

# S.B. NO. 1398

JAN 22 2007

## A BILL FOR AN ACT

RELATING TO ESCROW DEPOSITORIES.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1           SECTION 1. Chapter 449, Hawaii Revised Statutes, is  
2 amended by adding two new sections to be appropriately  
3 designated and to read as follows:

4           "§449- Disclosures involving personal property. An  
5 escrow depository that receives, holds, and delivers the money,  
6 other consideration, or instrument affecting title to personal  
7 property must disclose in writing to all parties involved in the  
8 transaction that the transaction is not covered by this chapter.

9           §449- Submission of security breach information. Upon  
10 discovery or notification of any security breach, as defined  
11 under chapter 487N, of the personal information of individuals  
12 whose personal information was, or is reasonably believed to  
13 have been, acquired by an unauthorized person, the escrow  
14 depository shall provide notice of the security breach to the  
15 commissioner. The notice shall be made without unreasonable  
16 delay and shall be consistent with any measures necessary to  
17 determine the scope of the breach, and restore the reasonable  
18 integrity, security, and confidentiality of the data system."

1 SECTION 2. Section 449-1, Hawaii Revised Statutes, is  
2 amended by amending the definition of "escrow" to read as  
3 follows:

4 "Escrow" means any transaction affecting the title to real  
5 property, including leaseholds, proprietary leaseholds, and  
6 condominiums, in which a person not a party to the transaction  
7 and neither having nor acquiring any interest in the title  
8 receives from one party to the transaction, holds until the  
9 happening of an event or performance of a condition and then  
10 delivers to another party to the transaction, any money or other  
11 consideration or any instrument affecting the title to that real  
12 property, all in accordance with the terms of the agreement  
13 between the parties to the transaction. For purposes of this  
14 chapter, "escrow" does not mean a transaction affecting title to  
15 personal property."

16 SECTION 3. Section 449-4, Hawaii Revised Statutes, is  
17 amended to read as follows:

18 "~~§449-4~~ **Administrative penalty.** Any person who [wilfully]  
19 violates any of the provisions of this chapter, [~~shall~~] may be  
20 subject to an administrative fine of up to \$5,000 for each  
21 violation. [~~No licensee shall be subject to this penalty for a~~  
22 ~~violation of section 449 16(b) or (c) if the violation was not~~

1 ~~intentional or resulted from a bona fide error, notwithstanding~~  
2 ~~the maintenance of procedures reasonably adopted to avoid that~~  
3 ~~error. Examples of bona fide errors include, but are not~~  
4 ~~limited to, clerical miscalculations, computer malfunction,~~  
5 ~~printing errors, and computer programming errors.] "~~

6 SECTION 4. Section 449-5.5, Hawaii Revised Statutes, is  
7 amended to read as follows:

8 "**§449-5.5 Net capital.** The net capital of any corporation  
9 engaging in the escrow depository business under this chapter  
10 shall be not less than [~~\$50,000~~] \$500,000. A corporation in  
11 lieu of the net capital requirement may alternatively file a  
12 bond for [~~\$50,000~~] \$500,000 conditional upon its satisfactory  
13 performance of escrow conditions and satisfaction of all escrow  
14 liabilities. The amount of the minimum net capital of [~~\$50,000~~],  
15 \$500,000, or the bond, or a combination of both net capital or  
16 bond totalling [~~\$50,000~~] \$500,000 shall be maintained at all  
17 times by the licensee.

18 [~~Licenses in operation~~] Any escrow depository licensed  
19 under this chapter on [May 24, 1973, pursuant to this chapter]  
20 the effective date of this Act with a net capital of less than  
21 [~~\$50,000~~] \$500,000 shall increase its net capital to [~~\$50,000~~]  
22 \$500,000 or file a bond for [~~\$50,000~~], \$500,000, or take action

S.B. NO. 1398

1 so that a combination of its net capital and bond totals  
2 [~~\$50,000,~~] \$500,000, before [~~May 24, 1978.~~] July 1, 2008."

