

**THE SILENT PARTNER:
THE INSURANCE INDUSTRY'S POTENTIAL
FOR COMMUNITY REINVESTMENT**

BY

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EXECUTIVE SUMMARY

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Consumers think of the insurance industry primarily as a provider of life, health, property and casualty insurance. They rarely perceive the industry as one of the top five sources of investment capital in the U.S. As an investor, the industry has tended not to be a retail lender like banks and thrifts but has focused instead on individual investments of greater than a million dollars. Consequently, the insurance industry has not been a major investor in difficult-to-serve markets, such as low- and moderate-income communities.

There is growing discussion of the need to require insurance companies to join banks and thrifts in reinvesting a portion of the premiums they collect in rural areas, low- and moderate-income urban communities and from small businesses to address the development needs of these communities. There are four compelling reasons why the insurance industry should reinvest in such communities:

- o Reinvesting in credit needy markets, be they low-income rural or urban communities, family farms or small businesses, is, and has been demonstrated over time to be, good business.
- o The insurance industry collects premiums from every market within every state, including low-income home and auto owners, family farmers and small business people. Because premiums are collected from such a broad base, the industry has an affirmative responsibility to help meet the investment needs of all of those markets, even the more difficult ones.
- o The insurance industry has been the beneficiary of a number of favorable regulatory considerations--first among them an exemption from anti-trust laws and federal regulation. Public privileges like these create public responsibilities like that of reinvestment.
- o Finally, the insurance industry is increasingly in direct competition with the banking industry to provide financial services. Since they are now competitors, it is only fair that insurance companies be held to similar standards of community reinvestment as banks and thrifts.

Although not required by law to do so, some insurers already sponsor community reinvestment programs. Reinvestment by the insurance industry, however, is uneven. It is concentrated among large companies with little participation by the majority of the industry--smaller and medium-sized insurers. Similarly, life/health insurers are more likely to make community invest-

ments than are property/casualty companies. Finally, investments tend to be made in urban rather than rural areas.

The Silent Partner makes the case for increased community reinvestment by the insurance industry. It traces the reinvestment history of the industry and documents the successes and shortcomings in this history. A series of recommendations for increasing reinvestment by the insurance industry are proposed. The key recommendations are as follows:

Change Industry Practices

- o Sponsor a new community investment program on the scale of the Two Billion Dollar Program supported by both sectors of the insurance industry.
- o Encourage major insurers to alter their practices and make investments of less than \$1 million to enable smaller community developers or intermediaries to take advantage of this potential source of capital.
- o Encourage insurance companies with retail lending subsidiaries to translate the company's reinvestment policies into actual community development loans made by their subsidiaries.

Enhance Reinvestment Opportunities

- o Speed up efforts to expand the secondary markets of the Local Initiatives Managed Assets Corporation (LIMAC) and Neighborhood Housing Services of America (NHSA) and to make their securities eligible for trading on the major public exchanges.
- o Reexamine existing incentive programs to maximize their value to foster reinvestment, i.e., the Federal Home Loan Bank Cash Advance Window.
- o Create new government subsidies and support programs necessary to make a broader range of community reinvestment activities feasible for private investment.

Improve Insurance Regulation

- o Extend the low-income housing tax credit.
- o Reclassify community development loans as "admitted" assets if they can be resold on a secondary market.
- o Enact state Insurance Community Reinvestment Acts thereby clearly establishing an ongoing, direct and affirmative responsibility on the part of the insurance industry to reinvest in the disinvested communities and markets of the state.

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I. THE INSURANCE INDUSTRY--A TRILLION DOLLAR GIANT

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The insurance industry in the United States is a financial giant. Controlling \$1.5 trillion in financial assets in 1987, the insurance industry is second only to commercial banking in the dollars that it controls and invests.¹ In 1987 alone, the approximately 6,100 insurance companies operating in the U.S. collected over \$406 billion in premiums from individuals and businesses.²

Consumers think of the insurance industry primarily as a provider of protection against accidents and ill health, and as a provider of financial benefits at death. However, while insurance companies are not retail lenders like commercial banks or savings and loan associations, the insurance industry is one of the major sources of capital for investment in the U.S. economy.

Many of the skyscrapers which dominate the skylines of America's large cities are financed by insurance companies. The insurance industry pours hundreds of millions of dollars into the nation's housing and commercial real estate markets, both through direct investments and through subsidiaries that supply both debt and equity capital. In addition, a large portion of the long-term debt of the nation's corporations is financed by the insurance industry, and billions of dollars are invested by life insurance companies in local, state, and federal government bond offerings. Recently, through foreclosures resulting from the crisis in the farm economy, the insurance industry has become one of the largest holders of farm land in the country.

Clearly, insurance industry investments are big business. Collectively, insurance companies made \$134 billion in new investments in the U.S. economy in 1987, ranking behind commercial banks, federal loan agencies and foreign investors, but far ahead of savings and loan associations, individuals, government pension funds and all other sources.³

Despite their large capital base and role as a major provider of investment capital in the United States, the insurance industry has not been a major investor in difficult-to-serve markets. Large insurance companies, where much of the industry's assets are concentrated, prefer individual investments of greater than a million dollars. Consequently, except for a handful of companies with special programs, few companies have made the credit needs of individuals, families and small businesses a part of their investment strategies.

In 1977, Congress recognized the critical importance of credit in maintaining quality housing and a thriving community economy when it passed the Community Reinvestment Act (CRA).

The CRA established as a national law the responsibility of banks and savings and loan associations to reinvest in local communities, particularly low- and moderate-income communities. Community reinvestment lending provides individuals and families with the credit necessary to purchase and sell homes, to operate family farms and rehabilitate older apartment buildings. These loans can be made directly to individuals or families; in partnership with community-based development organizations; through pooled funds or bank community development corporations; or via lending intermediaries such as community loan funds, micro loan programs, credit unions and/or development banks.

Banks and savings institutions are granted charters by government to serve the deposit and credit needs of the communities in which they are chartered. The CRA reaffirms their continuing and affirmative responsibility to meet these needs. The obligation to reinvest follows from the special privileges provided by the public sector including deposit insurance and special borrowing privileges such as the Federal Reserve discount window and advances from the Federal Home Loan Bank (FHLB).

In contrast, the insurance industry, which also enjoys special privileges such as exemption from federal regulation and ability to use the FHLB cash advance, is not subject to similar federal legislation mandating a responsibility to reinvest in the communities where it does business. Therefore, with some notable exceptions, the record of the insurance industry investing in low- and moderate-income communities has been minimal, uneven and concentrated among a few large companies.

Rationale for Community Reinvestment by the Insurance Industry

There is growing discussion of the need to require the insurance industry to join banks and thrifts in reinvesting a portion of the premiums they collect in rural areas, low- and moderate-income urban communities and from small businesses to address the development needs of these communities. This discussion is fueled by the growing problems of urban and rural disinvestment, problems which have been exacerbated by financial deregulation and by the declining availability of federal funds for housing and economic development.

The insurance industry has demonstrated that it can be a very important, silent partner in the business of community development. The role that the industry has played to date could be significantly expanded, if more resources were dedicated to reinvestment.

There are four compelling reasons for the insurance industry to reinvest in America's low- and moderate-income, urban and rural communities:

Reinvesting in credit needy markets, be they low-income rural or urban communities, family farms or small businesses, is, and has been demonstrated over time to be, good business. The jobs and affordable housing created by this type of investment help to improve living standards. This reduces the risks to both health and property for those living in depressed communities.

Furthermore, the experience with community development lending demonstrates that they can be both sound and profitable. In fact, defaults and delinquencies in community lending programs have been remarkably low.

The insurance industry collects premiums from every market within every state, including low-income home and auto owners, family farmers and small businesses. In 1987, premium receipts for life and property/casualty insurance policies alone totaled almost \$406 billion for the 50 states and the District of Columbia. Because insurance premiums are collected from such a broad base, the insurance industry has an affirmative responsibility and a financial self interest to assist in meeting the investment needs of all of those markets, even the more difficult ones.

The insurance industry has been the beneficiary of a number of favorable regulatory considerations--first among them an exemption from anti-trust laws and federal regulation. No other major industry involved in interstate commerce in the U.S. enjoys similar treatment. Public privileges like these create public responsibilities, such as the responsibility to reinvest some portion of the premiums collected within a state in such a way that they benefit all of the state.

Insurance companies that show a commitment to housing finance are also eligible for membership in Federal Home Loan (FHL) Banks. As members, they can take advantage of the FHL Bank's cash advance window.

Finally, the insurance industry is increasingly in direct competition with the banking industry to provide financial services. Like many banks, savings and loan associations, and securities firms, insurance companies have benefited from the deregulation of the banking business during the past ten years. In the deregulated financial services industry, competition is intense between different financial service providers. Since they are now competitors, it is only fair that insurance companies be held to similar standards of community reinvestment as banks and thrifts are. There should be a "level playing field."

The Need for Community Reinvestment

The massive changes in the financial services industry in the last ten years have broken down the traditional differences in the services provided and the markets served by banks, savings and loans, insurance companies, securities firms, retail corporations, and mortgage bankers. Even the distinctions between these different types of financial institutions are disappearing as the laws and regulations differentiating them change and multiple subsidiaries of the same "megafinancial" holding company provide different financial services.

Some insurance companies now function as the provider of just one of many financial services offered by major "mega-financial" firms attempting to establish "financial services supermarkets," where services can be cross-sold. The most visible example of this is the Allstate insurance company which as a subsidiary of Sears, works in cooperation with the Dean-Witter investment company subsidiary, the Discover credit card subsidiary, and the Sears Bank.

Other insurers have moved to become "megafinancial" corporations themselves. Prudential Insurance, for example, now offers much more than life and health insurance. Prudential sells securities through Prudential-Bache Securities, Inc., a brokerage firm; sells home mortgages by telephone through Prudential Home Mortgage Company; manages farm properties through Northern Trust Agricultural Services; offers comprehensive health care services through HMO Prucare; and offers multiple forms of business financing through a number of finance companies. The move of insurance companies to become "megafinancial" corporations is perhaps best symbolized by the name change of the Kemper Insurance Company to Kemper Financial Services in the 1970s.

Unfortunately, this deregulated environment has ignored the needs of many communities, businesses, and individuals. Increased competition has meant that financial services providers have targeted the more profitable "up-scale" markets, both individual and corporate. Investors pursue large, cost-effective investments. Standardized minimum loan criteria are set in far-off board rooms. This has meant that smaller, less established, and nonstandard borrowers--both individual and business--find credit difficult to obtain, regardless of their personal credit history. Those markets that are perceived as less profitable and more risky, low- and moderate-income communities, rural areas, and small businesses do not find investment dollars as plentiful or as well matched to their needs.

It is increasingly evident that urban and rural community revitalization must proceed from deliberate partnerships between

the private, public and community sectors, working together, performing the roles each does best. The Silent Partner discusses the role the insurance industry has played in community development partnerships and urges an expansion of that role.

This publication begins by describing the salient features of the insurance industry and its investments. It traces the recent history of reinvestment efforts by the insurance industry itself and by community advocates outside of the industry. It examines insurance reinvestment programs and draws conclusions about the lessons learned from the past 20 years of reinvestment efforts by individual companies.

A range of options for increasing reinvestment by both the life and property/casualty sectors of the insurance industry are recommended in the final chapter. Among these are: acknowledgement of some community development investments as admitted assets; creating a secondary market for community development investments; and the enactment of state-level Insurance Community Reinvestment Acts, which would establish the legal responsibility of insurers to invest in those communities in which they do business.

The Silent Partner concludes with an appendix that contains five case studies highlighting alternative models for insurance industry reinvestment. The studies include examples of company programs operated in partnership with community-based organizations, lending intermediaries used by insurance companies and a state-stimulated company capitalized and operated by insurance companies.

As America looks forward to the 21st Century, it is important to build a country where citizens can live in quality, affordable housing, hold decent jobs and belong to thriving communities. The fundamental changes which have occurred and which are occurring in the financial services industry are leaving many businesses, individuals, and communities behind, unable to participate in the economic life of this nation. The recommendations of this publication are intended to address these problems, and to forge profitable and mutually beneficial partnerships between the insurance industry and the communities left out of the benefits of the great "Financial Services Revolution."

II. THE U.S. INSURANCE INDUSTRY AS AN INVESTOR

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While the consumer issues of insurance company rates and profits have received much attention in the last two or three years, less attention has been paid to the role of the industry as a major source of capital in our national economy. This is largely due to the fact that insurance companies are not retail lenders. When insurance companies invest in home mortgages, for example, they do not lend directly to individuals, rather, they invest large blocks of funds. They do so by purchasing mortgage-backed securities or through investments in their mortgage banking subsidiaries.

The role of the insurance industry as a major source of investment capital in the nation's economy must be understood before proposals designed to foster insurance industry investment in disinvested communities can be developed. Three fundamental aspects of the insurance industry are critical to this understanding: 1) the differences between the two segments of the insurance industry: life/health and property/casualty insurers; 2) the domination of the industry by a small number of large companies; and 3) the state-level character of insurance regulation.

A Tale of Two Industries

The life/health and the property/casualty segments of the insurance industry in the United States provide very different types of insurance protection. While there has been some "cross-over" among the largest companies, the business of providing life/health and property/casualty coverage traditionally has been segregated in different companies that join different trade associations and follow different investment strategies.

Both life/health and property/casualty companies sell insurance and collect premiums which serve as their income base. In addition, the income generated by investments is very critical to both sectors of the insurance industry. In 1987, investment income for the life insurance sector was \$83 billion, or 26% of its total income. Investment income for property/casualty insurers was \$24 billion. This represents more than 11% of the industry's income.⁴

Although there are 68% more property and casualty companies in the U.S. than life insurance companies, life insurance companies control two and a half times the capital assets that property and casualty companies control. As can be seen in Chart 1, the 3,799 property and casualty insurers collectively control \$427 billion in assets. This compares with a total of

\$1,044 billion controlled by the 2,265 life insurers. (See Chart 1 below.)

CHART 1

NUMBER OF INSURANCE COMPANIES AND TOTAL ASSETS (1987)

	<u>Number of Companies</u>	<u>Total Assets</u>
Life Insurers	2,265	\$1,044 billion
Property and Casualty Insurers	3,799	\$ 427 billion
	<u>6,064</u>	<u>\$1,471 billion</u>

Sources: American Council of Life Insurers Fact Book, 1988 Update and Insurance Information Institute's Property/Casualty Factbook 1988-1989.

The investment strategies pursued by life/health insurance companies and property/casualty companies contrast sharply. Traditionally, life insurers have been a major source of long-term debt capital for U.S. corporations and a major source of financing for residential and commercial mortgages. Property/casualty companies, on the other hand, have invested heavily in shorter-term and more liquid investments. Property/casualty companies invest in such things as treasury bills, stocks, and securities that can be sold quickly on the secondary market.⁵ (See Chart 2 on Page 10.)

These different investment strategies stem in great part from differences in the nature of the business of the two major types of insurers. The life insurance industry, for example, can expect to take premium money in at a fairly constant rate over many years, through either pension plan or life insurance policy contributions. This money is usually paid out at a more-or-less predictable rate many years later, as the payees age and die. In the past, this led the life insurance industry to invest in long-term corporate bonds, and in commercial, residential, and farm mortgages. These investment vehicles were safe, long-term investments with a predictable return. The interest rate swings of the last several years and the dramatically increased competition in pension fund management, however, have stimulated a recent move by life insurance companies toward shorter-term and more speculative investments.

The property and casualty business, on the other hand, is much more short-term. Claim payments on property and casualty policies are unpredictable and virtually all are made within ten years of the payment on the policy. Therefore, the investments of property and casualty companies must remain liquid, that is, easily convertible to cash. Consequently, property/casualty companies are heavily invested in government securities which can quickly be resold as well as in common stocks and bonds that are easily traded on the stock exchange and the bond markets. The property and casualty sector of the insurance industry has almost no direct mortgage investments. Instead its mortgage investments are almost exclusively negotiable mortgage-backed government securities offered by such agencies as GNMA and FNMA.⁶

The short-term nature of the property/casualty investment portfolio hinders property and casualty companies from being very active in community reinvestment and development efforts as they are currently organized. Most housing and economic development projects require long-term investments. Because these investments can not be easily sold, both the insurance regulators and the insurance company rating agencies⁷ consider them to be "non-admitted" or "questionable" assets for a property and casualty company. This means that, like a car or a computer system, these investments might be worth something but can not be converted to cash quickly enough to be able to pay claims in an emergency.

