HB803, HD1

Measure Title:	**RELATING TO TAXATION.**
Report Title:	**Banks and Other Financial Corporations; Tax Rate Increases**
Description:	**Repeals requirement that $2,000,000 of tax revenues from banks and other financial corporations be deposited into the compliance resolution fund. Effective July 1, 2011. Sunsets on December 31, 2015. (HB803 HD1)**
Companion:	
Package:	**None**
Current Referral:	**CPN, WAM**

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TO THE
SENATE COMMITTEE ON
COMMERCE AND CONSUMER PROTECTION

THE TWENTY-SIXTH STATE LEGISLATURE
REGULAR SESSION OF 2011

Tuesday, March 15, 2011
9:00 a.m.

TESTIMONY ON H.B. NO. 803, H.D.1 RELATING TO TAXATION

THE HONORABLE ROSALYN BAKER, CHAIR,
AND MEMBERS OF THE COMMITTEE:

My name is Iris Ikeda Catalani, Commissioner of Financial Institutions ("Commissioner"), testifying on behalf of the Department of Commerce and Consumer Affairs ("Department") in opposition to House Bill No. 803, H.D.1. The Department opposes this bill which would repeal the current requirement that $2 Million of tax revenues from banks and other financial corporations be deposited into the Compliance Resolution Fund ("CRF") and instead would have those tax revenues deposited into the State's general fund account.

First, this bill takes away a significant and critical amount of the funding for the Division of Financial Institutions (the "Division") that it presently collects, through the CRF from these licensees. Without this funding, the Division would need to re-evaluate its staffing as there would not be enough funding to compensate all of the Division's current financial institution examiners. The current Division budget requested for Fiscal Year 2012 and 2013 is $3.4 million. It collected $2.4 million in Fiscal Year 2010 from banks and other financial institutions. The other $0.4 million collected in Fiscal Year 2010 was from the Division's other licensees (escrow depositories, money transmitters, mortgage loan originators, mortgage loan originator companies, and mortgage servicers) which totaled $2.8 million for Fiscal Year 2010.

The Division pays for all its staff and expenses from the Compliance Resolution Fund. If the Division does not receive the $2 million in each of the Fiscal Years 2012 and 2013, 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 recent economic situation, which has affected Hawaii's banks for the past two years, has also significantly affected the Division. The Division, along with the federal regulators, increased the frequency and scope of on-site examinations and off-site supervisory oversight. 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, State resources would not be available to examine Hawaii financial institutions, provide oversight activities with the federal regulators and provide a "local voice" to address the issue of how financial institutions have been affected by the national and global economic situation.
- Reduced staffing levels will also affect the Division's ability to timely respond to consumer complaints and inquiries from institutions and the general public, and to review and process applications from institutions and from applicants for license or charter. For new applicants, the delays in processing applications will impact their ability to begin engaging in

business, and for existing institutions it will impact their ability to open, relocate, or close branches; acquire or engage in new activities; restructure operations including the acquisition of additional capital and renew existing licenses.

- Additional recent federal requirements have added new regulatory programs to the Division's responsibilities. The new mortgage loan originator ("MLO") and mortgage loan originator company ("MLOC") license requirement, effective January 1, 2011, has dramatically increased the Division's workload. Although positions were allocated by the Legislature last year, the Division prudently did not fill all of those positions and instead attempted to shift resources within the Division to process the thousands of new MLO and MLOC license applications. However, since the effective date of the new law, the Division has not been able to process the license requests in the timely manner that licensees expect and now must fill positions using the funding from the Compliance Resolution fund.

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 27 staff, a significant percentage 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, resulting in a significant reduction in the Division's ability to fulfill its mission, the State would have lost more than funding, but the valuable knowledge and training provided those examiners. These examiners could doubtless find employment in the private sector or with the federal government.

As a corollary to the repeal of our budget, the Division does not have any general funds to supplement our budget and the laws must be changed to allow Division to receive funding from general funds if the Division is going to continue to be required to provide services to licensees and the public.

We also note that Section 241-7, Hawaii Revised Statutes 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 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. 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. Consequently, without the independent funding source and the ability to provide services to licensees and the public, the Division would not receive continued CSBS accreditation. Removing this source of funding for the Division's operations, and not replacing it, leaves the Division with uncertain and unpredictable funding.

We strongly believe the funding source should be restored to the Division's budget to allow the Division to continue to fulfill its mission to license, monitor, investigate, and examine its licensees. The Division has demonstrated that it has lived within its means under the present arrangement consisting of the $2 Million in tax revenues allocated to the CRF in conjunction with the fee-based revenues collected from its licensees.

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

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SUBJECT: BANKS AND FINANCIAL INSTITUTIONS, Disposition of funds

BILL NUMBER: HB 803, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 241-7 to suspend the deposit of $2 million into the compliance resolution fund and provide that the taxes collected on banks and other financial institutions shall be deposited into the general fund between July 1, 2011 and December 31, 2015.

This act shall be repealed on December 31, 2015; provided that HRS 241-7 shall be reenacted in the form in which it read on the day before the effective date of this act.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: It appears that this measure temporarily 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. 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.

The fees charged banks and other similar charges levied on other professions and activities used to go into the general fund until the last financial crisis when the department of commerce and consumer affairs came up with the idea of raising these regulatory oversight fees and putting the proceeds into special funds, arguing that then these fees would be earmarked to conduct the regulatory oversight with which the department is charged. Unfortunately for the various industries and professions, the fees levied were substantially more than was needed to conduct the oversight activities, and within a half dozen years the department was generating annual operating surpluses equal to the department's annual operating budget.

Not wanting to identify which fees were generating surpluses, the proceeds were then channeled in the "compliance resolution" fund where they were all lumped together so that the public could not discern how much belonged to which industry or profession. As this fund began to grow, it became a very large target for the legislature to raid when things turned south in the general fund after 9/11. This prompted the insurance industry to sue, claiming that the fees they paid were to be used only for the regulation of their industry and not to supplement the state general fund. The courts agreed.

While some believe that this decision rules out the return of the fee proceeds to the general fund, it should be remembered that this is how the regulatory fees were handled prior to the 1990's. Fees were paid into the general fund, lawmakers then reviewed the requests for funding the various regulatory programs of the department and determined whether or not the fees being charged covered the cost of the program and either adjusted the fees or made recommendations in order to bring the fees in line with the

costs of the program. Thus, there was a public airing of the fees charged and the services provided for those fees.

While this proposal would temporarily suspend the deposit of $2 million of the banks and financial institutions tax into the compliance resolution fund, that carving out of what used to be general fund receipts underscores the bad public policy it represents. Putting former general fund receipts into special funds reduces the flexibility of lawmakers to utilize all resources to address the core needs and services of the state. It precludes the ability to move funds from one program or service to another as the money in special funds can only be used for the designated purpose.

Consideration should be given to making permanent the disposition of the banks and financial institutions tax proceeds as receipts of the state general fund. General funds should then be appropriated to cover the cost of regulating financial institutions in the state based on the department justification of the costs and expenditures to run that program.

Digested 3/14/11