3 SECTION 5. Section 449-6, Hawaii Revised Statutes, is  
4 amended by amending subsection (b) to read as follows:

5 "(b) The application shall contain the following  
6 information:

7 (1) The corporate name, amount of capital, and office  
8 address of the applicant;

9 (2) The names of the stockholders, officers, and directors  
10 of the applicant;

11 (3) Evidence of the character, financial responsibility,  
12 experience, and ability of the officers and directors;

13 [~~and~~]

14 (4) The names of the proposed escrow officers and their  
15 qualifications~~[-]~~; and

16 (5) Information for each of the proposed officers,  
17 directors, and escrow officers of the applicant,  
18 accompanied by the appropriate payment of the  
19 applicable fee for each criminal history record check  
20 to be conducted in accordance with section 846-2.7."

21 SECTION 6. Section 449-15, Hawaii Revised Statutes, is  
22 amended by amending subsection (b) to read as follows:

1           "(b) The audited financial statements shall be prepared in  
2 accordance with generally accepted accounting principles and the  
3 examination by the independent certified public accountant shall  
4 be performed in accordance with generally accepted auditing  
5 standards. The financial statements and the independent  
6 certified public accountant's report shall include but not be  
7 limited to the following:

8           (1) An unqualified opinion on the fair presentation of the  
9 financial statements taken as a whole. To the extent  
10 that this is not possible, then a detailed footnote  
11 explaining the reason why an unqualified opinion could  
12 not be given shall suffice;

13           (2) A direct verification of escrow funds and escrow  
14 liabilities. If less than a one hundred per cent  
15 verification is performed, there shall be a separate  
16 letter from the independent certified public  
17 accountant indicating: the number of accounts  
18 verified; the percentage of the verification; the  
19 basis for determining the sample size; the method used  
20 in selecting the sample items to verify; a description  
21 of the sampling technique used; the discrepancies  
22 noted; and how the discrepancies were resolved;

1 (3) Footnotes to the audited financial statement showing  
2 the escrow funds and escrow liabilities and, to the  
3 extent that these amounts differ, a reconciliation of  
4 the amounts; [~~and~~]

5 (4) A statement as to whether the escrow depository is in  
6 compliance with this chapter. If the independent  
7 certified public accountant reports any incident  
8 involving noncompliance, the statement shall address  
9 whether the noncompliance may have a material adverse  
10 impact on the ongoing operations of the company[-];  
11 and

12 (5) A statement as to whether the escrow depository is in  
13 compliance with chapter 523A."

14 SECTION 7. Section 449-16, Hawaii Revised Statutes, is  
15 amended to read as follows:

16 "§449-16 Accounting for moneys, property, etc. (a) Every  
17 licensee under this chapter shall have the responsibility of a  
18 trustee for all moneys, other consideration, or instruments  
19 received by it. No licensee shall mingle any such moneys or  
20 other property with its own moneys or other property, or with  
21 moneys or other property held by it in any other capacity. All  
22 moneys held by a licensee in escrow as herein defined shall be

1 deposited in financial institutions, payable on demand. Under  
2 this chapter, deposits in financial institutions are limited to  
3 sweep accounts as described in this section, checking accounts,  
4 money market deposit accounts, and savings accounts with no  
5 specified maturity date. Deposits at financial institutions may  
6 be held in sweep accounts, provided that:

7 (1) The licensee using the sweep account shall have a net  
8 worth of not less than \$1,000,000;

9 (2) The sweep account is a deposit account administered by  
10 a financial institution in which the moneys over a  
11 minimum balance are periodically transferred into a  
12 money market mutual fund account invested only in  
13 obligations of:

14 (A) The United States government;

15 (B) Agencies backed by the full faith and credit of  
16 the United States government; or

17 (C) Agencies originally established or chartered by  
18 the United States government to serve public  
19 purposes; and

20 periodically recredited to the sweep account; and

1           (3) The licensee is liable for all moneys transferred to  
2           the money market mutual fund account under the sweep  
3           account, including any loss of value.