When the regulators and rating agencies examine the solvency of property and casualty companies, they prepare ratios of cash and short-term assets to total assets. These types of ratios serve to discourage any long-term community development investments because these investments do not count towards the ratio. Community development efforts, however, do have short-term capital needs, such as bridge financing and construction financing, that match property and casualty insurers' interest in investing in short-term vehicles. Furthermore, secondary markets are being developed that will make it possible to easily buy and sell community development loans. Consequently, property/casualty companies could play an important role in community reinvestment programs if offered the right opportunity.

A Few Gullivers and Many Lilliputians

Another factor affecting the ability of the insurance industry to invest in economic development efforts is the domination of the industry by a small number of large companies. As illustrated in Chart 3, the ten largest life/health and property/casualty companies control 44% and 38% of the total assets of their respective industry segments. The concentration

CHART 2

INSURANCE INDUSTRY ASSETS BY TYPE, 1987
(IN MILLIONS)

Type of Asset	LIFE INSURANCE COMPANIES		PROPERTY/CASUALTY COMPANIES	
	Dollars	Percent of Total	Dollars	Percent of Total
Government Securities	\$151,436	14.5%	\$202,686,471	47.5%
Corp. Securities:				
Bonds	405,674	38.8%	50,309,802	11.7%
Common Stock	87,215	8.4%	38,135,660	8.9%
Preferred Stock	9,300	0.9%	8,749,204	2.1%
Mortgages	213,450	20.4%	4,917,944	1.2%
Real Estate	34,172	3.3%	972,147	0.2%
Policy Loans	53,626	5.1%	145,686	0.0%
Cash	4,891	0.5%	5,525,757	1.3%
All Other	84,695	8.1%	79,617,019	18.7%
Total	\$1,044,459	100.0%		
Premium Balances			35,650,857	8.4%

Sources: Best's Aggregates and Averages of Property/Casualty 1988/89
Best's Aggregates and Averages of Life Insurance 1988/89

of capital in the large insurance companies means that most of the nation's insurance companies are small by insurance industry standards.

In 1986, only 300 (or 13%) of the 2,250 life insurers would be considered large companies with assets of greater than \$300 million.⁸ In the property/casualty segment, size is most accurately reflected by the amount of policyholder surplus funds held by a company. (Policyholder surpluses are funds from premiums which are not required to be held in reserve for claims payouts). By this standard, only 184 (or 5%) of the 3,555 property/casualty insurers had policy holders' surpluses of more than \$100 million and, therefore, would be considered large companies by the industry.⁹

Because industry assets are concentrated among so few companies, the majority of insurance companies are small. Smaller companies pursue very conservative investment strategies and often contract out the management of their investment portfolios because they are too small to justify in-house investment managers. Small companies have the greatest difficulty evaluating the quality of investments in economic development projects.

An Uneven Playing Field

The investments of insurance companies, and almost all other aspects of their operations, are regulated at the state level. Unlike banks, savings and loan associations and securities firms, there is almost no federal level regulation for insurance companies. This state-level regulation is a prerogative fiercely guarded by the industry because it is easier to turn back unfavorable legislation at the state level than at the federal level. At the state level, the industry can mobilize national resources to defeat legislation, far outstripping the resources of local opponents and state legislators. Whereas at the federal level, the industry would face more formidable national opponents with comparable resources. Consequently, a level playing field does not exist for the insurance industry. Rather regulatory rules vary by state.

State level regulation has its roots in an 1850s Supreme Court decision which determined that insurance was not "commerce" and, therefore, not subject to federal regulation. This decision was overturned in the early 1940s, but was replaced by Congress in 1945 through the McCarran-Ferguson Act. McCarran-Ferguson not only gives states the right to continue regulating the insurance industry, but it also exempts insurance companies from anti-trust laws and, therefore, allows the industry to collaborate on setting insurance rates.

CHART 3

**10 Largest Life and 10 Largest Property and Casualty Co's
by Assets and Their % of Total Industry Assets, 1989**

LIFE INSURANCE COMPANIES X ***PROPERTY AND CASUALTY XX ****

	<u>Assets</u> <u>(\$)in 000's)</u>	<u>% of Total</u> <u>Industry Assets</u>		<u>Assets</u> <u>(\$ in 000's)</u>	<u>% of Total</u> <u>Industry Assets</u>
Prudential	\$108,815,241	10.4%	State Farm	\$ 32,045,604	7.5%
Metropol. Life	88,140,130	8.4	Aetna	19,344,098	4.5
Equitable	49,288,199	4.7	Allstate	16,544,363	3.9
Aetna	45,684,623	4.4	American Int'l	15,005,486	3.5
Teachers Life	33,210,367	3.2	Cigna	13,876,152	3.3
NY Life	31,843,651	3.0	Liberty Mutual	13,724,332	3.2
Travelers	28,595,491	2.7	Travelers	13,616,562	3.2
John Hancock	27,354,869	2.6	CNA	12,144,698	2.8
Connecticut Gen.	26,785,508	2.6	Hartford	12,127,744	2.8
Northwestern Mut.	22,602,895	2.2	Nationwide	11,779,657	2.8
Total Top 10	\$462,320,974	44.3%		\$160,208,696	38.0%

X Includes individual companies only

XX Includes all companies within corporate group

* Source: Bests Agents Guide to Life Insurance Companies 1988/89

** Source: Bests Aggregates & Averages: Property/Casualty 1988/89

Insurance companies are primarily regulated in the state in which they are domiciled, but they are also subject to the conditions for doing business set by other states within which they operate. The primary concern of regulators has traditionally been the solvency of the companies they regulate, that is, ensuring that adequate reserves exist to pay the claims of policy holders. Regulators are also responsible for protecting individual and institutional consumers from insurance fraud and abuse.

State level regulation means that some states have a regulatory climate more "favorable" than others. Several states, including Indiana, Iowa, Kansas, and Nebraska, have a reputation for having regulations that favor companies which are chartered in those states.

The nation's insurance commissioners have worked to develop uniformity in insurance regulation through the National Association of Insurance Commissioners (NAIC). When obliged to by the controversies of the day, the NAIC has established temporary committees to address consumer issues such as redlining and reinvestment.

The NAIC, however, is not structured as a consumer advocate. It is a completely voluntary association and serves only as a forum. It has no authority and its recommendations have no legal standing. It is funded by the contributions of member states through the Commissioner of Insurance. The presidency of the NAIC is rotated annually, giving little continuity in the organization's leadership. Moreover, the NAIC is strongly influenced by the insurance industry itself. The industry underwrites many of the costs of NAIC meetings and often provides the staffing and research needed by the NAIC committees.

State regulators are also greatly influenced by the industry. A 1979 General Accounting Office report to the Congress on the adequacy of state insurance regulation observed that "one-half of state insurance commissioners were previously employed by the insurance industry and roughly the same proportion joined the industry after leaving office."¹⁰

Finally, state regulation is hampered by a lack of resources. A recently completed study comparing 47 state insurance departments conducted by the National Association of Professional Insurance Agents and the Consumer Insurance Interest Group concluded that, "In most states, regulators lack the personnel and tools to properly fulfill their missions of providing adequate consumer protection and monitoring insurers for solvency."¹¹

Insurance - A Multifaceted Industry

Those seeking to foster reinvestment by the insurance industry in the disinvested communities and businesses of their state must understand the various facets of the industry. Two basic dichotomies characterize the industry. The first of these is its division into two key segments. While the life/health segment can invest in long-term projects, the property/casualty insurers must have short-term and liquid investments. The large companies among both types of insurance company tend to make investments of more than \$1 million.

The second dichotomy manifests itself when the industry is broken down by company size. This analysis reveals that the industry is comprised of a small number of large companies and a

large number of small companies. The preponderance of small companies makes it more difficult for a large part of the industry to engage in community development investing due to a lack of capacity or expertise.

Finally, regulation of the insurance industry is decentralized and, as such, can vary significantly. Insurance companies and their investments are regulated at the state level by insurance commissioners primarily concerned with the solvency of the companies and by state legislatures heavily lobbied by the industry. The only national organization involved with the regulation of the insurance industry, the NAIC, has influence but no power to implement its recommendations. Community development practitioners must understand both the difficulties posed and the opportunities created by state-level insurance regulation.

III. THE RECENT REINVESTMENT HISTORY OF THE INSURANCE INDUSTRY

III. THE RECENT REINVESTMENT HISTORY OF THE INSURANCE INDUSTRY

While the insurance industry is a leading source of investment capital in the United States, some have complained that the industry does not fulfill its obligation to reinvest people's premiums for the good of the communities from which those premiums are collected. Efforts to influence insurance industry investments date to the start of the century, but they have escalated in the last twenty years. Throughout, the insurance industry has vigorously defended itself against attempts to channel its investments.

At the turn of the century, a Texas legislator named James Harvey Robertson introduced and passed the Robertson Investment Act after a series of serious scandals involving the large New York-based insurance companies. Robertson offered a classic reinvestment argument when he said in support of this legislation, "The purpose I had was to stop the long, continued practice of taking from Texas, money belonging to Texas people, and hoarding it in New York to be used by the officials of great insurance companies..."¹²

The past two decades have seen heightened controversy surrounding the investment policies of insurance companies. Public pressure has generated voluntary reinvestment programs initiated by the industry. The life insurance sector responded to its targeting by the civil rights movement with the extensive \$2 billion Urban Investment Program of the late '60s, while both property/casualty and life insurers responded to the anti-redlining movement of the 1970s by building partnerships with nonprofit urban lending intermediaries and community-based organizations. The recent history of reinvestment efforts is described below.

The 1960s and the Two Billion Dollar Program

In the 1960s, the insurance industry was targeted by the civil rights movement for discriminatory hiring and underwriting practices and policies. In 1966, Dr. Martin Luther King, Jr., and twenty national civil rights organizations called for a boycott of Metropolitan Life to pressure the company to improve its investment policies.

Nineteen times between 1965 and 1972 unsuccessful attempts were made to advance mandatory reinvestment legislation, in the states of Arkansas, Delaware, Hawaii, Kansas, Maryland, Mississippi, Montana, New York, North Dakota, South Dakota,

Tennessee, Virginia, and West Virginia. The majority of these laws were aimed at promoting investment in home mortgages, and creating an obligation for the companies to reinvest within the state between 20% and 75% of the premiums collected from residents and businesses of the state.¹³

In 1967, as plans to build President Lyndon Johnson's "Great Society" gained momentum, the Urban Problems Committee of the Life Insurance Association of America (LIAA) discussed a plan to create and significantly fund an urban investment program targeted to low- and moderate-income communities. The riots of 1967 in Newark, Detroit, and other cities gave great urgency to these plans. In September of 1967, the Urban Investment Program, a \$1 billion commitment for investment in housing and job creation in American inner cities, was announced by a number of CEOs of major life insurance companies with President Johnson in the White House.

By 1969, the initial \$1 billion commitment had been invested and the industry made a pledge to invest a second billion dollars. This commitment was announced with President Richard Nixon in April of 1969. This goal was reached at the end of 1972 and the program was not renewed.

The Urban Investment Program, or the Two Billion Dollar Program, as it came to be known, was an initiative of the life insurance industry. A total of 161 companies representing 90% of the assets of that industry participated in the program. Approximately 50 of the smaller companies dropped out of the program after the first billion dollars were invested because they experienced difficulty finding appropriate investments in the inner city.¹⁴

A total of \$2 billion was invested in loans in urban areas over five years. An evaluation report, issued in 1973, said that the investments created 116,000 housing units, 60 day care centers, two industrial parks, and 40 nursing homes. Additional investments were made in hospitals, minority colleges, and minority-owned banks. Between 40,000 and 50,000 jobs were created or retained in the cities.¹⁵

While all of the lending in the \$2 Billion Program was done directly by the companies using no loan pools or nonprofit intermediaries, a very important partner in the program was the federal government, especially the Department of Housing and Urban Development (HUD). The insurance industry worked very closely with HUD to avail itself of loan guarantees, such as FHA mortgage insurance, that protected its investments from losses.

Despite, or perhaps because of, the loan guarantees, the Urban Investment Program suffered a significant problem with loan delinquencies, defaults, and foreclosures. By mid-1972, 6.4% of

the loans were in foreclosure, a foreclosure rate about eight times greater than that of nonprogram investments by participating companies and far exceeding acceptable standards for banks and savings and loan associations. It was estimated at that time that the foreclosure rate would reach 10%. This meant that 5,000 of the 51,000 homes financed ended in foreclosure, and often as a result became vacant and abandoned, further aggravating already existing urban blight. Approximately 99% of the foreclosures were on FHA single-family mortgage loans.¹⁶

Federal loan guarantees did mean that the actual dollar losses to the insurance industry were negligible. The lost opportunity cost, what the money would have been earning if it had been invested elsewhere, was also small, estimated to be between .75% and 1.6% less than the market interest rate of the time.¹⁷

The excessive foreclosure rate was the most apparent shortcoming of the program and was due to three factors. First, most of the housing loans were not underwritten by the insurance companies themselves, but rather by their mortgage correspondents (companies and individuals who make multiple home mortgage loans with insurance company capital). Secondly, the federal loan guarantees protected the insurance company from actual dollar losses and pressure to make the loans quickly led to weak underwriting criteria. Because their own money was not at risk, the companies had no real incentive to insure that strict, business-like procedures were observed. Finally, the companies had no community "partners", community-based organizations with an understanding of the communities in which investments were being made and with a stake in the success of the loans.

Other weaknesses of the program included inadequate start-up time before loans were made. The speed with which the program was implemented and completed meant that insufficient attention was paid to design a program that would succeed. A final deficiency of the program was the inclusion of loan categories, such as hospital loans, that were not viewed as community development loans by community residents.

The obvious strength of this program was its size and scope. An investment this massive has a positive impact on the lives of many people. In addition, through the \$2 Billion Program, a large portion of the life insurance industry was exposed to the problems of urban America. Their active participation in dealing with these problems led many of these companies to become active advocates for improvements in federal programs and to become involved in urban improvement programs of their own.

The Urban Investment Program began as a crisis response to an emergency situation. However, it was also launched with the hope that a program of such scope could have a real impact on urban problems. Insurance industry CEOs still consider the

program a "mixed success," with "lofty and well-publicized" goals.¹⁸ Nevertheless, the high default and foreclosure rates and some high visibility failures caused this program to be seen by many within the industry as a classic example of throwing money at a problem. The program continues to be used to illustrate the perceived problems associated with urban reinvestment.¹⁹

The practical, hands-on experience with the successes and failures of the Urban Investment Program became the basis of subsequent and more realistic urban reinvestment efforts by individual companies. This knowledge became institutionalized within several companies through the creation of corporate social responsibility officers and, in 1971, through the creation of the Clearinghouse on Corporate Social Responsibility, a subsidiary of LIAA and the American Life Convention (ALC).

The 1970s and the Anti-Redlining Campaigns

The insurance industry again found itself the target of widespread citizen protest in the 1970s. An extensive anti-redlining movement was mounted by neighborhood organizations around the country against property/casualty companies. These organizations contended that as a result of racial change or the perceived possibility of racial change, property and casualty insurers were canceling homeowners and renters coverage in specific urban areas. Insurance companies were thought to be drawing a "red line" around entire communities and, in effect, saying, "This community and every property in it is a bad risk, and we will not offer insurance there any more."

The organizing campaigns around the country aimed at the insurance industry were largely coordinated by National Peoples Action, a national coalition of neighborhood organizations based in Chicago and led by Gale Cincotta. The anti-redlining campaigns began as small meetings of angry homeowners on the near Northwest side of Chicago in the early 1970s. However, insurance redlining was enough of an issue to be included on the agenda of the first national conference of NPA in 1972.

