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TO THE
HOUSE COMMITTEE ON FINANCE

THE TWENTY-FIFTH STATE LEGISLATURE
REGULAR SESSION OF 2010

Wednesday, February 17, 2010
1:30 p.m.

TESTIMONY ON H.B. NO. 2872 RELATING TO TAXATION

THE HONORABLE MARCUS R. OSHIRO, CHAIR,
AND MEMBERS OF THE COMMITTEE:

My name is Nick Griffin, Commissioner of Financial Institutions ("Commissioner"), testifying on behalf of the Department of Commerce and Consumer Affairs ("Department") in opposition to House Bill No. 2872. The Department opposes this bill which has, among its stated purposes, the temporary repeal of the requirement that $2,000,000 of the tax revenues from banks and other financial corporations be deposited into the Compliance Resolution Fund, and temporary authorization for the Commissioner to expedite the imposition of new fees on banks and other financial corporations.

The bill, in part, diverts the primary funding source for the Department's Division of Financial Institutions ("Division"). Specifically, the bill would, for five years, divert $2 million from the Compliance Resolution Fund and redirect those monies to the general fund. To compensate for the loss of those monies to fund the operations of the Division, the bill would authorize the Commissioner to adopt new rules, or amend existing rules to impose or increase fees authorized to be charged to banks and other financial corporations under Hawaii Revised Statutes ("HRS") Chapter 412, without regard to public notice and public hearing requirements of section 91-3, HRS, the small business impact review requirements of HRS Chapter 201M, or the limit on fee increases under section 92-28, HRS.

Our first objection relates to the proposed amendment of section 241-7, HRS, which was enacted by the Legislature in 1999, to provide a stable, financial services industry-derived source of funding, independent of the general fund, for the operations of the Division, to meet the Accreditation Guidelines of the Conference of State Bank Supervisors (CSBS). As part of the Department's initiative to become fully self-sufficient, the transfer of funds from the taxes paid by banks and other financial corporations to the Compliance Resolution Fund (CRF) was established in 1999 in order to provide the Division with the necessary revenues to support all of its operations. Self-sufficiency was also part of the Division's continuing efforts to achieve and maintain its accredited status by the Conference of State Bank Supervisors ("CSBS"). The CSBS accreditation program, which recognizes those state banking departments that meet the highest standards and practices in state banking supervision, requires that a banking department have adequate funding to supervise and regulate its banks and recommends that a banking department be self-supporting.

Removing this assured, stable source of funding for the Division's operations, and replacing it with a fee-based alternative source of funds ignores the CSBS requirement that accredited bank regulators need a secure source of funding, leaving the Division instead to the uncertainty and unpredictability of funding that would somehow have to be derived from new or increased fees established by rule.

Additionally, the measure's purported dispensation of public notice and hearing requirements, the small business impact review, and the limits on fee increases could be challenged by affected persons, thereby leaving the Division without any source of funding whatsoever.

Further, from a policy standpoint, the imposition of new or increased fees, or both, while maintaining the requirement that banks and other financial corporations continue to pay the tax required under section 241-4, HRS, a tax which, incidentally, would be further increased under this measure, is inconsistent with the Department's long standing focus on reducing the cost of doing business in Hawaii. Because the Division would have to make up the loss of these funds through new or increased fees, the net result is that the affected financial institutions would face a $2 million increase in their cost of doing business. Ultimately, that must be balanced against the need for additional general fund revenues.

If the $2 million is not deposited into the Compliance Resolution Fund (CRF) and the revenue from the increased fees does not generate $2 million, the Division will be required to significantly reduce its operations (including reducing staffing levels) since personnel expenditures comprise approximately 85% to 90% of the Division's expenditures. This could be potentially damaging to Hawaii's consumers and State licensed or chartered financial institutions because:

- Division examinations, investigations, and complaints processing involving State licensed or chartered financial institutions have resulted in administrative enforcement actions that directly benefited Hawaii consumers, with more than $8 million refunded or returned to consumers and the State since 2006. Should the Division be required to significantly reduce staffing levels, no resources will be available to examine Hawaii financial institutions in order to enforce compliance with State and federal consumer protection statutes.
- The current economic crisis, which has been affecting Hawaii's banks for the past eighteen months, has required a significant increase in the frequency and scope of on-site examinations and off-site supervisory efforts. Examinations and supervisory efforts regarding banks and depository financial institutions are most often conducted jointly by the Division and its regulatory colleagues from the Federal Reserve Bank ("FRB") and the Federal Deposit Insurance Corporation ("FDIC"). However,

should the Division be required to significantly reduce staffing levels, there will be no State resources available to examine Hawaii financial institutions and the "local voice" currently provided by the Division will be lost, to the obvious detriment of our State chartered and licensed financial institutions.

