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## Testimony of the Department of Commerce and Consumer Affairs

**Before the**
**House Committee on Finance**
**Monday, February 25, 2019**
**2:30 p.m.**
**State Capitol, Conference Room 308**

**On the following measures:**
**H.B. 1125, H.D. 1, RELATING TO THE DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS**

Chair Luke and Members of the Committee:

My name is Catherine Awakuni Colón, and I am the Director of the Department of Commerce and Consumer Affairs (DCCA or Department). H.B. 1125, H.D. 1 relates to the base budget of the DCCA's Financial Services Regulation (DFI), program ID CCA-104). The DFI's requests for fiscal biennium (FB) 2019-2021 are reflected in H.B. 1330.

The Department:

(1) **Supports parts I and II of this bill**, which appropriate funds for the FB 2019-2021 operating budget of the DFI; and

(2) **Opposes part III of this bill**, which: (a) repeals the existing statutory requirement that $2,000,000 of certain taxes collected on bank and financial corporations be deposited to the credit of the Compliance Resolution Fund (CRF); (b) requires adjustments to fees and assessments collected by the DFI based on the amount of moneys credited to the division in the CRF; (c)

requires the Commissioner of Financial Institutions (Commissioner) to adjust fees or cease collection of payments when the mortgage loan recovery fund attains a funding level of $750,000.

**Testimony on Parts I and II**

The Department supports parts I and II of this bill make program appropriations for the DFI to carry out its duties. These duties include: (1) addressing the safety and soundness of state-chartered and state-licensed financial institutions; and (2) ensuring regulatory compliance by state-licensed financial institutions, escrow depositories, money transmitters, mortgage servicers, mortgage loan originators, and mortgage loan originator companies by fairly administering applicable statutes and rules to protect the rights and funds of depositors, borrowers, consumers, and other members of the public. Among other things, the DFI:

(1) Charters, supervises, regulates, and examines all state banks and credit unions, foreign bank branches, agencies and representative offices, and intra-Pacific branches;

(2) Licenses, supervises, regulates, and examines non-depository companies including escrow depositories, money transmitters, mortgage loan originators, mortgage loan originator companies, and mortgage loan originator branches and mortgage servicer companies; and

(3) Accepts and investigates complaints by consumers.

**Testimony on Part III**

Section 4 of part III amends Hawaii Revised Statutes (HRS) chapter 241, entitled “Taxation of Banks and Other Financial Corporations,” by deleting the provision that requires transfer of $2,000,000 of the taxes paid each fiscal year to the CRF to support the operations of the DFI.

Section 5 of part III provides for the DFI to assess its state-chartered banks certain amounts, including any administrative costs of the division, but also paradoxically provides that the assessment shall not exceed its ceiling. As currently drafted, it appears that banks and other financial institutions will be paying the full amount of the tax provided for in HRS chapter 241, as well as the full amount of the costs to administer the DFI. In other words, the DFI's state-chartered banks will be paying $2,000,000 more than it currently pays.

Section 5's addition to HRS section 412:2-105(d) will likely change the landscape of the banking industry in Hawaii. Since the special assessment applies only to state-chartered banks, these banks will likely decide to either change to a national charter or close, as they will be unable to determine the assessment for financial planning purposes. When all of these banks change to a national charter, Hawaii will not have a state bank regulator, and banks will be regulated by national regulators. During the last financial crisis, four out of six state-chartered banks were under enforcement orders. It was the Commissioner who convinced the national bank regulators to keep the state-chartered banks in operation, although the national bank regulator strongly suggested closure. Consequently, Hawaii was the only state with no bank closures. The Commissioner chose to assist the state-chartered banks to alleviate their financial crises.

The financial services industry runs on a cyclical cycle with the economy. When the economy is strong, the number of financial institution branches and licensed entities and individuals increases. In contrast, when the economy is showing signs of weakness, the numbers drop. Currently, the cycle is on a downward projection. In FY 2019, the DFI witnessed a $400,000 decrease in revenues as companies closed or decreased the number of branches to service the public. In FY 2022, the ending balance of $1.4M will not be sufficient to cover expenses. The DFI collects the majority of its revenue during the license renewal period, which is October to December of each year.

Assuming the DFI continues to have the same number of state-chartered banks and licensee base, the below chart shows the detrimental consequence of eliminating the franchise tax. While the financial institutions, mortgage loan originators (MLOs), and mortgage loan originator companies (MLOCs) would continue paying the franchise tax, they would receive no supervision from the DFI. Further, only the state-chartered banks would bear the proposed special assessment.

| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 | FY 2023 |
|---|---|---|---|---|---|---|
| **Revenues** | **$5,678,123** | $4,787,705 | $2,656,000 | $2,658,000 | $2,656,000 | 2,656,000 |
| **Expenditure** | **$4,231,480** | $4,514,147 | $5,096,803 | $5,096,803 | $5,096,803 | 5,096,803 |
| **Overhead** | **$643,137** | $688,703 | $688,703 | $688,703 | $688,703 | 688,703 |
| **Net (if revenue)** | **$803,505** | ($415,145) | ($3,129,506) | ($3,127,506) | ($3,129,506) | ($3,129,506) |
| **Ending Balance from reserves** | **$11,209,350** | $10,794,205 | $7,664,699 | $4,537,193 | $1,407,687 | ($1,721,819) |

Section 6 requires the DFI to cease payments into the Mortgage Loan Recovery Fund. HRS section 454F-41 established this trust fund to compensate consumers who suffered loss involving fraud, misrepresentation, or deceit by an MLO or an MLOC. Although recovery is capped at $25,000 per transaction, if an MLO defrauds a consumer for one year, the amount defrauded would be $300,000 ($25,000 x 12 monthly mortgage payments). Currently, the DFI is aware of claims totaling at least $200,000 from consumers who are still going through the circuit court process.