Local campaigns focused first on policy cancellations and non-renewals, lack of availability of homeowners protection, the high cost of alternative FAIR Plan protection, and the policies of individual companies in urban communities. NPA found that in Chicago, during only nine months in 1977, Allstate Insurance had canceled or non-renewed 4,300 homeowners policies, almost all in Black and Hispanic communities.²⁰

The anti-redlining campaigns also targeted individual companies, the National Association of Insurance Commissioners, the Federal Government, and many individual state regulators and

legislatures. In response, numerous task forces were established to study the problem, and reports such as **Insurance Redlining: Fact Not Fiction** by the U.S. Commission on Civil Rights, and **Insurance Redlining: A Guide For Action** by the U.S. Department of Housing and Urban Development²¹ were published.

The anti-redlining drive peaked in 1978, when hundreds of angry community residents stormed the Sears stockholders meeting. They wrapped the meeting room with red ribbon streamers and demanded that the president of Sears require the president of Allstate, a subsidiary, to meet with community groups. As a result of this action, a meeting with the president of Allstate was arranged, and the first anti-redlining agreement with an insurance company was negotiated. The decade produced reinvestment agreements with life/health companies as well as property/casualty insurers. NPA or its member groups negotiated anti-redlining agreements with the State Farm, Travelers, Hartford, and Aetna insurance companies.

The Emergence of Community Reinvestment Partnerships

While the initial organizing and negotiation process focused on issues of insurance availability and price, community groups quickly came to understand the importance of negotiating reinvestment provisions as a part of any anti-redlining drive. A **1979 Guide to Organizing On The Insurance Issue**, published by NPA stated, "Insurance companies...can spend our money any damned way and place they want. They are not required to detail their investments to the public and not even to their own policyholders or stockholders. Every community organization now organizing on insurance redlining should include reinvestment on their agenda."²²

Shel Trapp, Staff Director of the National Training and Information Center and one of the community organizers central to the campaign, later recalled, "I saw in the sports page that the Aetna Insurance Company had posted a \$50 million bond so that the Hartford Whalers could join the NHL. I thought, 'Why, that's a lot of money.' So we researched it and found that Aetna had the awesome task of finding some place to invest \$13 million per day, 365 days per year. We decided to add reinvestment to our list of demands."

Unlike the Urban Investment Program, the reinvestment agreements negotiated in the '70s did not call for massive direct investments by the insurance companies. Instead the agreements were based on the idea of forming reinvestment partnerships, either directly with community groups or with neighborhood lending intermediary organizations.

Both the Allstate and State Farm agreements utilized local partners to achieve neighborhood reinvestment. The Allstate agreement, for example, called for a substantial investment by the company in Neighborhood Housing Services (NHS) in Chicago. The State Farm agreement included a provision for a linked deposit in ten local community banks that was to be used by the banks to make loans at only 2% above passbook rates.

The most extensive partnership was negotiated with Aetna Life and Casualty whose president, William Bailey, won the grudging respect of the community groups who called him "as responsible a leader as you are ever likely to find in corporate America." The Aetna agreement contained provisions for an upfront commitment to provide mortgage financing for low- and moderate-income housing development projects, as well as to provide technical assistance and grant support to enable the community organizations to obtain the expertise and training necessary to carry out the projects. Although this was a direct lending program, it called for investment as a facet of a partnership with existing community organizations.

The Aetna Neighborhood Investment Program has become a model of how a successful community reinvestment partnership can work. In the eight years since its creation, Aetna has directly invested more than \$30 million through 13 neighborhood organizations in 11 cities across the country. These investments have created or rehabilitated 3,000 units of housing. In addition, Aetna has invested nearly \$1.5 million in capacity building grant support to the participating community organizations. The ripple effects of the program are responsible for an additional \$63 million of urban investments and the construction or repair of an additional 8,300 units of housing. All of this was accomplished with near market rate investments and an unprecedented default rate of less than 1%--lower than the default rate of the company's regular loan portfolio.²³

A State-Stimulated Program Fills a Gap

Visible and vocal organizing against the insurance industry generated some activity by state legislatures and state governments as well. In addition to numerous anti-redlining clauses which were inserted into state insurance codes, an interesting state-stimulated reinvestment program was developed in Massachusetts.

The Massachusetts Capital Resource Company (MCRC) was created by the state legislature in late 1977. The MCRC was set up as a private, limited partnership to be capitalized at \$100 million by the state's insurance industry and to be owned and operated by the industry. Behind the drive which led to the creation of the MCRC was the desire of the Massachusetts

insurance industry for the repeal of a 1% tax on their premiums, and interest by the administration of Governor Michael Dukakis in a source of nonsecured, long-term financing for the struggling high-tech firms considered vital to the state's economic future.²⁴

Many Massachusetts community organizations opposed this "quid pro quo" tax break and the insurance industry predicted the program was doomed to failure. Foster Aborn, an executive of the John Hancock Insurance Company, who has chaired the investment committee of MCRC from its inception and considers the program "an outstanding success," still maintains that the deal was "high level bribery," the price of the tax break.²⁵

Insurance industry officials who had expected the fund to be a complete failure have been very pleasantly surprised at its success. By 1988, after ten years, the MCRC had made some 200 investments totaling \$175 million to over 130 companies. These investments have been conservatively estimated to have created 10,000 jobs. Loan losses have been moderate and profits healthy. Although the company declines to reveal this information, David Osborne's report, Economic Competitiveness, reported that by 1986, MCRC had suffered only \$8 million in losses on \$140 million of investments, and the fund had generated profits of \$21 million.²⁶

One of the major unforeseen benefits of the program has been the modification of the investment practices of the parent insurance companies. The investment successes of the MCRC in the high tech field have led the insurance industry as a whole to invest more aggressively in this sector. As this has happened, the MCRC has moved toward identifying and financing similar unmet credit "gaps" in basic industries, such as textiles. The MCRC is an example of a successful state-stimulated effort to create an appropriate investment vehicle for the insurance industry to invest in an identified credit "gap" and support a state's economic development and job creation programs.

The 1980s and Reinvestment Through Lending Intermediaries

The anti-redlining agreements negotiated with the insurance companies in the 1970s laid the groundwork for reinvestment via lending intermediaries in the 1980s. In the early 1980s, the insurance industry and insurance regulators were still under considerable pressure to foster urban investment. At this point, life/health insurers assessed what had been accomplished by the Clearinghouse on Corporate Social Responsibility in the ten years since its creation. Similarly, the National Association of Insurance Commissioner's Task Force on Urban Reinvestment issued a report emphasizing the importance of reinvestment

and recommending ways to link insurers and community organizations in urban investments. However, it was not clear that the industry fully backed a renewal of efforts to foster urban reinvestment. In both instances, the industry renewed its commitment to reinvestment but did not implement key recommendations and reduced staff at the Center for Corporate Public Involvement.

At the same time, community advocates were struggling to find effective ways to implement reinvestment programs using their new-found access to the insurance industry. Increasingly, the insurance industry, insurance regulators, and community organizations looked to emerging nonprofit neighborhood development organizations and lending intermediaries as cost-effective and neighborhood-sensitive vehicles for appropriate reinvestment efforts by the insurance industry.

The Insurance Industry Waivers on its Commitment

In October of 1981, a conference of CEOs and high-level executives from the member companies of the American Council of Life Insurers and the Health Insurance Association of America met in Oak Brook, Illinois, to discuss the ten year anniversary of the Clearinghouse on Corporate Social Responsibility.

In the report issued from that conference, the life/health companies chose to affirm their commitment to the concept of social investment stating, "A more focussed effort should be made by the companies--and a higher priority set--to use investments where possible to help resolve pressing national and community problems. These include job-creation, housing, urban and rural revitalization, minority enterprise and education, energy and pollution abatement."²⁷

The conference report recommended that this commitment be institutionalized by transforming the Clearinghouse on Corporate Social Responsibility to the new Center For Corporate Public Involvement. The Center was charged with responsibility for defining priority areas for appropriate involvement and serving as a technical assistance resource to the industry on social investing, and helping to identify appropriate investments.

The growing importance of nonprofit community development lending intermediaries was acknowledged. The report stated, "Information will be compiled and maintained on national nonprofit organizations' programs which relate to the industry's priority areas and which have the potential for company participation, e.g., the National Urban League's economic development and job creation projects, Neighborhood Housing Services (NHS), and Local Initiatives Support Corporation (LISC)."²⁸

In June of 1982, the Task Force and Advisory Committee on Urban Reinvestment to the National Association of Insurance Commissioners (NAIC) issued its final report. The report concluded, "Community investments are critical to the future of our nation's cities and are within the realm of insurance companies, large and small, as part of their investment portfolios. If such investments can become a part of the normal course of insurance company investment activity, we will have been completely successful. Toward that objective, efforts to improve the fit between companies' capabilities and worthy community investment projects should proceed."²⁹

The Task Force recommended the "partnership" approach to urban investing, and catalogued existing successful efforts. NHS, LISC, Shore Bank of Chicago, and numerous other housing and economic development groups were mentioned as viable partners providing sound investment opportunities for the insurance industry. In addition, the Task Force recommended that the NAIC work toward the establishment of a permanent national mechanism which could help insurers and community organizations reach agreement on urban investments.

In response to the Task Force report, the Center established the Socially Responsible Investments Technical Advisory Group (SRITAG). SRITAG is a group of corporate public involvement and investment officers from major insurance companies with experience in social investing who are willing to aid other companies interested in establishing or expanding social investment programs. SRITAG continues to be a very active committee of the Center, and many of its members and the companies they represent continue to be at the forefront of reinvestment efforts. According to Response magazine, recent SRITAG meetings have discussed such topics as farm and rural economic development, affordable housing, and small business and venture capital.

The Center itself remains a clearinghouse of information on reinvestment programs. It publishes a quarterly magazine Response, documents successful programs, and advocates within the industry for increased reinvestment efforts. Unfortunately, the Center recently saw its staff reduced by 50%, and serious consideration was given to disbanding the committee of CEOs which oversees the Center's work.

The recommendation of the Task Force on the establishment of a national organization to develop reinvestment partnerships between insurance companies and community organizations was never implemented, and there was little follow up on the Task Force report except for the above-noted establishment of SRITAG.

However, the sentiments and recommendations of the CEOs and the Insurance Commissioners echoed and reinforced the already clear trend in neighborhood development in the 1980s--private sector partnerships with community-based nonprofit economic and housing development organizations.

Lending Intermediaries Come of Age

The confrontational community organizing drives of the 1970s matured into a sophisticated and multi-faceted neighborhood development movement in the 1980s. Organizing continued but a whole generation of innovative local and national economic and housing development self-help initiatives were developed to address a wide range of urban and rural problems. Local development corporations actively began to promote and redevelop urban shopping districts. Nonprofit housing developers were piecing together multiple sources of financing and subsidy to build and rehabilitate thousands of units of low- and moderate-income housing. Community organizations developed extensive reinvestment programs for the individuals and businesses of their communities.

As community redevelopment efforts have grown more sophisticated, equally sophisticated financing vehicles have been developed to meet the financing needs of community-based development. Revolving loan funds capitalized by government agencies, foundations, or individual investors; national equity funds using low-income housing tax credits; national secondary markets guaranteed by major national charitable foundations for community development loans; and community development banks whose primary mission is reinvestment; are all examples of the kinds of financing vehicles which have been developed or expanded over the last ten years.

One of the critical financing needs of the new generation of community economic development practitioners is for long-term financing. Lance Buhl, the Director of Corporate Communications of Standard Oil/BP America, wrote in the forward of **Alternative Investing in Community Development**, "The very growth in development capacity has brought about an increasingly urgent need for an expansion of longer-term investment finance. This is the need that the people who manage America's wealth-- the pension funds, endowments, and investment capital--are urged to respond to."³⁰

A number of insurance companies have responded to the growth of the community development movement through their corporate charitable contributions programs. They provide grant support, in large and small amounts, to economic and housing development organizations.

A smaller number of companies, mainly the largest insurance companies, have established social investment programs which are

ongoing, staffed, and use written criteria to evaluate investments. In its 1987 Social Report, an annual report on the social investment activities of the life insurance industry, the Center For Corporate Public Involvement reported that 15% of its companies have this type of staffed program.³¹ Among the largest companies with social investment programs are Metropolitan Life, Equitable, Prudential, Aetna, CIGNA, Connecticut Mutual, and Allstate.³²

During the past decade, the insurance industry, particularly the life insurance segment, has entered a number of imaginative partnerships to foster community development. Often these partnerships have been with reinvestment intermediaries, and are well suited to meet the investment needs and experience of the insurance companies.

The larger reinvestment intermediaries can accept large investments, which are then reinvested in neighborhoods through small loans. This investment relationship is very similar to the relationship which insurance companies have with their mortgage banking subsidiaries. In Hartford, the Travelers Corporation invested \$1 million in the Inner Cities Venture Fund of the National Trust for Historic Preservation, to provide long-term loans at below-market interest to community groups for housing and economic development.³³ Local Neighborhood Housing Services branches across the country have accepted investments from insurance companies as well as other financial institutions to create revolving loan funds to make home improvement loans available to homeowners in the urban neighborhoods they serve.

In 1986, Prudential Insurance Company announced plans to invest \$5 million in the American Indian National Bank, to finance economic development projects which would benefit American Indian communities and tribes. As the bank makes loans for Indian business enterprises, Prudential will be issued loan participation certificates.³⁴

Reinvestment intermediaries can also develop large, sophisticated financing packages for commercial and housing developments, which insurance companies can finance much as they do other development projects. These investments are often made at slightly below market rate interest, and are usually combined with some public sector support.

Aetna Life and Casualty Company recently committed \$750,000 in permanent financing to the Mobile Community Organization of Mobile, Alabama, to construct 20-23 detached affordable single-family homes.³⁵ Similarly, Equitable Life Assurance Society provided \$2.6 million in construction financing for the first major nonsubsidized housing development in the central Harlem community of New York City in 1986. The project was supported by the Harlem Urban Development Corpora-

tion, and renovated 71 residential units in two apartment buildings.³⁶ In Arlington, V.A., the Travelers Insurance Company provided the Arlington Housing Corporation with \$690,000 in below market-rate financing to renovate 49 units of housing for low- and moderate-income families.³⁷

While most reinvestment efforts are programs of large life insurance companies, several of the more sophisticated reinvestment intermediaries are beginning to develop reinvestment strategies adapted to the investment needs of property and casualty companies. One of the simplest ways in which property and casualty companies can support community development is through charitable grant support. Local branches of NHS solicit numerous insurance companies to provide small amounts of grant support. The Chicago NHS, which developed this approach, currently lists 13 insurance companies among its supporters.³⁸

A more sophisticated approach to tapping the investment reserves of the property and casualty industry is being pursued by the National Equity Fund, an affiliate of LISC, a reinvestment intermediary that provides financing for community development projects in 23 cities and regions. Investments in the National Equity Fund allow investors to take advantage of the low-income housing tax credit. An investment in the fund of one dollar generates 2.5 dollars in tax savings over a 15 year period. Although the National Equity Fund has raised \$13 of \$51 million from insurance companies, the bulk of this has been invested by life insurers.³⁹ Nevertheless, the Equity Fund hopes that this tax write-off will be increasingly attractive to property and casualty insurers because they received a substantially increased tax burden as a result of the Tax Reform Act of 1986.

Other initiatives of note are the purchase of community development loans by insurance companies and the efforts to create a "secondary market" for economic development loans. One example of the purchase of community development loans by an insurance company took place when Equitable purchased \$1.5 million in housing loans made by the Shore Bank of Chicago in 1982.

The first effort to create a secondary market for community development loans was begun by NHS in 1974. Secondary markets allow similar products (such as single-family mortgages or commercial loans) to be packaged in large numbers (bundles of 100, for example) and sold by the originator(s) of the loans to other institutions interested in holding a bundle of loans as an investment. The ability to resell such loans on a secondary market serves three important purposes. First, it allows the originator of the loans to replenish its capital thereby making it possible for the originator to make more loans. Second, it allows large institutions not directly involved in retail

lending to participate indirectly by purchasing large numbers of individual loans. Third, since a market exists for the sale and purchase of these products, they can be resold more easily and converted to cash should the need arise.

