently are not appropriate or acceptable because they are individually too small, they do not merit an investment grade rating from a nationally recognized credit rating agency, the transactions are often idiosyncratic and structured in widely varying ways, and, frankly, often are too risky on their own to meet prudent investor requirements.

These are the primary conditions that have inhibited insurers from playing a larger role in community investment activity in California.

Impact Community Capital

Impact Community Capital can and will help insurers become willing, indeed enthusiastic, partners in the revitalization of California's under-served communities.

In short, Impact will purchase loans that have been originated by banks, non-profit organizations like the California Community Reinvestment Corporation, and other community development lenders. Impact will package these loans into pools, and then present each loan pool to one or more of the credit rating agencies for an investment grade rating. We do not expect the entire portfolio will be ratable. In fact, we are confident some of the loans simply will be too risky or non-productive to be rated. But we will seek, and I am confident we will receive, ratings for the portions of the loan portfolios we purchase.

Impact will securitize both the rated and unrated portions of the pool, and sell the investment grade rated securities to our insurer investors. In this manner, we will provide to those investors the critical mass, the structure, the stability, the liquidity and the return they need to make these investments. With the proceeds of loans from its investor members, Impact will purchase, and hold for its own account, the unrated portion of each pool.

By providing a successful, properly structured secondary market for community investment loans, Impact's investment approach will facilitate recycling of the originating lenders' capital back into the communities.

This structure is not merely a theory or plan. Impact currently is in the process of finalizing an initial $40 million transaction with the California Community Reinvestment Corporation. Impact is purchasing 12 loans; the proceeds of these loans were used to build more than 1,500 units of affordable rental housing throughout California. And, I am pleased to report, we have received a rating from Standard and Poor's for a significant portion of those loans.

Benefits of an Impact Investment Program

Impact Community Capital represents a voluntary, market-driven approach to community investing. This approach offers a much better, and ultimately more successful, solution to community investment than a government mandated approach. Why do I feel this way? For two reasons.

First, my experience for the past 15 years has been creating and managing investment grade rated community investment pools acceptable to large institutional investors. That experience has proven to me that with the right approach, the right expertise and depth of commitment, these investments can be made in such a way that provide real, permanent benefits to the communities they serve at the same time they provide the stability, structure and return required by institutional investors. This is not a hypothetical or speculative opinion. It works. I have seen it work. Indeed, I have made it work. And when it works, these market-based investments provide the long-term economic stimuli that ignite real and permanent community revitalization.

Impact will make investments in such a way that they will be not only palatable, but attractive, to insurance industry investment managers.

Conclusion

As you can see, I am extremely excited about this effort. Nothing like Impact has ever before been attempted. California insurers have the opportunity in Impact to lead the way to creative, successful solutions to financing significant social and economic needs.

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