Since 2014, the Commissioner has used the authority in HRS section 454F-41(d) to determine the Mortgage Loan Recovery Fund is sufficient to cover known claims. Accordingly, the Commissioner has stopped collecting payments into the fund for existing MLOs and MLOCs. Hawaii is seen as an attractive place to be an MLO or MLOC because of the high price of real estate. A mainland MLO would have to originate three to four mortgage loans to constitute one origination in Hawaii. Although the mainland MLOs are required to learn Hawaii's laws, they are not fastidious in complying with those laws. Approximately 70% of the MLOs live on the mainland. Consequently, all new MLOs and MLOCs are required to pay into the Mortgage Loan Recovery Fund, as existing MLOs and MLOCs should not have to pay for the bad acts of MLOs who did not contribute to the recovery fund.

| | FY 2015 (actual) | FY 2016 (actual) | FY 2017 (actual) | FY 2018 (actual) |
|---|---|---|---|---|
| Appropriation ceiling | 220,000 | 220,000 | 220,000 | 110,000 |
| Beginning cash balance | 1,124,965 | 1,429,665 | 1,578,165 | 1,813,815 |
| Payments | $304,700 | $148,500 | $235,650 | $176,900 |

Thank you for the opportunity to testify on this bill.

Hawaii Bankers Association
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LATE

Presentation to The
Committee on Finance
February 25, 2019 at 2:30 P.M.
State Capitol Conference Room 308

**Testimony in Opposition to House Bill 1125, HD 1**

TO: The Honorable Sylvia Luke, Chair, Committee on Finance
The Honorable Ty J.K. Cullen, Vice Chair Committee on Finance
Members of the Committee

My name is Neal K. Okabayashi, the Executive Director of the Hawaii Bankers Association (HBA). HBA is the trade association representing banks with branches in Hawaii.

This bill mirrors House Bill 1528 in that it seeks to amend the current fee and assessment structure for state banks and will increase the fees and assessments for state banks but not federally chartered banks. There are currently six state banks. They are First Hawaiian Bank, Bank of Hawaii, Central Pacific Bank, Territorial Savings Bank (that recently converted from a federal charter to a state charter), Finance Factors, and Ohana Pacific Bank.

Presently, state banks pay (1) a franchise fee; (2) expenses in connection with examination, and (3) an assessment outlined in section 412:105.2. If this bill is enacted, state banks will pay an additional fee that is difficult for banks to determine in advance for budgeting purpose because it is based on a formula difficult to calculate.

We understand that the purpose of this measure is to decrease the reserves held by the Division of Financial Institutions (DFI) by adding a new section 412: 2-105(d) but even after the reserves are depleted the banks will continue to pay the additional third fee that is based on the reserve amount.

Reserves are a necessary item for banks and in fact, we are required to have it by law, so we understand the need for reserves. Among other purposes, one purpose is to have liquidity for unknown and unexpected needs. Thus, we respectfully request that HB 1125, HD 1, be held in Committee.

Thank you for the opportunity to submit this testimony on HB 1125, HD 1 and for the reasons set forth herein, we oppose this bill. Please let us know if we can provide further information.

Neal K. Okabayashi
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LATE

# HAMB

Hawaii Association of Mortgage Professionals
PO Box 1074, Honolulu, HI 96808

TO: The Honorable Sylvia Luke, Chair
The Honorable Ty J.K.Cullen, Vice Chair
Members of the Committee on Finance

**RE: Testimony HB1125 HD1**– Monday Feb 25, 2019 – Room 308

I am Bobby Chow, the President of the Hawaii Association of Mortgage Professionals (HAMB). We are a trade association that represents the residential mortgage brokerage industry and are regulated by the Department of Financial Institutions (DFI) under the DCCA in Hawaii

We oppose the portion HB 1125 HD1, dealing with repeal of funding to DCCA, for the following reasons:

1. The elimination of a current $2,000,000 annual funding to DCCA impacts approximately 40% of the existing revenue stream to DCCA and is highly likely to seriously disrupt operation of the department negatively impacting the regulated parties and the public.
2. The option of replacing the funds collected with varying annual assessment to financial entities to the sum of something like $2,000,000 is a tangible increase in operating costs related to being a Hawaii based financial Institution.

We do recognize that the current fee and tax structure has resulted in substantial cumulative surpluses in the DCCA CRF operating account and in numerous special Recovery and Education fund accounts under DCCA control. We certainly support the sections of the bill to cap and control the overall size and continued collection of fees paid by the regulated entities. Some funds are as much as double the statutory caps and are a drain on the businesses that continue to add to the overages.

As to the DCCA's current surplus in the primary operating CRF account: We recommend that the committee strongly consider directing that the budgeting process for DCCA specifically include annual consideration of reserves in the CRF. It should make adjustment for the return of funds to the general fund when appropriate while maintaining operational balance. It is our understanding that this has been accomplished informally in several previous years. This would be much less disruptive than permanently underfunding the revenue stream to the department and the financial cost and uncertainty of the assessment process to the affected businesses.