The creation of a secondary market for loans in poor urban and rural communities allows reinvestment intermediaries to "recycle" their dollars. If the development of the secondary market continues and creates an actual market for negotiable community development loan-backed securities, then it will also provide the property and casualty companies with the liquidity they need to invest in economic development.

The Neighborhood Housing Services' secondary market, Neighborhood Housing Services of America (NHSA), was incorporated in 1974 as a nonprofit organization to provide a secondary market for loans made by the Neighborhood Housing Services network nationwide. NHS offices package their below market rate housing loans and sell them to NHSA, which in turn combines them with similar packages from other NHS groups and augments their value with subsidy dollars raised from corporate and private foundations. These packages are then sold to insurance companies. The first NHSA agreement with an insurance company was made with Equitable in 1978. Since its creation, NHSA has sold over \$30 million in loans from 114 NHS groups nationwide. At this point, the life insurance industry purchases 100% of NHSA's securities and has suffered no defaults on these investments.⁴⁰

NHSA serves two important functions. First, it helps the NHS network provide a constant below market-rate loan pool by recycling their loans. Secondly, it gives insurance companies a secure and profitable investment vehicle through which to invest in urban neighborhoods.

An effort to create a broader secondary market for community development loans is being pursued by Local Initiatives Managed Assets Corporation (LIMAC), an affiliate of LISC. LIMAC purchases housing and economic development loans from LISC and other reinvestment intermediaries. It then packages these loans as securities and sells them to investors, primarily insurance companies. Higher rate funds from insurance companies are blended with lower rate funds from foundations, to allow the loan interest rate to remain as low as possible. To reassure investors concerned with the risk involved in purchasing these investments, 15% of each loan package is guaranteed by a loan guarantee funded by foundations.

LIMAC is planning two other programs designed to involve insurance company investors on a larger scale. One is a program to securitize government second mortgages on housing and economic development projects, discounting the purchase price so that the securities backed by these loans can offer a market rate of return. The second is a purchase program for low-income multi-family housing loans originated by banks. LIMAC is currently

negotiating a risk-sharing arrangement with Fannie Mae and Freddie Mac, the government secondary market agencies, in which the agency securities would serve as collateral for LIMAC securities. Such an arrangement would make LIMAC securities more liquid, and also would represent a way to offer collateralized mortgage obligations (CMOs) with a range of maturities, thus making them more attractive to property and casualty companies.

These program efforts are sophisticated attempts to address the major weakness of NHSA and LIMAC, which is that their securities cannot be traded on any of the public exchanges. Because investments in NHSA and LIMAC currently can not be publicly traded, they are not appealing investments for property and casualty companies. NHSA and LIMAC actually function in a fashion very similar to the "private placement" market with which the life insurance industry is very familiar. In a private placement an investor buys an entire bond offering directly from a corporation, thereby avoiding the complex Securities and Exchange Commission (SEC) requirements for public offerings.

One other way in which insurance companies have been significantly involved in community development activities has been through participation and leadership in city-wide redevelopment efforts in the cities of their home offices. Prudential Insurance has been a leader in the Newark Collaboration Group, an effort by the public, private, and community sectors to develop a strategic plan to improve the city of Newark, New Jersey. Equitable has been a leader in the efforts of the New York City Community Preservation Corporation (CPC) to rehabilitate residential neighborhoods in New York. The CPC is a banking consortium with insurance company participation, designed to address New York City's housing shortage. In Minneapolis/St. Paul, Minnesota, the Northwestern National Insurance Company spearheaded a drive to create the Twin Cities Community Initiatives Consortium, which has been active in investing in small and minority businesses.

Patterns Revealed by History

Several patterns emerge from this review of reinvestment by the insurance industry in the last two decades. **First and foremost, the history illustrates that many sound investment opportunities do indeed exist in urban America.** These investments have been proven to be safe and reasonably profitable when the investment instruments parallel the industry's investment experience. Companies were more successful, for example, with multi-family housing and real estate projects than with small business or single-family financing.

Second, partnerships between insurance companies and community groups can spell success. Profitable investments and visibly improved communities were achieved when the industry forged joint ventures with community based organizations or lending intermediaries who had knowledge of and a vested interest in the success of the investments.

Third, the insurance industry demonstrated that it can move quickly and invest large sums of money when deals are structured to meet its needs and investment criteria. The Urban Investment Program was researched, designed and implemented in a little less than a year. All of the two billion loan dollars were committed in a mere five years.

Fourth, quid pro quos do work and state governments can stimulate the insurance industry to explore the opportunities they offer. The MCRC demonstrates how successful this approach can be in meeting credit gaps and influencing insurance industry practices.

Fifth, life insurers have been more active than property/casualty insurers in committing resources to community reinvestment. The life insurance sector has institutionalized its commitment to social investing through the Center for Corporate Public Involvement and the activities of SRITAG.

Sixth, investments have not kept pace with the growth of the insurance industry and of community development practitioners over the twenty year period. The industry has enjoyed unprecedented growth during this period. The assets of life/health insurers have increased by four-and-a-half times between 1970 and 1986, while the property/casualty sector's assets increased nine-fold between 1965 and 1986.

Seventh, reinvestment activity has been concentrated among the largest companies while small companies are relatively inactive. The 1987 Social Report states that smaller companies represented 1.5% of the total \$2 billion in social investments made that year.

Finally, the uneven distribution of community development investments by insurance companies reflects the absence of a framework for evaluating local needs across the country. Life insurance companies made over \$2 billion in new community investments in 1987. The bulk of this investment was concentrated in urban not rural settings and in the North and East. Only \$15 million of the \$2 billion, or 0.7%, was invested in the South or Western regions of the United States. Furthermore, only \$39 million, or 1.9%, was invested in minority enterprises or institutions⁴¹.

IV. LESSONS LEARNED

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During the past twenty years, much has been learned about how insurance companies can successfully and profitably invest in disinvested communities and markets. A range of strategies have been employed that include direct lending programs, state-stimulated investment pools, and investments made in nonprofit reinvestment intermediaries. Efforts to foster additional insurance company reinvestment need not start from a blank slate, but can build on this experience. The lessons highlighted in this section are organized under three key themes: the nature of the industry and its practices; the abundance and limits of today's reinvestment opportunities; and insurance regulation as a disincentive.

The Nature of the Industry and its Practices

- * Life/health and property/casualty insurers have very different investment needs and regulatory constraints and can reinvest best using different investment vehicles.

Life/health insurers and property/casualty insurers operate under different investment imperatives. Reinvestment programs must meet the term and liquidity requirements of the two types of insurers.

- * Insurance companies are not retail lenders and generally make investments of more than \$1 million.

The average size of insurance industry investments means that there is a mismatch between the preferred large size of insurance company investments and the investment needs of the community development field, which are generally much smaller. One way to bridge this difference is through lending intermediaries, such as community loan funds, community development credit unions, development banks and others.

- * The practice of designating a limited portion of the company's portfolio as "social investments," or of making social investment loans only out of charitable foundation dollars serves to cap the amount of money available for reinvestment efforts.

All social investments which are considered "admitted" assets by the insurance regulators should be

moved to the regular investment portfolio. The "social investment" portfolio should contain only those investments which require special arrangements on risk or unusual investment instruments.

- * **Insurance companies, like banks, make better investments when they have money at risk.**

The Urban Investment Program demonstrated that irresponsible underwriting of loans in poor communities can do as much damage as not investing at all. Well structured reinvestment programs encourage responsible investment by leaving some of the investment decision making and some of the investment risk with the insurance companies.

- * **The life insurance industry has developed experience and knowledge of urban reinvestment issues and partnerships with nonprofit lending intermediaries.**

Twenty years of experience with reinvestment programs has left the life insurance industry with a core of professionals familiar with the challenges of community reinvestment efforts; an organization which serves as an information clearinghouse on how to reinvest; and extensive relationships with those community organizations and nonprofit lending intermediaries who have served as community partners in reinvestment efforts.

- * **The insurance industry responds to public, political, and regulatory pressure.**

The Urban Investment Program grew out of a pressing need to respond to the Civil Rights Movement and the urban riots of the late 1960s. Many of the reinvestment partnerships of the 1980s grew out of the community protests of the 1970s and the gentle urging of the National Association of Insurance Commissioners. The only state-stimulated programs in existence are the result of state chief executives, legislatures and regulators who understood the critical need for reinvestment and were willing to negotiate with the industry or legislate to obtain it.

- * **Under current circumstances, insurance companies can easily avoid participating in community reinvestment.**

The lack of legislated responsibility, the decentralized regulation of insurance companies by state, the great number of medium and small size companies, and the sophisticated nature of some community development vehicles all operate to ease company participation out rather than in.

Reinvestment Opportunities Abound But Are Limited

- * **Successful reinvestment programs can take many forms, including direct lending programs, investments in intermediaries, and state-stimulated programs.**

As community development practitioners have grown more sophisticated, they have developed equally sophisticated approaches and financing vehicles for local development initiatives. Many of these have been tapped successfully by the insurance industry to channel funds to disinvested markets. Nevertheless, a host of others remain to be discovered and utilized by the industry.

- * **Insurance reinvestment programs can be safe and reasonably profitable when well-designed.**

Community development lending is not inherently more risky or less profitable when time is spent carefully designing the program and when community "partners" have a stake in the programs' success. The community development market is a sound and profitable lending market.

- * **The community development field is increasingly sophisticated, has a need for many different types of investment, and can design investment vehicles to meet investors' needs.**

The community development field is developing increasingly sophisticated projects and has a need for short-term as well as long-term financing. While long-term investments by the life insurance companies are critical, there is also a need for short-term forms of financing. These can take the form of construction financing or bridge loans, and would be appro-

priate investments for property and casualty insurers. There are multiple investment opportunities for insurance companies of varying types and sizes to participate in.

- * **The field of community development has a limited number of appropriate direct investment opportunities for investors unfamiliar with particular urban and/or rural markets.**

Direct investments by insurance companies in unfamiliar urban or rural markets often involve higher transaction costs to evaluate unfamiliar investments. Often these investments are much smaller than insurance companies are accustomed to making. Overcoming the problems of lack of experience, size, and high transaction costs is especially difficult for smaller companies.

- * **The community development field still lacks a secondary market for urban and rural low-income community investments.**

Although two secondary markets, LIMAC and NHSA, are in the process of formulation, neither is truly operative yet. The absence of a secondary market with tradable securities is especially a problem for property and casualty companies, which need an active resale market to keep their investments liquid. It is a problem as well for life insurance companies with large current portfolios of well-performing but unmarketable social investment loans. Many of these firms control investments through what is known as the "Prudent Portfolio Management Principle". Under this principle, no more than 5% of any account should be invested in any one category of investments, in this case social investments. Once social investments reach the 5% mark, the company stops making additional social investments until the percentage drops below five.

- * **Reinvestment intermediaries still lack the scope and investment opportunities to absorb very large investments.**

The number and size of reinvestment intermediaries such as NHS, LISC, Enterprise Foundation and community loan funds are growing, but are not yet large enough to address the pressing need for residential, commercial and industrial development nor to handle massive

reinvestment efforts by the insurance industry of the scale of the \$2 Billion Dollar Program. Additional philanthropic resources are needed to help nonprofit intermediaries and local community development organizations increase their capacity to develop good housing and economic development projects on a much broader scale.

- * **Improved strategies for accepting large investments by insurance companies, and relending them to disinvested communities are needed.**

Effective vehicles are necessary to enable insurance companies to make the smaller investments (less than \$1 million) needed by disinvested communities with more ease.

- * **The government subsidies necessary to make large scale community development reinvestment possible currently do not exist.**

Very few of the housing or economic development projects financed by the insurance industry would be economically feasible in poor or depressed communities if not for various forms of public sector financial support. Future broad scale insurance reinvestment efforts will need public sector subsidy dollars to succeed. Public sector subsidy or guarantee programs will need to be carefully designed to enable community development projects that truly serve low-income people but encourage market underwriting discipline.

Insurance Regulation As A Disincentive

- * **For property and casualty insurers, many low-income investments would be considered "non-admitted" or "questionable" assets by regulators and the insurance rating companies, and this serves as a disincentive to make these types of investments.**

Because community development loans cannot be easily resold, and because of a perception of increased risk, insurance regulators and the rating agencies will not consider these assets when applying solvency ratio tests. Property/casualty insurers can make these investments, but they negatively impact solvency ratios. This serves as an active disincentive to make

these types of investments, especially for property and casualty companies and smaller companies.

- * **Insurance companies are under no legal obligation to reinvest their premium dollars in the low- and moderate-income communities of this country.**

The reinvestment successes of the past twenty years have shown that the final obstacle to large scale reinvestment efforts by the insurance industry is not technical, but rather the lack of legislated accountability mechanisms. Many of the technical obstacles which have arisen during the past twenty years have been overcome through the hard work and creativity of individuals within both the insurance industry and low- and moderate-income communities. As resources from the insurance industry have become available to reinvest in low- and moderate-income communities, the capacity of the community-based development organizations to utilize those resources has expanded in-kind. However, unlike banks and savings and loan associations, the insurance industry is not subject to any community reinvestment requirements. This has meant that many of the insurance reinvestment programs have been implemented, not as the normal course of doing business, but rather as a result of pressure from communities.

The past twenty years of experience in implementing reinvestment programs has taught a great deal about what makes an insurance company reinvestment program a success and what makes it a failure. This experience has demonstrated the enormous impact which a serious reinvestment effort by the insurance industry could have in providing decent jobs and affordable housing in America.

The history of insurance industry reinvestment, however, also illustrates that a number of impediments still exist before the vast potential of the industry can be tapped for reinvestment in disinvested communities. These obstacles must be removed or overcome before significant reinvestment can occur.

V. INCREASING INSURANCE INDUSTRY REINVESTMENT

V. INCREASING INSURANCE INDUSTRY REINVESTMENT

Much progress has been made and many fruitful, innovative partnerships forged in the two decade movement to compel the insurance industry to reinvest in the communities from which it collects its premiums. Nevertheless reinvestment still represents too little of the insurance industry's vast resources and too few insurers make it their business to find and invest in such opportunities.

A compelling case has been made for the recommendations put forward here. The demand exists--there are substantial numbers of quality, prudent community development investment opportunities. Furthermore, community-based developers have grown more sophisticated at conceiving and implementing prudent community development projects. Consequently, the chances for success in the community development field are much greater than they were in the past. Default and delinquency experience in community development investments over the past ten years have been remarkably low, representing, among other things, an improved understanding by lenders of the integral role of community-based organizations in fashioning projects.

The capital exists in the insurance industry to increase the scale and scope of its participation. Such an increase would still represent a very modest portion of insurance company investments. Stimulating affirmative investments by insurance companies in the revitalization of the communities in which they do business is not, by any stretch, a radical notion. It is simply an appropriate idea whose time has come.

Several challenges remain for those inside and outside of the insurance industry who would like to see more activity and resources from the insurance industry dedicated to reinvestment. This report has highlighted the fact that shortcomings still exist in the industry and its practices, in the range and types of investments that can be offered and in the regulation of the industry.

What follows are a series of recommendations which, if implemented, could foster greater reinvestment by the insurance industry. Responsibility for implementing these recommendations could naturally fall to one or more of the actors who converge in this arena of insurance industry reinvestment: industry executives, community development practitioners, state legislators and insurance regulators. However, the history has shown that public pressure is much more likely to produce results than reliance on the voluntary actions of those involved. Consequently, community development practitioners and reinvestment networks and coalitions should be prepared to carry the reinvestment banner yet one more time.