It should be noted that a significant reduction in staffing cannot be considered a "temporary" downsizing of the Division since trained and experienced examiners will not be easily replaced when and if the Division is able to hire again. The Division currently employs 24 staff, the majority of whom joined the Division within the past five years. The Division's financial institution examiners, who comprise the majority of the Division's staff, generally have an undergraduate degree in accounting, finance, or related fields when they join the Division. They are then required, particularly in the case of field examiners, to attend a variety of formal schools, administered by either the FRB or the FDIC, and to undergo on-the-job training under the guidance of either a senior Division examiner or FRB/FDIC examiners, before they are ready to take on independent financial services industry examinations on their own. This formal classroom training process takes from three to five years, with an additional two to three years of on-the-job training before a field examiner is fully qualified in their position. Should funding for the Division's operations be redirected to the general fund and revenue from new or increased fees fall short of $2 million, resulting in a significant reduction in the Division's ability to fulfill its mission, those examiners could doubtless find employment in the private sector or with the federal government; however, the State has invested a significant amount of time and money training its existing Division staff and that investment should be preserved, rather than lost.

For these reasons, the Division opposes Sections 4 and 6 of House Bill No.2872, and asks that those sections be stricken from the bill.

Thank you for the opportunity to testify. I would be pleased to respond to any questions you may have.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: BANKS AND FINANCIAL INSTITUTIONS, Increase rate

BILL NUMBER: HB 2872

INTRODUCED BY: Say

BRIEF SUMMARY: Amends HRS section 241-4 to provide that the tax on banks and other financial institutions shall be increased from 7.92% to 8.71%.

Amends HRS section 241-4.3 to increase the alternate tax rate from 4% to 4.7%.

Amends HRS section 241-7 to suspend the deposit of $2 million into the compliance resolution fund.

Amendments made by this act shall apply to the entire net income received for the calendar year preceding January 1, 2011; provided, in the case of a taxpayer operating on a fiscal year basis, the amendments made by this act shall apply to the entire net income received for the fiscal year in which January 1, 2011 occurs.

Directs the commissioner of financial institutions, between July 1, 2010 and December 31, 2010, to adopt new or amend existing rules to impose or increase fees authorized to be charged to banks and other financial corporations without regard to the public notice and public hearing requirements of HRS section 91-3, the small business impact review requirements of HRS chapter 201M, or the limit on fee increases under HRS section 92-28.

This act shall be repealed on December 31, 2015; provided that sections HRS 241-4(a), 241-4.3, and 241-7, shall be reenacted in the form in which they read on the day before the effective date of this act.

EFFECTIVE DATE: July 1, 2010

STAFF COMMENTS: It appears that this measure temporarily increases the tax rates on banks and other financial institutions and suspends the deposit of $2 million into the compliance resolution fund in an attempt to generate additional revenues to address the state's financial crisis. The state needs additional revenues and the easiest thing to do is increase taxes on businesses, in this case the financial institutions. Any increase in costs to a business will, no doubt, be passed on to taxpayers in the form of higher prices of goods and services. In a down economy, taxpayers are examining their spending priorities and paring back their spending - a concept that state government has to adopt to regain control of their finances.

It should be remembered that the bank franchise tax is imposed on financial institutions in lieu of the general excise tax and corporate net income tax. When the 1990 Tax Review Commission made recommendations to restructure the Hawaii tax on banks and other financial institutions, it had intended to eliminate many of the exceptions the financial institutions enjoyed under the general excise tax so that it could bring the franchise tax rates into line with the net corporate income tax rates. However, because the banks did not want to give up their preferences under the general excise tax which were not bank unique, the rate could not be reduced to the top corporate income tax rate of 6.4%. This effort was intended to prepare Hawaii banks to be able to compete in the multi-state banks movement that was sweeping the nation at the time. Thus, consideration might be given to eliminating the general excise tax preferences and then adjusting the bank franchise tax rate in accordance with any adjustment to the corporate income tax rates.

Digested 2/16/10

HAWAII FINANCIAL SERVICES ASSOCIATION

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February 17, 2010

Rep. Marcus R. Oshiro, Chair
and members of the House Committee on Finance
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **House Bill 2872 (Taxation)**
Hearing Date/Time: Wednesday, February 17, 2010, 1:30 P.M.

I am the attorney for the **Hawaii Financial Services Association** ("HFSA"). The HFSA is the trade association for Hawaii's financial services loan companies which make mortgage and other loans and which are regulated by the Hawaii Commissioner of Financial Institutions.

The HFSA **opposes** this Bill as drafted.

