
Government of the District of Columbia



Department of Insurance, Securities and Banking

Testimony of
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Commissioner

A Public Hearing

on Bill B18-1042,

The Capital Access Program Act of 2010

Committee on Public Services and Consumer Affairs
Muriel Bowser, Chairperson
Council of the District of Columbia

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John A. Wilson Building
1350 Pennsylvania Avenue, NW, Room 120
Washington, DC 20004

Good Afternoon Chairperson Bowser, Members of the Committee on Public Services and Consumer Affairs, and Committee Staff. I am Gennet Purcell, Commissioner for the Department of Insurance, Securities and Banking (“DISB” or the “Department”). I appreciate the opportunity to present testimony today on Bill 18-1042, the Capital Access Program Act of 2010 (“Bill”).

Access to capital is a major obstacle for start up businesses and businesses trying to grow and expand. As a result of the recent financial crisis, many banks have consolidated their lending practices and have centralized the processing of loans making it more difficult for small local businesses to explain the unique circumstances of their business and to obtain a loan. Another problem faced by small businesses because of the mergers and acquisitions of banks is that small business loans are decreasing. History demonstrates that as banks become more wary of possible loan defaults in tough times, they react in two ways. First, they “shrink the credit box”, and demand higher down payments, shorter terms, and impose higher interest rates to compensate for likely loan losses. Second, they turn to “credit enhancement” vehicles to decrease their risk of loss in the event of a loan default.

Capital Access Fund (CAF) programs such as the one outlined in the Bill are designed to encourage banks to underwrite loans to a higher risk threshold than conventional lending criteria. Whereas most banks experience loan losses on their traditional loan portfolio of under 0.5% of loan principal outstanding annually, the Bill will allow banks to protect themselves from greater losses with its program-funded reserves. This is where the Bill can assist; by providing credit enhancement for credit risks that are just slightly outside the scope of lender's traditional underwriting, enabling participating banks to make profitable loans to small business owners that would otherwise, on an individual basis, be viewed as too risky.

DISB is supportive of the Bill's overall purpose to increase access to capital for local businesses and nonprofits. The Bill proposes to accomplish this goal by establishing a Capital Access Fund to allow the District of Columbia to use at least \$13.5 million dollars of federal funds to create a public private partnership with financial institutions.

Through this partnership the District government would set up loan loss reserve accounts at participating financial institutions in exchange for that financial institutions' commitment to make loans outside of conventional underwriting standards, or what are termed ("capital access loans"). The

reserve accounts could only be used by an eligible financial institution to cover losses arising from a default on a capital access loan. The reserve accounts would be funded by enrollment fees paid by both the borrower and the bank, and the \$13.5 million provided by the federal government.

To discourage lenders from using capital access funds for their conventional loan portfolio, it will be important to clearly define both “enrolled loans” as loans issued in accordance with the participation agreement and in accordance with the program objectives. The Department believes that this will be a key objective during the rulemaking process and believes the participation of all stakeholders is essential.

Financial institutions eligible to participate in the Capital Access Program include banks, trust companies, banking associations, savings and loan associations, mortgage companies, investment banks, credit unions, and nontraditional financial institutions. For better clarification of this section, the Bill should to define the term “nontraditional financial institutions.”

The Bill requires participating financial institutions to enter into a participation agreement with the Mayor that sets out the terms under which the institution will make contributions to the reserve account and

the criteria for a loan to qualify as a capital access loan. However, the minimum criteria to qualify as a capital access loan are as follows, that:

- The loan be made to a District of Columbia small business, medium sized business, or nonprofit;
- The loan be used by the business or nonprofit to foster economic development; and
- The loan not exceed \$5 million dollars;

Section 305((a)) of the Bill provides generally that the Mayor may not determine the recipient, amount or interest rate of a capital access loan or the fees related to the loan. Section 305(b) of the Bill provides further, that loans are not eligible for the capital access program if they are for residential housing, simple real estate investments, or “inside bank transactions, as defined by the policy board.” For better clarification of this section the Bill needs to define the terms “inside bank transactions” and “policy board.”

Section 306 of the Bill requires the borrower to pay a fee of at least 2% but not to exceed 3.5% of the principal amount of the loan, which shall be deposited in the financial institution’s reserve account. The Bill requires the financial institution to match the fee amount paid by the borrower. The Capital Access Fund may then deposit an amount ranging from 100% to 200% of the combined amount deposited by the borrower and the financial institution into the reserve account. If the financial institution has assets of

more than 1 billion dollars, or has made more than 2 million dollars in capital access loans, the institution is eligible for a 100% match. All other financial institutions are eligible for a 150% match except the two categories eligible for a 200% match: 1) which include loan made within an enterprise zone; and 2) loans made by a community development financial institution.

If the intent of the bill is to ensure \$10 of lending for every dollar invested by the capital access program, the Department would suggest that the Bill place a cap on the percentage of the total dollars that can be deposited in the two categories requiring a 200% match, or provide rulemaking authority to establish similar limits to ensure that the desired leverage is achieved.

Based on our calculations of the worst case scenario, 366 loans with a principal amount of \$250,000 and a 3.5% fee would exhaust all of the federal funds (excluding the 5% administrative fees) and would result in only \$91,500,000 in total lending. Placing a cap on the 200% match category would ensure that the deposits would result in at least \$128,250,000 in total loans.

Also, it is important to note that the Capital Access Program has some similarities with the District's linked deposits program that authorizes the Chief Financial Officer to place deposits in financial institutions in exchange for specific community development loans in low to moderate

income areas. In addition, the capital access program has some similarities to the existing CAPCO program administered by the Department of Insurance Securities and Banking.

An important note is that the Federal Small Business Job Act mandates that in order to be approved for participation in the Capital Access Fund program, a specific department, agency, or political subdivision of the State must be designation to implement the state capital access program and participate in the Program. Also, that all legal action must have been accomplished to participate in the Federal program.

Moreover, the significant amount of responsibility required to administer this program would require hiring additional staff. Since this program is federally funded, DISB would assume that any hiring associated with the Capital Access Program would be exempt from the recent hiring freeze. Finally, although the Bill addresses the annual reporting requirement, it should be amended to include the quarterly reporting required by the federal law.

In sum, the Department is supportive of this Bill and looks forward to working with the Committee to ensure greater access to capital for our small business community.

That concludes my testimony. Thank you again for providing the opportunity for me to testify on this important subject. I will be happy to answer any questions you may have at this time.