Change Industry Practices

More so than any other actor or institution, the insurance industry itself can do the most to increase its reinvestment. It can do so by establishing corporate policies on reinvestment and then monitoring the implementation of those policies to ensure greater impact and success. Investment guidelines may need to be made more flexible to meet community needs; and policies and guidelines should be extended to retail lending subsidiaries. Finally, insurance companies should become more active in creating community capacity and in continuing to join communities as partners in their development. Recommendations to be implemented by the insurance industry are as follows:

- o Sponsor a new community investment program on the scale of the Two Billion Dollar Program. As has been shown, an investment this massive can have a positive impact on the lives of many people. With assistance and input from the many sophisticated financial intermediaries and neighborhood development organizations across the country, the insurance industry could repeat many of the successes of the original Two Billion Dollar Program while avoiding some of the pitfalls.
- o Encourage major insurers to alter their practices and make investments of less than \$1 million on a case by case basis to enable smaller community developers or intermediaries to take advantage of the potential source of capital. The number of community developers and/or intermediaries who could utilize the insurance industry's capital could be increased dramatically if its investments were made in smaller amounts. For example, many community development credit unions can accept nonmember deposits from insurers thereby increasing the credit that could be made available to their low- and moderate-income members. The feasibility of doing this without significantly raising costs should be explored.
- o Encourage insurance companies with retail lending subsidiaries to translate the company's reinvestment policies into actual community development loans made by their subsidiaries. As previously stated, insurance companies are not retail lenders. Nevertheless, many of the biggest insurers have mortgage banking subsidiaries that are retail lenders. Just as banks and savings institutions use their mortgage banking subsidiaries to fulfill their community reinvestment obligation so too should insurance companies.
- o Establish additional state lending intermediaries capitalized and operated by insurance companies for the purposes of reinvestment as was done in Massachusetts.

- o Increase the ability of small insurance companies to reinvest in disinvested communities by linking them to lending intermediaries which can make investments for the companies or advise them as to the soundness of any particular investment.
- o Train portfolio managers handling the investments of small insurance companies to seek out and assess community investment opportunities.
- o Finally, insurance companies should become more active in increasing community development capacity through partnerships with community development corporations and the dedication of resources to capacity-building.

Enhance Reinvestment Opportunities

To succeed, reinvestment programs must be tailored to meet the needs of the investor and the community. Probably the most important change needed to increase the resources available for community development is the establishment of a secondary market for community loans. The ability to buy and sell community development loans would meet the need for liquid assets and make it possible for lending intermediaries to recycle their funds. Establishment of such a market may also facilitate participation by small insurance companies. Recommendations to expand community development opportunities include:

- o Speed up efforts to expand the secondary markets of LIMAC and NHSA and to make their securities eligible for trading on the major public exchanges. Secure government support and assistance for a secondary market.
- o Reexamine existing incentive programs to maximize their value to foster reinvestment, i.e., the Federal Home Loan Bank's cash advance window.
- o Create new government subsidies and support programs necessary to make a broader range of community reinvestment activities feasible for private investment. In addition, explore the feasibility of using public deposit programs at the state and local levels to partially replace federal subsidies that have now disappeared.
- o Increase the number and type of direct investment opportunities. A recent survey of community-based development organizations by the National Congress for Community Economic Development (NCCED) found that they were

concentrated in the northeast and central portions of the country and that they tended to focus on housing rehabilitation and development. Twenty percent of these groups operated in rural settings and another 15% in rural/urban areas. The numbers, types and distribution of these organizations need to be diversified if reinvestment opportunities are to be expanded.

- o Develop vehicles that allow property/casualty companies to make short-term investments in community development initiatives. Community development projects do in fact have short-term financing needs. These need to be more broadly advertised and should be packaged with terms and liquidity attractive to the property/casualty sector of the industry.
- o Develop a comprehensive directory of lending intermediaries and neighborhood development organizations. Distribute this directory broadly among insurance firms, industry associations, the Center for Public Corporate Responsibility/SRITAG and the NAIC in an attempt to increase industry awareness of reinvestment opportunities.

Improve Insurance Regulation

Finally, state governments as the industry's prime regulator can craft new legislation and regulations designed to increase insurance reinvestment in all communities, especially low- and moderate-income communities. Regulatory changes for the insurance industry should include a combination of incentive, enabling, and mandatory laws to encourage, allow and require the industry to fulfill their community reinvestment responsibility. Legislative and regulatory changes include:

- o Extend low-income housing tax credits. Ensure their continuation as a permanent public contribution to the three-way partnership between the private, public and nonprofit sectors.
- o Reclassify community development loans as "admitted" assets if they can be resold on a secondary market. This enabling change in current regulation has the potential for acting as an incentive to insurance companies to invest in disinvested communities. Current regulation discourages and punishes such behavior on the part of insurance companies. The "social investment" portfolio should contain only those investments which require special arrangements on risk or unusual investment instruments.

- o Enact state Insurance Community Reinvestment Acts* thereby clearly establishing an ongoing and affirmative responsibility on the part of the insurance industry to reinvest in the disinvested communities and markets of the state. State legislation is necessary because experience has shown that many, in fact most, insurance companies will not meet these responsibilities voluntarily. The Social Report of the life insurance industry has reflected declining investments in multi-family housing, as one example. Experience has also shown that insurance regulators will rarely implement reinvestment programs to reach disinvested markets without a legislative mandate.
- o Government bodies should establish reinvestment policies attached to the award of life, health, property and casualty insurance contracts for their employees and properties. Such policies would leverage additional reinvestment by requiring insurance companies to report their community investments. Government entities could then rank insurance companies according to their performance and reward good performers through the award of insurance business.

* A proposed model Insurance Community Reinvestment Act has been developed by the Woodstock Institute. The Act outlines a combination of reinvestment responsibilities, disclosure requirements, and oversight and enforcement mechanisms designed to ensure that the insurance industry participates as full partners in the reinvestment in those parts of this country which need it most.

VI. APPENDIX

VI. APPENDIX

The following Appendix contains detailed information on five different approaches to community investment by the insurance industry. This is not intended to be an exhaustive listing of insurance industry programs for or participation in community investment efforts. Rather, they have been selected as representative of those efforts and as examples of alternative means for the insurance industry to invest in the communities in which it conducts business.

The case studies offer three models by which to achieve community investment:

- * insurance industry programs dealing with individuals and business borrowers;
- * insurance industry programs implemented in cooperation with nonprofit community based organizations;
- * insurance industry participation in and support for nonprofit lending intermediaries and their networks of community based organizations.

The first three case studies, the \$2 Billion Urban Investment Program, the Massachusetts Capital Resource Company and Aetna Life and Casualty Company's Neighborhood Investment Program, are all initiatives completely managed and controlled by insurance companies. Of these three, Aetna's program is the only one which has worked in concert with nonprofit community based organizations to make its investments. The other two cater directly to the individuals and/or businesses seeking financing. The last two case studies, Neighborhood Housing Services (NHS) and the Local Initiatives Support Corporation (LISC), highlight insurance industry participation in two sophisticated private nonprofit intermediaries. These intermediaries have affiliates in 150 cities and states across the country and work with over 750 community organizations.

These case studies illustrate in greater detail the successes and the shortcomings mentioned in the text of reinvestment by the insurance industry. They also demonstrate the opportunities that exist to design programs that offer a variety of vehicles tailored to meet local community needs.

THE \$2 BILLION URBAN INVESTMENT PROGRAM OF THE LIFE INSURANCE INDUSTRY

Background

Inspired by the Civil Rights Movement and the "Great Society" plans of the Johnson administration, the life insurance industry began discussions in 1966 about the possibility of organizing a major investment effort in America's inner cities. The Industry's Urban Problems Committee was headed by Gilbert Fitzhugh, Chairman of the Metropolitan Life Insurance Company, and Orville E. Beal, Chairman of the Prudential Insurance company, who suggested the idea of the \$1 billion program.

The riots of 1967 in Newark, Detroit, and other cities gave great urgency to these plans, and in September of 1967 a \$1 billion commitment for investment in housing and job creation in American inner cities was announced in the White House with President Lyndon B. Johnson by Gilbert W. Fitzhugh and other business leaders.

By 1969, the initial \$1 billion had been invested and, in April of that year, the industry made a pledge to President Nixon to invest a second billion dollars. This goal was reached by the end of 1972 and the program was not renewed.

Objectives

The initial focus of the program was housing, due in large part to the priorities of the federal government in the wake of the riots, but also because housing loans were closer to the investment experience of participating insurance companies. According to **A Report on the \$2 Billion Urban Investment Program of the Life Insurance Business**, as the program entered its second phase the priority changed to job creation, largely because of the federal government's shifting priorities.

Program Design

All lending was done directly by life insurance companies--there was no loan pool or intermediary used. An Urban Clearinghouse was established to set guidelines for the program, review all investments and tally investments by each company against its pledge. In addition, the Clearinghouse functioned as an information source between companies, between investors and potential borrowers, and as a liaison to government agencies.

The loans were to: be made in urban areas to improve housing conditions or create jobs; be devoted to projects that could not be financed otherwise; and carry interest rates no higher than market rates. There was some flexibility in the review process.

A very important partner in the program initially was the federal government, especially HUD. As the federal focus shifted to job creation under the Nixon administration, an effort was made to establish a similar working relationship with the Small Business Administration (SBA). This effort proved to be less successful.

Participants

The Urban Investment Program was an initiative of the life insurance sector of the insurance industry. A total of 161 companies representing 90% of the sector's assets participated in the program. Individual company goals were assigned according to the relative size of each company.

About 50 of the smaller companies dropped out of the program after the first billion dollars were invested because they had experienced difficulty meeting their original commitments. The larger companies made up the difference.

Types of Investments Made

Housing

The urban reinvestment program came at a time of a housing crisis for low-income Americans. Housing starts in 1966 were at the lowest level since World War II. Only 70,000 of the 1.3 million housing units built that year were subsidized for low-income families. The great need for housing could be translated into economic demand and the insurance companies, using federal housing subsidies, decided to invest in it.

A total of \$1.3 billion was invested in housing. (See Table 1 on Page 47.) To make these investments, the companies worked very closely with the federal government to: a) access appropriate investment vehicles, b) obtain federal insurance to lower risks, and c) win improvements in government program procedures and special considerations to protect them from unpleasant consequences.

The insurance industry was a major source of financing for the HUD Section 221(d)(3) multi-family low- and moderate-income housing built in the late 1960s. While FNMA financed the 3%

below-market mortgages, the life insurance sector financed the market rate mortgage projects. These mortgages were made economically attractive by combining them with the Rent Supplement Program, a precursor to Section 8. Almost \$600 million was invested to build 42,000 units of housing through this program.

TABLE 1

URBAN INVESTMENT PROGRAM OF THE LIFE INSURANCE BUSINESS

Investments in Housing: Status January 1, 1973

	Dollars Committed Or Disbursed (000 omitted)	Number of Housing Units Financed
Mortgages and Real Estate (One- to Four-Family Housing)		
Federally-Insured or Guaranteed	\$ 583,146	48,976
State-Insured or Guaranteed	6,815	1,757
Not Insured or Guaranteed	11,286	1,166
	-----	-----
Total: One- to Four-Family Housing	601,247	51,899
Multifamily Housing		
Federally-Insured or Guaranteed	572,609	41,957
State-Insured or Guaranteed	14,071	1,641
Not Insured or Guaranteed	132,638	18,873
	-----	-----
Total: Multifamily Housing	719,318	62,471
Total Mortgages and Real Estate	\$1,320,565	114,370
Securities and Other Investments	24,816	1,885
	-----	-----
Total Investments in Housing	\$1,345,381	116,255

Source: A Report on the \$2 Billion Urban Investment Program
of the Life Insurance Business

In addition, the Federal Housing Authority (FHA) program was modified in 1967 to insure mortgages in blighted areas. The Urban Investment Program provided financing and support to this new policy. With the availability of investment funds, retail lenders and mortgage correspondents began making inner city mortgages. The quality of the loans was supposed to be reviewed by FHA, who was insuring them. The mortgages were packaged for sale to the insurance industry.

When many loans began to go bad, the insurance industry convinced the FHA Commissioner to allow the industry to turn the bad loans over to the FHA without foreclosing and evicting the owners or tenants "in those areas where civil disturbances were a problem." This system, in effect, absolved the industry of any responsibility for good loan underwriting; reduced its risk through federal insurance; and eliminated the unpleasantness of cleaning up the mess created. A total of 49,000 single family homes were financed in this fashion, an investment of almost \$600 million.

In addition to its direct investments, the industry also counted more traditional, indirect investments such as securities, including state bonds, federally guaranteed mortgage-backed securities; and stock and partnership interests in two housing development corporations (National Corporation for Housing Partnerships and the North American Development Corporation) as program investments. Approximately \$50 million was invested in conventionally financed housing projects, with no federal subsidies. According to the report, "This was one of the riskiest types of investment and one of the most difficult to develop in large numbers."

Jobs and Service Facilities

Almost \$700 million was invested in jobs and service facilities, especially during the later phase of the program. (See Table 2 on Page 50). Of this, almost half, \$340 million, was invested in hospitals and medical facilities. Two hundred and forty million dollars were invested in commercial ventures, \$65 million was invested in social services, and \$46 million was invested in securities. The industry estimates that 40,000 to 50,000 jobs were sustained or created by the program.

A combination of factors made this part of the program the least successful. First, the investments were generally smaller than the housing investments (which were generally over \$1 million) and, therefore, needed more individual attention. Second, direct business lending, especially in the inner city, was outside of the experience of the companies. Third, there were inadequate government programs to provide credit enhancement on the scale needed and the federal bureaucracy was less responsive

to changes advocated by the industry. Finally, the industry was never able to find a way to turn unmet needs into economic demand.

As many investors and community development practitioners have found, small business lending was much more difficult to do. Lending to local industries was hampered by the problems of outdated, inefficient industrial facilities, high crime and property taxes, and poor streets. Retail opportunities were constrained by limited purchasing power, blighted conditions and high crime in the surrounding area. Ironically, the insurance industry found that its small business investments were also limited by insurance redlining! The industry attempted to work with SBA and with MESBICs, but found that these loans were hard to do because of government procedures as well as because the industry was unfamiliar with this type of small, retail lending. The most promising investments were made early in the program, which had some high visibility failures, including a failed supermarket in Trenton.

Subsidies Needed

The successes that this program enjoyed were largely the result of its symbiotic relationship with the federal government. The federal government had earlier created the insurance, rent subsidies, and investment opportunities which the companies used for their investments. These subsidies, in fact, minimized the real losses to the industry from bad loans. The subsidy provided by the industry itself was primarily the lost "opportunity cost" and the investment of staff time and other corporate resources.

Without these subsidies, this program would probably not have happened on the same scale. In fact, when the federal government pulled back on its commitment to urban areas, the program slowed and then ended. One might characterize the program as a case of the government eliminating the risk for private industry, since almost all of these loans were made at market rate and were federally insured. When the subsidy ended, so did the commitment to solve urban problems.

Results

A total of \$2 billion was invested in urban areas over five years. The first billion was committed in 18 months; the second billion took more than twice as long to commit. According to the evaluation report issued in 1973, the investments created 116,000 housing units, 60 daycare centers, two industrial parks, and 40 nursing homes. Between 40,000 and 50,000 jobs were created or

TABLE 2
URBAN INVESTMENT PROGRAM OF THE LIFE INSURANCE BUSINESS
Investments in Job-Creating and Service Facilities
Status January 1, 1973

	Dollars Committed or Disbursed (000 omitted)
Mortgages and Real Estate	
<u>Medical</u>	
Hospital	\$176,805
Nursing Home	105,512
Clinic	27,430
Other Medical	28,324

Total Medical	338,071
<u>Commercial and Industrial</u>	
Factory	45,602
Other Industrial	55,571
Warehouse	8,840
Shopping Center	26,925
Retail Store	34,887
Other Commercial	68,118

Total Commercial	239,943
<u>Social Services</u>	
Day Care	41,627
Minority College	10,175
Other Social Services	13,482

Total Social Services	65,284
Mortgages and Real Estate	643,298
<u>Securities (Bonds, Notes, Deposits, Stocks)</u>	
Medical	1,030
Industrial	16,513
Commercial	8,633
Minority Financial Institution Deposits	7,295
Minority Colleges	12,691
Social Services	138

Total Securities	46,300
Grand Total	\$689,698

Source: **A Report on the \$2 Billion Urban Investment Program of
the Life Insurance Business**

retained in the cities. One hundred and seventy-seven million dollars was invested in hospital construction, building programs at 15 minority colleges were supported, and 30 minority-owned banks received deposits. (See Table 3 on Page 52.)