This Bill: (1) Increases the tax rate for banks and other financial corporations, (2) Repeals the requirement that $2,000,000 of tax revenues from banks and other financial corporations be deposited into the compliance resolution fund, (3) Authorizes the commissioner of financial institutions to expedite the imposition of fees on banks and other financial corporations, (4) Takes effect on July1, 2010 and sunsets on December 31, 2015, and (5) Applies the change to entire net income received for calendar year preceding January 1, 2011or the fiscal year in which January 1, 2011 occurs.

The Hawaii franchise tax is paid by various financial institutions such as banks, savings and loan associations, financial services loan companies, and other entities. Under Section 2 of this Bill, the tax would increase ten percent from 7.92% to 8.71% until December 31, 2015.

Currently $2 million of the franchise tax collected annually goes to the credit of the Compliance Resolution Fund of the Department of Commerce & Consumer Affairs ("DCCA"). The Compliance Resolution Fund is used to fund the operations of the DCCA, including the Division of Financial Institutions ("DFI"). The $2 million is earmarked for the DFI.

But under Section 4 of this Bill, the $2 million franchise tax would be diverted from the DCCA to the Hawaii General Fund until December 31, 2015. As a result, the revenue of the DFI will be negatively impacted. To make up the shortfall in revenue, it is foreseeable that the fees that Hawaii financial institutions currently pay to the DFI will be increased. Those increased fees could be expeditiously imposed on financial institutions by the DFI using the authority of Section 6 of this Bill. Those anticipated fee increases would be in addition to the increase in the franchise tax.

The HFSA understands Hawaii's challenging fiscal situation. However, the increase in the franchise tax and the anticipated increase in fees will financially burden Hawaii financial institutions which need to maintain capital levels and add to reserves. Any added costs of doing business in Hawaii could ultimately be passed on by the financial institutions (lenders) to Hawaii consumers (borrowers). All these increases will hinder Hawaii's economic recovery.

Accordingly, we ask that you do not pass this bill as drafted. Thank you for considering our testimony.

Marvin S.C. Dang

MARVIN S.C. DANG
Attorney for Hawaii Financial Services Association

(MSCD/hfsa)

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Presentation to the Committee On Finance

Wednesday, February 17, 2010, at 1:30 p.m.

Testimony on Bill H.B. 2872

In Opposition

TO: The Honorable Marcus R. Oshiro, Chair
The Honorable Marilyn B. Lee, Vice Chair
Members of the Committee on Finance

My name is Gary Y. Fujitani, Executive Director of the Hawaii Bankers Association (HBA), testifying on behalf of the Association. HBA is the trade association representing all of Hawaii's FDIC insured depository financial institutions.

We oppose this bill H.B. 2872, the *Bank and Other Financial Corporations Tax Rate; Increase*. The proposed increase in fees and taxes would hamper Hawaii's banks ability to maintain needed capital, add to loan loss reserves and offer credit. A healthy banking industry is necessary to the revival of Hawaii's economic and bank credit is the fuel for the engine of economic growth. Raising bank taxes and fees takes money out of the banks and means less money to lend and at a time, that the government is urging banks to lend, taking money out of the hands of banks is counterproductive to our economic recovery.

Hawaii banks are being challenged to maintain profitability like many other businesses. In these troubled times, our Federal Regulators are imposing stricter capital and loan loss reserve standards. On the federal level, the Administration and FDIC are contemplating raising taxes and fees on banks. To avoid the piling on effect, we need to ensure that banks are not overly burdened with additional fees/taxes that reduce capital levels, hamper our ability to add to reserves and to lend to Hawaii's consumers and businesses.

This bill combined with HB 1926, *Department Of Business, Economic Development, And Tourism Operation Special Fund,* has the tripling effect of dramatically increasing costs for Hawaii banks by 1) adding on a $20 surcharge to every State fee we pay, like the Department of Financial Institution (DFI) hourly examination fee **jumping 50%** from

$40 an hour to $60; 2) an estimated **400% rise** in DFI fees, in addition to the $20 surcharge, in order to make up the $2 million being diverted from the compliance resolution fund to the general fund; and 3) a **10% increase** in the franchise tax rate. The proposed dramatic increase in DFI fees will impact only State of Hawaii chartered banks.

We realize that these are extraordinary times and that we need to work together to help our State recover. Banks are inevitably impacted by the loss of any tax credit but due to the economic conditions, we did not oppose such legislation last year. However, we notice more bills this session that propose to take away tax credits. We will oppose measures that further drain capital required for safety and soundness by our regulators.

These various proposals to dampen profitability of Hawaii banks may have the unintended consequence of affecting the very institutions that should be one of the key drivers in helping turn around Hawaii's economy.

We believe we pay our fair share of taxes/fees on any income we earn in contributing to Hawaii's economy and urge you not to pass this bill which would only increase the disparity between tax paying financial institutions and some of our brethren who do not pay taxes or are not subject to the same jump in fees.

We thank you for allow us to testify and for your consideration of this matter.