The Clearinghouse on Corporate Social Responsibility's report on the Two Billion Dollar Program cites several reasons why the second billion dollars took longer to invest: the economy weakened in 1969 and 1970; job-related investments were smaller and more difficult to assemble; companies had less money to invest when policy loans rose to historic levels; and, finally, the federal commitment to cities weakened.

The program suffered a significant problem with loan delinquencies, defaults, and foreclosures. By mid-1972, 6.4% of the loans were in foreclosure, a foreclosure rate about eight times greater than that of non-program investments. At this time, it was estimated that the foreclosure rate would reach 10%. Approximately 99% of the foreclosures were on FHA 1-4 unit mortgage loans. However, 38% of the dollar amount foreclosed was for multi-family projects, and 4% was for nursing homes, factories, stores, and other non-residential facilities.

Actual losses to the industry through foreclosure were small, because almost all of the loans were federally insured. The lost "opportunity cost" was estimated to be between .75% to 1.6% in interest rate on special urban investments.

General Discussion

Strengths

The obvious strength of this program was its size and scope. An investment this massive has a positive impact on the lives of many people. In addition, a large portion of the life insurance industry was exposed to the problems of urban America, and their active participation in dealing with these problems led them to become active advocates for improvements in many federal programs.

The practical, hands-on experience with the program's successes and failures also became the basis for more realistic urban improvement efforts in the future by individual companies. This experience led to the creation of corporate social responsibility officers and of a permanent Urban Clearinghouse.

TABLE 3

URBAN INVESTMENT PROGRAM OF THE LIFE INSURANCE BUSINESS

Investments: Status January 1, 1973

	Dollars Committed or Disbursed (000 omitted)
Housing	
Mortgages and Real Estate	\$1,320,565
Securities	24,816

Total Housing*	\$1,345,381
 Job-Creating and Service Facilities	
Medical and Social Services	\$ 417,198
Commercial and Industrial	265,104
Minority Financial Institution Deposits	7,295

Total Job-Creating and Service Facilities	689,597
 Grand Total	 \$2,034,978

* This figure represents financing for 116,255 housing units.

Source: A Report on the \$2 Billion Urban Investment Program of the Life Insurance Business

Weaknesses

The weaknesses of the program include the lack of any community accountability; inadequate start-up time before loans were made; inadequate underwriting controls on loan quality; a failure to use intermediaries to make the smaller loans; and the inclusion of many questionable loan categories. The high default and foreclosure rates might have been eliminated if the industry itself had assumed some of the risk involved in these investments. The very scope of the program led in part to the massive FHA abandonment problem that has plagued U.S. cities ever since.

Summary

A 1973 evaluation of the \$2 billion Urban Investment Program by the Clearinghouse concluded that money alone could not solve urban problems. Political leadership, regional planning and a specific role and commitment by businesses were required if such efforts were to be successful in the future.

Since the 1960s, life insurance companies have involved themselves in a variety of community reinvestment programs. With the exception of the Massachusetts Capital Resource Company, these efforts usually are conducted in conjunction with community organizations who have the development skills to successfully complete projects.

Nevertheless, community reinvestment still remains a small part of most insurance company investments and is relegated to the less well funded "social investment" portfolio. Though the scale of the problems has, if anything, grown since the 1960s, investments by the insurance industry have not.

THE MASSACHUSETTS CAPITAL RESOURCE COMPANY

Background

The Massachusetts Capital Resource Company (MCRC) was created through legislation in late December, 1977 by the Commonwealth of Massachusetts to encourage increased insurance company investment in hi-tech industry. The Company is a limited partnership privately-owned and funded by nine Massachusetts-based life insurance companies.

The early 1970s were a difficult period for Massachusetts. Unemployment stood at over 12% by 1975, per capita income as compared to the national average had been falling steadily since 1947, and the state was in the midst of a fiscal crisis with a deficit of \$550 million.

In addition, the relations of community, consumer, and environmental organizations and state government officials with the business community were poor. This state of affairs was reflected in a 1% tax which had been levied on the gross income (as opposed to profits) of the insurance industry. This tax had been levied in retaliation against the industry for its role in financing a campaign to defeat a proposed graduated income tax.

Despite all of the problems, however, Massachusetts was poised for recovery, the much vaunted "Massachusetts Miracle". By 1975, the make-up of the Massachusetts economy had shifted to a broad-based industry mix. A large number of engineering programs at local universities and a highly educated workforce had attracted a high proportion of computer-related and electronics industries.

By the end of 1975, a consensus was developing that Massachusetts needed to develop a coherent approach to development finance. As a result, Governor Dukakis appointed the Massachusetts Task Force for Economic Development. The work of this body spawned a number of state programs to increase business development and expansion, including the Massachusetts Capital Resource Company.

For some time, the insurance companies had vociferously complained that the 1% tax on gross income was hurting their competitiveness. Following the Task Force report, the Dukakis administration offered them a deal: capitalize a \$100 million investment fund and make unsecured, long-term loans to state firms unable to get similar capital elsewhere if they can demonstrate that they have the ability to grow and are going to create jobs. Do that, they said, and the tax will be rescinded.

Despite initial resistance, the industry agreed and the Massachusetts Capital Resource Company was created. Foster Aborn of John Hancock, who chaired the investment committee from its inception, still maintains that the deal was "high level bribery." However, he also says that MCRC has been "an outstanding success."

Objectives

The unstated purpose in the creation of the MCRC was to force the huge pool of life insurance capital, which had invested only slightly in hi-tech firms, to support the medium-size, expanding technology firms that were to become the key to the "Massachusetts Miracle." The MCRC's stated objectives are to invest creatively and aggressively in a broad variety of firms; to support portfolio companies on a continuing basis; to promote job creation; and to provide partners in MCRC with investment returns commensurate with the underlying risks.

Program Design

The Massachusetts Capital Resource Company is a private, limited partnership chartered by the Commonwealth of Massachusetts. It makes non-secured investments of five years or more in Massachusetts-based companies.

The company was capitalized at \$100 million over five years by nine Massachusetts life insurers. Four companies contributed more than \$5 million, and they are the general partners. (John Hancock contributed \$48 million; Massachusetts Mutual, \$23 million; New England, \$17 million; and State Mutual, \$6 million.)

The CEOs of the four general partners serve on the Executive Committee, which functions as the Board of Directors. Senior level vice presidents from the general partners serve on the Investment Committee, which meets monthly and provides ongoing direction. In 1981, when MCRC reached its capital base of \$100 million, it was, according to their annual report, "one of the largest private investment companies in the United States." MCRC employs a staff of five investment professionals.

MCRC takes proposals from any Massachusetts-based operation and the investment process formally begins with the submission of a business plan. If MCRC is interested, representatives meet with management and make on-site visits. The MCRC's Investment Committee has responsibility for the review and final approval of any proposal.

The bill creating MCRC established job creation and broad investment targets. Investments are prohibited in the utilities, real estate, retailing, construction, and financial services industries. Job creation is monitored by the Secretary of Economic Affairs.

The insurance company's tax cut was then phased in over five years. The legislation included a provision which said that, if the industry did not live up to their part of the agreement, the tax cut would be canceled and the industry would have to pay the accumulated back taxes.

Participants

General Partners: John Hancock Mutual Life (\$48.4 million); Massachusetts Mutual Life (\$22.8 million); The New England (\$17.4 million); State Mutual Life (\$6 million).

Limited Partners: Paul Revere Life (\$2 million); Monarch Life (\$1.5 million); Berkshire Life (\$1.2 million); Boston Mutual Life (\$427,814).

Types of Investments

MCRC prides itself on being a flexible, non-traditional lender with a wide variety of investment instruments to solve business problems. Because MCRC's investment relationship with its "portfolio companies" is from five to ten years long, the relationship is active and long-term. Forty eight of MCRC's companies have received at least one "follow-on" or repeat investment.

MCRC provides four types of financing: 1) long-term debt; 2) mezzanine capital; 3) venture capital; and 4) leveraged buy-outs. A total of 52% of its invested dollars has been in the form of subordinated debt with equity; 25% has been subordinated debt; 18% has been senior debt; and 5% has been equity.

The long-term debt financing is modeled after the private placements of the insurance industry, but is targeted to a smaller and more risky market. MCRC provides loans from \$500,000 to \$5 million in senior and subordinated debt at fixed market interest rates for a term of five to ten years. Over \$70 million had been invested in fixed rate debt transactions in approximately 50 companies by 1987, largely in the lower growth and more traditional industries, such as paper, textile and jewelry.

Mezzanine capital investments have been used by companies in the intermediate sales range--\$5 million to \$100 million--in all industries. More than 25% of MCRC's financing has been done in this highly complex form of financing which employs the use of coupon rates, warrants, exercise price, puts, forced convertibility, registration rights and other sophisticated financial instruments and strategies. Young, growing venture-founded companies have used this as a bridge to their initial public offering, while older firms have used it to finance expansion or product line acquisition.

MCRC has invested more than \$30 million in venture capital in over 40 young technology companies. Its niche is that of a latter stage investor, working with earlier investors to provide growth capital to companies which have outgrown traditional venture financing but cannot access the public market.

MCRC has participated in 18 leveraged buyouts, with purchase prices ranging from \$5 million to \$35 million. It has focused on the spin-offs of divisions of corporate conglomerates and the ownership transfers of small, privately held firms.

At the end of 1987, the MCRC had cash reserves of \$36 million held in short-term Commonwealth obligations. MCRC's cash reserves, must be invested in state bonds as stipulated in the enabling legislation.

Subsidies

MCRC is a completely private venture, and deals are done at market rate.

However, the "subsidy" which MCRC brings to the deal are: a) the long-term nature of the investments, b) the fixed rate, c) the willingness to make unsecured or subordinated investments, d) the smaller size of the investments, e) the riskier nature of the investments, and f) the flexibility of MCRC in negotiating the deal.

Results

MCRC currently has more than 130 companies in its portfolio. Forty-eight of these portfolio companies have received at least two investments from the company. In its first ten years, MCRC has made approximately 200 investments totaling \$175 million and created 10,000 jobs. This job creation figure is considered conservative, because Massachusetts uses a job creation formula which does not include ripple-effect job creation.

Sixty-five percent of MCRC's investments were for less than \$1 million. Basic industry has received 51% of the dollars invested, while high technology has received 49%.

Insurance industry officials had expected the fund to be a complete failure, and have been very pleasantly surprised at its success. One of the major successes of the program has been to modify the investment practices of the parent insurance companies. The investment successes of MCRC led the insurance industry as a whole to more aggressively invest in this field in Massachusetts. As the more conventional investors moved into the high-tech field, the MCRC has moved toward identifying and financing similar unmet credit "gaps" in basic industries such as textiles, paper and fish processing.

The principle involved in MCRC--that it is more effective to change private investment patterns than simply to make public loans--has since become a centerpiece of state economic development thinking. It is called "wholesaling," to distinguish it from "retailing," or providing direct public investments. Not all capital gaps can be filled this way; some areas are simply too risky for all but the public sector and a few hardy private investors.

General Discussion

Strengths

One of the obvious strengths of this program is its size. Capitalizing a \$100 million fund from state revenues or bonding authority would have been impossible. Another strength of the program is that, through an activist government approach, private sector investment was channeled in directions it would not otherwise have gone. This had the additional benefit of modifying the investment patterns of the participating insurance companies. This program is an example of what state government can do to advocate for investment in underserved markets.

Weaknesses

The program has been accused of not taking enough risks in high unemployment areas or with minority-owned businesses. Apparently the state oversight of the program is limited, and perhaps the state should have negotiated a position on the executive committee and investment committee. The MCRC addresses only narrow segments of the unmet credit needs, and this means that they should be either doing more or that there is a need for a range of financing mechanisms.

An important question that deserves attention concerns the **quid pro quo** strategy employed in funding the MCRC. The

establishment of MCRC has clearly resulted in bringing new resources to bear upon state economic development. Whether tax revenue sources should be exchanged for corporate responsibility is a question to be seriously considered on a state by state basis weighing a number of practical political and economic factors.

**AETNA LIFE & CASUALTY INSURANCE COMPANY'S
NATIONAL URBAN NEIGHBORHOOD INVESTMENT PROGRAM**

Background

The Aetna Life and Casualty Insurance Company's National Urban Neighborhood Investment Program has invested millions of dollars in distressed inner city neighborhoods across the country and made a profit doing it. The program was started in 1980 as a demonstration project sponsored by Aetna and the National Training and Information Center (NTIC), the technical assistance arm of National Peoples Action headed by Gale Cincotta that provides education and training for neighborhood organizations nationally. The program has demonstrated that community reinvestment, when handled properly, can be both safe and profitable.

Aetna and NTIC's partnership developed out of struggles in the 1970s to end property and casualty redlining in urban areas by insurance companies. In 1978, after becoming the uncomfortable focus of a national anti-redlining campaign and in the wake of national demonstrations against other insurance companies, Aetna negotiated an insurance availability and reinvestment program with NTIC, which had coordinated the campaign, together with leaders of six neighborhood organizations in four cities.

Aetna, like Allstate and State Farm before it, decided to create a partnership with the very community groups which had been critical of their performance. In partnership with NTIC, Aetna established a national model for community-based reinvestment known as the National Urban Neighborhood Investment Program (NIP).

Eight years later, Aetna's Neighborhood Investment Program has invested more than \$30 million and directly leveraged another \$30 million. Its mortgage financing has enabled 13 neighborhood organizations in 11 cities to rehabilitate or build more than 3,000 affordable housing units in distressed neighborhoods across the country for low-income families. The trickle effect of the program has resulted in the leveraging of an additional \$63 million and the construction or renovation of over 8,300 additional units by these same 13 neighborhood organizations.

The social benefits of the program as well as the benefits to the investors have surpassed the expectations of many. Since its creation, the program has provided Aetna with: nearly ten years of solid, near-market rate investments, loans with a

default rate of significantly less than 1%, and an open door to new markets (such as state government pension funds) because of Aetna's commitment to community reinvestment.

Objectives

The Neighborhood Investment Program was established with three primary objectives in mind:

- * To make secured, well-designed real estate investments in projects in urban neighborhoods sponsored by grass-roots neighborhood organizations, while attracting the participation of other investors, particularly local financial institutions;
- * To establish a partnership model of community, private, and public sector institutions through which each sector can contribute to neighborhood revitalization by doing what it does best; and
- * To develop, through grants and technical assistance, the capacity of local, nonprofit organizations to plan and manage the implementation of neighborhood development projects developing sufficient credibility to obtain financing from private institutions.

Program Design

NIP works with community groups to develop housing in low-to moderate-income neighborhoods throughout the country. Through NIP, Aetna provides grant support and mortgage financing to community groups working to improve single or multi-family housing in their neighborhoods and make it available to residents at an affordable price.

NTIC works with Aetna to identify community organizations capable of development and with strong grassroots leadership and neighborhood ties. Once a group has been chosen, Aetna and a program consultant provide direct technical assistance to ensure that the groups have the development skills and financial savvy needed for success.

A multiyear commitment by Aetna to each of the neighborhoods is also made to encourage substantial change. This financial commitment facilitates the leveraging of financial and technical assistance from private lenders, government, philanthropic organizations, and other institutions.

Aetna has integrated these investments into its regular social investment operations handled by the Corporate Responsibility Investment Committee (CRIC) and its real estate financing subsidiary, Aetna Realty Investors. An interdepartment task force, together with NTIC representatives, has met quarterly throughout the program to oversee its direction and make program modifications or institute new practices when necessary.

Participants

Since its inception NIP has worked with thirteen neighborhood organizations in eleven cities across the country. Of these groups, eight are still working successfully with Aetna or with other financing resources leveraged through the program. Three groups are now defunct and the other two have decided to focus on other aspects of community development. Groups participating in NIP include:

- * **New York, NY:** **Northwest Bronx Community and Clergy Coalition, Fifth Avenue Committee (Brooklyn)**
- * **Philadelphia, PA:** **Kensington Action Now**
- * Cleveland, OH: St. Clair-Superior Coalition
- * **Cincinnati, OH:** **Working In Neighborhoods**
- * **Columbus, OH:** **Southside United Neighbors**
- * **Chicago, IL:** **South Austin Coalition Community Council; Greater Roseland Organization**
- * New Orleans, LA: Coalition For Action
- * Denver, CO: Concerned Citizens of Westwood
- * **Washington, DC:** **Washington Inner-City Self Help**
- * **Lowell, MA:** **Coalition for a Better Acre**
- * **St. Louis, MO:** **St. Louis Association of Community Organizations**

Bold indicates that city/organization is still active with Aetna.

Types of Investments

Grants

Community groups receive grants from Aetna of \$30,000 a year for the first two years of their participation in the program. These funds are used to increase staff development capacity.

Initially, grants were channeled through NTIC for program supervision and NTIC also received annual grant support from Aetna to provide technical assistance to the participating community groups. Currently, NTIC continues to receive Aetna grant support for its national reinvestment program but is no longer responsible for funneling the grants to neighborhood organizations that Aetna supports.

Mortgage Financing

Aetna has provided direct mortgage financing at 1-5% below market rate for single-family and multi-family projects in each of the communities, depending upon project need and market rates for financing at a particular time. Mortgage funds range from 30% to 80% of the property value. In some cases, Aetna assumed a second mortgage position by adding financing for rehabilitation to an existing first mortgage. In one community, Aetna invested \$150,000 for a construction revolving loan fund, and currently anticipates repeating this successful model, on a slightly adapted basis, in another of the communities.

Subsidies

Frequently, organizations also receive HUD grants, LISC financing, Section 8 rent subsidies, municipal subsidies and/or additional foundation grant support, with municipally-sponsored deferred repayment second mortgages the most common of these. A number of the city governments, the District of Columbia and New York City among them, have been especially innovative and flexible in their injection of public dollars to leverage private financing.

Results

Benefits for Community Organizations

- * Increased Housing: NIP was initiated in 1980 with six community groups in four cities. By 1988, the demonstration

program had expanded to 13 neighborhoods in 11 cities across the country.

Aetna has invested more than \$30 million in mortgage financing, resulting in the direct leveraging of an additional \$30 million.

Through NIP, more than 3,000 units of low-income family housing have been rehabilitated or constructed. As a result, organizations have acquired a track record enabling them to access an additional \$63 million from other sources for other development projects. These funds have resulted in 8,300 additional housing units.

Several of the community groups have "graduated" from the Aetna program and have acquired access to cheaper and sometimes quicker local financing. Aetna continues its commitment to those neighborhoods by financing projects of the organizations on a case-by-case basis, where requested.

- * Partnership: Aetna and NTIC work with the community groups to improve their development skills and their ability to enlist other external institutions through grants and technical assistance. This creates strong organizations capable of making the program successful in the long term and of expanding the program by creating new partnerships.
- * Capital: The front-end commitment to provide permanent mortgage financing for feasible development projects helps organizations overcome the greatest barrier to starting housing rehabilitation and new construction programs--the lack of an upfront, flexible capital source that is willing to make the first commitment.
- * New Resources: With the backing and commitment of a strong financial institution, community organizations are given the opportunity to develop good track records and gain credibility, which in turn can provide access to untapped private, public and philanthropic resources.
- * Corporate Sensitivity: Community groups feel that in order for grassroots development programs to be successful, financial institutions must be sensitive to the needs and nuances of individual communities. Aetna's NIP showed this kind of sensitivity.

Benefits for Investing Companies

- * Good Profit Margins: Although this type of financing has traditionally been considered unprofitable and risky, the program has shown that companies stand to lose less than 1%

in profit from loans made at only slightly lower than market rates, if a lower rate at all. In addition, these loans are considered "admitted assets" by the company regulators and A.M. Best, the insurance rating company.

- * Low Default Rate: During the past eight years, these loans have had a default rate of substantially less than 1%, a lower rate than the company's regular commercial loan portfolio.
- * Subsidies: Because projects are located in low- and moderate-income communities, investments are made frequently with the support of various federal, state and local government guarantees and subsidies, most regularly deferred repayment second mortgages issued by municipal governments, using federal Community Development Block Grant funds.
- * New Markets: Programs like this have the potential for leading companies into new markets.
 - e.g., Aetna's fire and casualty insurance policy sales have increased in the Bronx, due to the fact that property owners not involved with the program have seen the company's commitment to the community and have chosen to buy policies from Aetna.
 - e.g., Although Aetna is not domiciled in Massachusetts, it was allowed to compete for state government pension funds because of its involvement in Lowell.
- * Company Resources: Aetna's ability to integrate NIP into its regular social investment operations made it possible to dedicate the necessary technical assistance without taking a great toll on company resources.
- * Stronger Neighborhoods: NIP is also an indirect investment. It helps strengthen the social and economic stability of communities where Aetna may be selling insurance policies and/or have other investments.
- * Good P.R.: Through NIP, Aetna has become the concerned corporate partner of many communities. This gives the company an excellent public image.

Problems

Five community groups are no longer active in the NIP because of internal organizational difficulties, or because they were dealing with housing development issues they could not solve.

Perhaps not coincidentally, all of these organizations were working with the purchase, rehab and resale of single-family housing, a model that proves difficult in low- and moderate-income neighborhoods because the acquisition of private properties is difficult, economic rehabilitation of deteriorated single-family homes is expensive and time consuming, and because 'lower' income families often lack adequate resources to cover downpayment and closing costs. A couple of these groups have begun working on downpayment subsidy programs.

Aetna is not currently planning an expansion of the Neighborhood Investment Program as it now exists because:

- 1) The Demonstration Program Succeeded as a Demonstration Project: What began in 1979 as a national demonstration program no longer needs to be demonstrated to Aetna. It succeeded by Aetna's standards. Grass-roots neighborhood organizations proved to Aetna that they possess the capacity to become credible community developers, identifying, packaging and implementing feasible development projects of low-income housing that a private financial institution can readily support.
- 2) Aetna has Moved to a New Stage: As a result of its experience under the NIP since 1979 and its social lending activities nationally since 1976, Aetna's real estate lending underwriters in Hartford and its mortgage banking correspondents in localities throughout the country regularly receive, review and commit financing for social investment projects sponsored by increasingly capable community development organizations. Aetna publicizes the fact it does this by instructing its mortgage banking correspondents to seek out such investments as well as by broadly distributing its annual report on social investments and through national organizations, like NTIC, that make community organizations aware of Aetna's social investments. Consequently, Aetna feels that the need for a special program to stimulate this process is no longer as great.
- 3) Limited Resources and Secondary Market Prospects: NIP is part of the company's social investment program arm, CRIC, through which the company currently makes approximately \$40 million available for social investments yearly. However, Aetna controls its investment portfolio through what is known in the industry as the "Prudent Portfolio Management Principle". This principle dictates that no more than 5% of any account should be invested in any one category of investments, in this case social or CRIC investments. CRIC investments derive primarily from the company's Capital and Surplus Account. Aetna does not want outstanding CRIC loans to make up more than 4% of that account. Therefore, the

company is rapidly reaching its social investment limit. A secondary market is needed for these social investment loans, and Aetna is now looking into various possibilities.

Summary

Aetna, NTIC and the participating community organizations agree that the Neighborhood Investment Program is replicable. Although they do not think it is necessary to recreate it step by step, they all agree that it can be implemented by others with the same kind of commitment and community sensitivity that NIP has had. A program like NIP provides numerous benefits for both the investor and the participating community groups.

The partnerships established through NIP have had long-lasting, positive effects on all parties involved. In less than a decade, Aetna has become a supporting honorary member of many inner city communities. According to an Aetna representative, "it is time for other financial institutions and insurance companies to follow our lead and establish similarly successful reinvestment projects."

For neighborhood organizations, partnerships such as NIP have played a major role in their development. These partnerships help make neighborhood organizations become credible, highly skilled and sophisticated developers, capable of tackling a wide variety of community development issues effectively. However, this can only continue if there is a willingness on all parts to expand the partnerships. One community organizer explained that Aetna helped them overcome one of the greatest barriers to starting development programs, the lack of front-end, flexible capital commitments. "We need more of them."

NEIGHBORHOOD HOUSING SERVICES

Background

The Neighborhood Housing Services (NHS) is a national network of neighborhood revitalization organizations founded on partnerships between residents in declining neighborhoods, city officials and local businessmen. Beginning as a single, self-help effort in Pittsburgh, NHS is now in 239 neighborhoods in 137 cities, towns, and counties across the country. Insurance companies have participated in NHS almost from the beginning and are an important source of funds and support for NHS activities.

NHS was discovered in 1970 by the Federal Home Loan Bank System which, in an effort to eliminate redlining, was conducting workshops around the country to help savings and loan organizations strengthen their support to urban organizations. Impressed by NHS's approach, the Federal Home Loan Bank System began testing it as a model in other cities where it proved equally successful.

In 1978, the Neighborhood Reinvestment Corporation (NRC) was created by Act of Congress to continue the job of coordinating NHS activities. It is assisted in this task by the Neighborhood Housing Services of America (NHSA), a sister, nonprofit organization created in 1974 to operate a secondary loan market to keep NHS loan funds capitalized.

Insurance company support of NHS takes six forms: direct grants to local NHS organizations, participation in NHS Revolving Loan Funds, direct investment in multi-family housing projects, purchase of NHSA securities, insurance protection for marginal communities, and in-kind or management services for local organizations. In general, local support has been provided by property and casualty companies and support at the national level, i.e., NHSA securities, has come from life insurance companies.

Since its inception, NHS has grown into a major national revitalization program leading to cumulative investments of over \$4 billion in American cities and communities across the country.

Objectives

NHS's goal is to return declining neighborhoods to a healthy and self-reliant state. Early NHS operations focused on revitalizing owner-occupied housing, but more recently local partnerships have been encouraged to broaden their scope to include commercial revitalization, multi-family rental housing production and the preservation of affordable housing.

NHS views partnerships between local residents, business and government as essential for achieving and maintaining neighborhood self-sufficiency.

Program Design

The national NHS network has three basic levels: local Neighborhood Housing Services (NHS) organizations; the Neighborhood Housing Services of America (NHSA); and the Neighborhood Reinvestment Corporation (NRC). This profile will focus on how each of these levels has used insurance company investments.

Local Neighborhood Housing Services (NHS) organizations

NHS organizations are incorporated as state-chartered, tax-exempt, nonprofit organizations. Initial funds to develop a NHS organization usually come from local government which also targets necessary capital improvements as well as loans, grants and special programs to the NHS neighborhood and supplies principal funding for the NHS revolving loan fund.

NRC provides initial technical and organizing assistance for the creation of individual local NHS offices, but each NHS develops its own strategy for community revitalization.

Local residents form the leadership of NHS organizations. They hold the majority of seats on the board of directors, are represented on all committees and determine the goals and standards for their neighborhoods. Community business leaders from insurance, banking, thrift organizations and other, non-financial corporations also serve on the board.

Local NHS programs have received support from insurance companies for both grants and loans. For example, support for Chicago NHS, the first to receive insurance company support, has taken several forms:

- * In 1978, the Allstate Insurance Company committed \$300,000 for a new NHS in the West Humboldt neighborhood. This was the first insurance company investment in NHS in the country.
- * Thirteen other insurance companies collectively matched Allstate's \$300,000 grant. (Cigna Insurance Company, Aetna Life & Casualty Insurance Company, CNA Insurance Companies, Fireman's Fund Insurance Companies, Hartford Insurance Company of Illinois, Kemper Group/Lumberman's Mutual Casualty Company, Liberty Mutual Insurance Company, Prudential Property and Casualty Company,

Safeco Insurance Company, St. Paul Fire and Marine Insurance Company, State Farm Fire & Casualty Company, The Travelers Insurance Company, and W.W. Vincent & Company)

- * Allstate invested an additional \$500,000 in New Partnerships, Inc., a subsidiary of NHS, for the purchase of multi-family housing in Central Austin.
- * State Farm and Golden Rule Insurance Company have made below-market rate loans (5.25%) of \$500,000 and \$100,000, respectively, to help fund NHS's Revolving Loan Fund.
- * Traveler's Insurance Company has made an \$800,000 market rate loan to NHS for the rehabilitation of a multi-family building in Austin.
- * Allstate has directed fundraising efforts, provided a grant for a vocational training program at Farragut School in Little Village, performed in-kind public relations work and invests in NHSA's secondary loan market.
- * Approximately \$200,000, or 10%, of NHS's yearly budget comes from insurance companies, largely property and casualty companies.
- * Since 1979, insurance companies have provided \$2,354,845 in operational support to NHS and 22 different insurance companies have supported Chicago NHS through grants, investments, training, public relations assistance, and volunteer fund raising.

Neighborhood Housing Services of America (NHSA)

NHSA is a national nonprofit corporation created in 1974 to operate a secondary loan fund using NHS loans. NHSA buys loans from local NHS organizations and then sells collateralized securities, backed by pools of NHS loans, to social investors. Initially NHSA used its own funds to purchase NHS loans. In 1978, the Ford Foundation and NRC contributed loan-fund working capital and the Equitable Life Assurance Society of the United States agreed to invest \$1 million in NHSA notes. To date, 114 NHS organizations have sold loans to NHSA.

Currently 100% of NHSA notes are bought by insurance companies which have active note participation agreements now totaling \$30 million. During the past two years, NHSA has purchased \$5 million in NHS loans per year at 6% with a 12-year term.

NHSA has set up a warehousing system with Bank of America and the Presbyterian Church. These two institutions provide NHS with shorter term capital, i.e., six years, to buy NHS loans. These loans are stored with the two investors until a large amount of similar loan packages are acquired to make larger notes available to insurance companies.

During the last two years, NHSA has been dealing primarily with the Metropolitan Life Foundation, the Equitable Life Assurance Society of the United States, and the Prudential Insurance Company. The only property and casualty company which has dealt with NHSA is Allstate.

The yield on NHSA notes varies from year to year, but the current average is approximately 8% which is two points higher than average NHS loans. NHSA raises grant funds in order to make up the difference.

NHSA is also developing a new Local Government Secondary Market in which they will buy loans from local governments. Allstate has pledged to buy the first \$10 million note.

Neighborhood Reinvestment Corporation (NRC)

NRC was established by the federal Neighborhood Reinvestment Corporation Act to promote reinvestment in older neighborhoods by local financial institutions in cooperation with community residents and local government. NRC is funded primarily through Congressional appropriation. NRC provides ongoing assistance to local NHS organizations through a structure of national and regional advisory councils and in the form of technical assistance, training, conferences and special workshops. NRC also conducts regular program reviews of local NHS organizations to measure local program progress.

Participants

The participants in the NHS network are a mix of local and national government officials, community residents and business leaders.

At the national level NRC is made up of the Chairman of the Federal Home Loan Bank Board; the Secretary of Housing and Urban

Development; a member of the Board of Governors of the Federal Reserve System; the Chairman of the Federal Deposit Insurance Corporation; the Comptroller of the Currency; and the Chairman of the National Credit Union Administration. The NRC Board uses its influence with the businesses regulated by these agencies to support NHS activity.

At the local level, government officials provide funds for new NHS organizations and for the NHS revolving loan fund, as well as target special programs, grants, and loans to NHS neighborhoods.

Local business leaders provide a variety of in-kind services, direct grants, insurance coverage, loans, and investments to the NHS network.

Types of Investments

NHS organizations invest in a number of different kinds of projects including housing rehabilitation, neighborhood economic development, commercial revitalization, energy programs, and industrial development.

Of particular interest is the National Insurance Industry Full Partnership. The Partnership was begun in Chicago in 1978 with NHS, Allstate, Cigna, Fireman's, Liberty Mutual, Kemper/Lumberman's, Prudential, First Marine, State Farm, Hartford Insurance Company of Illinois, Aetna and Travelers Insurance companies. It was established to encourage participation by the property and casualty insurance industry in local NHS organizations through financial support, board participation, and by creating NHS insurance counseling services.

This program has expanded now to 28 cities and receives an average of \$1 million per year from the industry. Other forms of support have also emerged from the Full Partnership including increased underwriting of insurance policies in older, urban neighborhoods, the development of new products (for example, Prudential is establishing a policy for property undergoing rehab); and participation by insurance company staff in NHS boards and communities.

Subsidies Used or Required

NHS activities as a whole are subsidized through a wide variety of grants and loans.

In order to provide an average of an 8% return on NHSA notes to investors, those notes are augmented with:

- grants from NRC: capital grants from NRC are \$550,000 yearly.
- private fundraising: approximately \$2 million has been raised in the past two years. The funds are raised from corporate or private foundations and are used as subsidy dollars.
- internal resources: yields from previous investments that surpass the payment of previous notes. For example, investments from 10 years ago which are currently maturing.

Result

The NHS strategy of creating local partnerships between government, business and community residents has clearly met with success around the country. NHS has been especially effective for residents with limited incomes or special needs wanting to repair their homes and improve their neighborhoods.

The development of NHSA has increased the funds available to local NHS organizations and given corporations an opportunity to make social investments with a market rate of return. Approximately \$30 million in NHSA loans have been purchased by seven insurance companies (Prudential, Metropolitan, Aetna, Allstate, Equitable, Mutual Benefit Life, Employers Insurance of Wausau) since the program began.

General Discussion

Strengths:

Insurance companies have been a consistent partner in NHS programs, with both property and casualty and life insurance companies involved.

Though the extent of their overall support cannot be exactly quantified, they provide a regular percentage of local operating funds (10%) and are participating at all levels of NHS activity.

With their support and support from other businesses and local government, NHS has had an impact in the neighborhoods in which they work in terms of reinvestment and building local leadership and partnerships for the future.

Weaknesses:

Though the NHS partnership approach has proven to be an effective catalyst for neighborhood revitalization, all organizations involved in neighborhood revitalization efforts have the same restriction: the scope of the problem is much greater than the resources available to date. One major factor limiting the scale of investment in NHS is the exclusive use of social investment funds to purchase NHSA notes. Because social investment funds are considered to be riskier and carry a lower return than other types of investments, the amounts available in this investment category are usually very limited. Though 100% of NHSA's notes are bought by insurance companies, some NHS people involved in the program feel considerably more money would be available if the companies can be convinced to buy notes from their regular investment portfolios.

Long-term NHS investments do not meet the liquidity needs of property and casualty companies which, with the exception of Allstate, do not invest heavily in NHSA. However, property and casualty companies have participated in the form of grants, in-kind service and loans at the local NHS level. This type of involvement is likely to benefit the industry over the long run, since healthy, thriving neighborhoods are more likely to use conventional insurers and have fewer thefts, fires and other claims against those policies.

Summary

Insurance company involvement has been critical to the growth of NHS and is likely to continue. Although both life and property and casualty companies have been involved in this growth, with the exception of Allstate, they have participated in two different ways which are compatible with differences in their investment strategies. Property and casualty companies have invested at the local level primarily through grants and in-kind services. Life insurance companies have purchased long-term NHSA securities.

Expanding insurance company involvement will require convincing insurers, particularly purchasers of NHSA securities, to make these investments out of their regular portfolio rather than from the more limited funds available for social investing and seeking additional social investment funds.

Although the development of property and casualty involvement at the local level and life insurance involvement at the national level was not planned by NHS, it illustrates one way to meet the different investment needs of these two types of

insurance companies. Local organizations have a much easier time gaining the attention and support of property and casualty companies which are, by their nature, more likely to be connected to a local community. NHSA, on the other hand, provides a vehicle for approaching the more nationally oriented life insurance companies. As NHS has evolved, each type of organization has been given an investment tool which meets its needs and general orientation.

LOCAL INITIATIVES SUPPORT CORPORATION

Background

In an era of diminished federal support for affordable housing and neighborhood redevelopment efforts, hundreds of America's most determined grassroots groups are successfully fighting disinvestment and despair in their communities with help from an unusual "social investment banker"--the Local Initiatives Support Corporation (LISC).

LISC was founded in 1979 to channel private-sector financial and technical resources to nonprofit community-based groups. Part funder, part project broker, LISC finances these projects and helps neighborhood groups work with banks and local government to build low-income housing and improve commercial and retail services to community residents. This development activity not only improves the quality of community life, it also revives corporate and government commitment to low-income neighborhoods.

LISC was capitalized initially by the Ford Foundation with a \$4.75 million grant. Additional support was provided by banks, large life insurance companies and a manufacturer. Aetna Life and Casualty and the Prudential Insurance Company were among the original corporate supporters of LISC. Subsequently, Ford has given at least an additional \$30 million to LISC. Today LISC has assets of about \$75 million.

In nearly ten years, more than 515 major corporations and foundations--including major insurers, money-center banks and industrial concerns--have contributed over \$200 million to LISC-supported community development projects in 120 cities. Insurance companies participate primarily by contributing to National LISC, although they may, in some cases, participate at the local level by providing insurance for a project or loan.

LISC funds have leveraged an additional \$1 billion from public and private sources, leading to the creation of more than 17,000 housing units and five million square feet of commercial and industrial space. This activity has made LISC one of the nation's largest private, nonprofit community development support organizations.

Program Objectives

LISC's goals are:

- To encourage and support projects that promote the revitalization of deteriorated communities.

- To help build strong ties between community development organizations and investment sources in the local and national private sectors.
- To help strengthen the management capabilities of community development organizations enabling them to raise and effectively invest their own funds.

Program Design

LISC operates through 23 "Local Areas of Concentration." The "local area of concentration" is a LISC term for the areas targeted by the organization. The 23 areas include cities ranging in size from New York to Kalamazoo, Michigan, and regions as diverse as California and eastern North Carolina. Each area is served by LISC staff and a local advisory committee, which recommends projects for funding consideration by National LISC. National LISC commits funds to match those raised by local corporations and foundations. Since 1987, CDCs have received \$48.1 million in direct loan and grant support from LISC.

CDCs use these funds to finance their developments, as well as to attract other private and public sector funds essential to project success. Though LISC seldom finances more than 20% of a project, its involvement in the development makes it easier for other private lenders, investors and government to become active partners in projects of significant scale and neighborhood impact. LISC also provides resources to help strengthen the management capabilities of CDCs, thus enabling them to raise and effectively invest their own funds.

Residential development projects receive 70% of LISC funds. Conventional business standards are used to judge project credit worthiness but there is flexibility about which aspects of development it will finance. LISC often plays a crucial role in the risky pre-development phases of projects by making low-interest (6-7%) loans or grants to cover such costs as architectural and legal fees. LISC also provides construction loans and permanent financing.

As a social investment banker, LISC also seeks creative ways to adapt sophisticated finance instruments for use by CDCs. For example, LISC formed the National Equity Fund (NEF) in 1987 to syndicate corporate investments in low-income rental housing using the federal Low Income Housing Tax Credit. The credit, part of the Tax Reform Act of 1986, provides companies and certain individuals with a competitive return on their investment in the form of tax benefits.

Another LISC affiliate, LIMAC is a secondary market fund designed to increase the flow of funds to CDCs by purchasing seasoned loans to community development projects made by LISC and other institutions. Since 1987, LIMAC has raised \$10.5 million from major corporations and foundations to purchase loans.

In addition to expanding its development finance activities, LISC is putting more resources into building the development capacity of the CDCs. For example, the Chicago office of LISC is currently administering a multi-year, \$11.3 million MacArthur Foundation grant to improve management and organizational skills of Chicago CDCs involved in housing and other real estate projects and to enable them to participate financially in the projects.

Following are fuller treatments of the two LISC financing affiliates.

National Equity Fund

The National Equity Fund has enabled CDCs to expand their development activity. NEF investments have supported the work of 33 CDCs building 58 affordable housing developments in 14 cities across the country. The projects vary widely, including single-family, multi-family and "single room occupancy" housing, both newly built and rehabilitated. All of the projects have received local, state and/or federal support.

The basic tool used by NEF is the Low Income Housing Tax Credit, one of the very few tax shelters still available to large corporations. The credit is awarded annually to the corporation for a ten-year period and can total as much as 90% of eligible costs. Projects are eligible to receive credits if they provide housing for low-income tenants at rents less than 30% of their eligible income, and if the apartments remain affordable for at least 15 years. Though the credit is scheduled to expire at the end of 1989, legislation to extend the credit has been introduced in Congress, and has strong bipartisan support.

In just two years, NEF has raised \$66 million from 45 corporations. Those funds will lead to the creation by 1990 of 2,700 units of affordable housing valued at more than \$200 million. NEF hopes to raise \$80 to \$90 million for its 1989 Fund.

NEF typically purchases a 99% sole limited partnership interest in each investment project, with the CDC general partner retaining a 1% share and management control. Companies purchase "units" of limited partner interest for \$1 million each, paid in over seven years. Investors receive a tax credit in the first year and estimated cumulative tax savings of 150% of their investment and an estimated annual rate of return of 15% to 20%.

NEF's technical staff also works with CDCs and various local technical consultants to develop project proposals which meet NEF's investment standards. These projects must produce quality affordable housing for low-income families; provide competitive, targeted after-tax returns to investors utilizing the tax credit; be sponsored, developed and managed by experienced nonprofit CDCs; increase CDCs' opportunities for growth in production and capacity; and be located in target areas selected for their existing resources and support for housing production.

Insurance companies can use the tax advantage provided through the Equity Fund. However, percent changes in the federal tax code which disallow projected future losses as tax shelters for property and casualty companies make low-income housing tax credits a more attractive investment for these insurers than they were in the past. Consequently, Continental Casualty, which had invested \$1 million in 1987, increased its investment to \$7 million in 1988 and St. Paul Companies invested \$2 million for the first time. Even half share, i.e., \$500,000 for seven years, investments are allowed, making the total yearly investment as small as \$70,000. Insurers provided 40% of the \$52 million NEF raised for its 1988 Fund.

In addition to Continental and St. Paul companies, the following insurers invested in the 1988 fund: Prudential (\$5 million); New York Life (\$2 million); Kansas City Life (\$1 million); Transamerica Occidental (\$1 million) and Mutual Benefit (\$1 million).

Local Initiatives Managed Assets Corporation (LIMAC)

LIMAC is a tax-exempt not-for-profit corporation initially capitalized with grants from the Ford Foundation and LISC. LIMAC's first bond issuance of \$10.5 million was purchased by Aetna, CIGNA, Metropolitan and Prudential insurance companies and the MacArthur and Ford foundations in April 1988. The yield on those bonds was set at the below-market rate of 6%. Future investors are expected to include pension funds, private foundations and other corporations.

LIMAC is designed to purchase loans from community development loan originators (nonprofit intermediaries, city and state public entities, and banks and other commercial lenders), pool them and issue securities backed by these pools of mortgages. Each pool will contain loans from only one of the three categories. Bonds backed by nonprofit loan pools will carry a below-market return, while those backed by public-entity and commercial-lender loan pools will generally carry a market rate. The securities will be sold via private placement to large

institutional investors such as insurance companies, foundations and pension funds.

LIMAC's primary initial focus is on purchasing multi-family housing loans, with a secondary emphasis on commercial/industrial real estate projects in economically depressed areas. These are two of the loan types least served by the existing secondary markets. LIMAC will purchase both bridge and semi-permanent loans and will seek to purchase fixed-rate obligations.

The notes will vary in maturity from three to ten years and longer term bonds will range from fifteen to thirty years. The usual pool size will be approximately \$10 million. LIMAC will cover its operating budget from the spread between its cost of funds and the return on the loans it purchases. The Ford Foundation has guaranteed the top 15% of its first loan pool.

LIMAC has an independent Board of Directors composed of LIMAC investors, representatives of LISC and at-large directors. An Investment Committee reviews all proposed loan purchases before recommending them to the Board for approval.

Types of Investments

LISC works entirely with nonprofit community based groups. Its portfolio is 73% residential, 18% commercial, 7% industrial and 3% other.

Subsidies Used or Required

LISC's work is subsidized with grants and/or loans (providing low or modest returns) from foundations and corporations. Many of these individual projects use city, state or, in a limited number of cases, federal subsidies. Many projects also rely on foundation support.

Participants

"Areas of Concentration": There are now 23 areas of concentration which have worked with 525 CDCs in 120 cities

throughout the nation. Their work has been funded with grants and loans from more than 500 contributors, including corporations, the insurance industry, foundations, individuals and government agencies.

NEF: Insurance companies invested almost 40% of the \$52 million raised for the 1988 fund.

LIMAC: The first investors are CIGNA, Aetna Life & Casualty, the Prudential Insurance Company and Metropolitan Life Insurance Company, along with the MacArthur and Ford foundations. Future investors are expected to include pension funds, private foundations and other corporations.

General Discussion

Both NEF and LIMAC are promising vehicles for further stimulating the flow of private investment money into community development organizations. NEF has gotten off to a fast start, raising \$14.5 million in 1987 and \$52 million in 1988. It hopes to raise \$80 to \$90 million in 1989. Private and nonprofit demand for low-income housing tax credits continues to increase. It is critical that this be extended. LIMAC's goal is to become a centralizing influence on the often fragmented and localized field of community development. LIMAC also wants to expand the supply of community development loans and increase the demand among institutional investors for such loans.

LISC believes LIMAC will use the funds already committed to community development more efficiently by quickly recycling them. Its orientation to fixed-rate loans is designed to encourage banks to offer more fixed rate loans, thus rendering projects less vulnerable to interest rate and refinancing risks. By securitizing these loans, LIMAC hopes to attract new investors to the field. The drawback at this point is that LIMAC has not provided notes carrying a market rate and, therefore, has been limited to corporate social responsibility funds rather than standard investment portfolios. LIMAC plans to provide a market rate of return in the future through its government and commercial lender purchase programs by effectively packaging loans and adding the necessary layers of credit enhancement to provide principal security. It is currently negotiating credit enhancement arrangements with Fannie Mae and Freddie Mac.

Summary

In general, LISC receives only a few grants from insurance companies. However, a number of life insurers find that LISC is a good investment and a number of property and casualty

companies have invested in NEF. With the extension of the low-income housing tax credit and the particular need in the property and casualty industry for a new tax shelter to replace projected future losses, LISC hopes to attract new insurance investors.

LISC still must work with companies to break out of the social investment portfolio. Increasing the use of NEF by property/casualty insurance companies simply requires outreach and education as the tax credit does represent a competitive rate of return for them. LIMAC, however, must reach a point where it can offer market rates. Both are very new funds, however, and have a lot of potential.

VII. ENDNOTES

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5. A secondary market refers to an arrangement where original or primary loans or investments are resold to other parties or investors. For over a century, the mortgage banking industry has thrived on selling loans it originates to investors. This arrangement provides the investor an investment with a steady interest income and the mortgage banker with funds to make additional loans. The mortgage banker profits from fees for originating and servicing the loan. Secondary markets can be loosely organized and formalized as is the case with the Federally-sponsored secondary mortgage markets and organized stock and bond trading exchanges.
6. The Government National Mortgage Association (GNMA) is an agency of the U.S. Department of Housing and Urban Development which promotes the low- and moderate-income housing market by guaranteeing payment on FHA mortgages pooled together to form mortgage bonds. By guaranteeing and pooling these mortgage loans into bonds, they have become regarded as safe investments and have become actively traded in the secondary market, making them very liquid investments as well. The Federal National Mortgage Association (FNMA) is a semi-private corporation created by Congress that actually invests in mortgages (both FHA and Conventional) and issues mortgage-backed securities.

7. Insurance ratings agencies conduct a series of tests on the financial soundness of insurance companies and publish ratios in each area of examination. A company's ratios can be compared to industry averages and to other companies to determine both overall soundness and areas of relative strength and weakness. These ratings are used by insurance companies in dealing with other companies, particularly in reinsurance arrangements; by brokers who purchase insurance on behalf of customers; and by large and sophisticated buyers of insurance. Insurance companies submit to ratings on a voluntary basis and not all companies choose to be rated, though generally only small companies find it unnecessary to have published ratings. A.M. Best Company serves as the major rating service for all the insurance industry.
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