4           (b) No licensee shall [~~disburse funds from an escrow~~  
5 ~~account until cash and or items sufficient to fund any~~  
6 ~~disbursements from the account have been received and deposited~~  
7 ~~to the account, and with respect to such items the licensee~~  
8 ~~complies with the provisions of either paragraphs (1) or (2)~~  
9 ~~hereof.~~

10          ~~(1) Where an item has been received and submitted for~~  
11           ~~collection, no licensee shall disburse funds from an~~  
12           ~~escrow account with respect to the item until final~~  
13           ~~settlement of the item has been received by the~~  
14           ~~financial institution to which the item has been~~  
15           ~~submitted for collection.~~

16          ~~(2) No licensee shall disburse funds from the escrow~~  
17           ~~account with respect to an item drawn on a financial~~  
18           ~~institution until the licensee confirms that~~  
19           ~~sufficient collected funds are on deposit in the~~  
20           ~~drawer's account.] make a disbursement on behalf of a~~  
21           ~~specific escrow unless sufficient collected funds have~~  
22           ~~been received for that escrow.~~



1       ~~[(c) A licensee may deliver any money, consideration, or~~  
2 ~~instrument affecting the title to real property prior to funds~~  
3 ~~becoming available for disbursement under subsection (b) if it~~  
4 ~~has received the written consent of the parties to the~~  
5 ~~transaction.] "~~

6       SECTION 8. Section 846-2.7, Hawaii Revised Statutes, is  
7 amended by amending subsection (b) to read as follows:

8       "(b) Criminal history record checks may be conducted by:

- 9       (1) The department of health on operators of adult foster  
10       homes or developmental disabilities domiciliary homes  
11       and their employees, as provided by section 333F-22;
- 12       (2) The department of health on prospective employees,  
13       persons seeking to serve as providers, or  
14       subcontractors in positions that place them in direct  
15       contact with clients when providing non-witnessed  
16       direct mental health services as provided by section  
17       321-171.5;
- 18       (3) The department of health on all applicants for  
19       licensure for, operators for, and prospective  
20       employees, and volunteers at one or more of the  
21       following: skilled nursing facility, intermediate  
22       care facility, adult residential care home, expanded

- 1 adult residential care homes, assisted living  
2 facility, home health agency, hospice, adult day  
3 health center, special treatment facility, therapeutic  
4 living program, intermediate care facility for the  
5 mentally retarded, hospital, rural health center and  
6 rehabilitation agency, and, in the case of any of the  
7 above-related facilities operating in a private  
8 residence, on any adult living in the facility other  
9 than the client as provided by section 321-15.2;
- 10 (4) The department of education on employees, prospective  
11 employees, and teacher trainees in any public school  
12 in positions that necessitate close proximity to  
13 children as provided by section 302A-601.5;
- 14 (5) The counties on employees and prospective employees  
15 who may be in positions that place them in close  
16 proximity to children in recreation or child care  
17 programs and services;
- 18 (6) The county liquor commissions on applicants for liquor  
19 licenses as provided by section 281-53.5;
- 20 (7) The department of human services on operators and  
21 employees of child caring institutions, child placing

1 organizations, and foster boarding homes as provided  
2 by section 346-17;

3 (8) The department of human services on prospective  
4 adoptive parents as established under section 346-  
5 19.7;

6 (9) The department of human services on applicants to  
7 operate child care facilities, prospective employees  
8 of the applicant, and new employees of the provider  
9 after registration or licensure as provided by section  
10 346-154;

11 (10) The department of human services on persons exempt  
12 pursuant to section 346-152 to be eligible to provide  
13 child care and receive child care subsidies as  
14 provided by section 346-152.5;

15 (11) The department of human services on operators and  
16 employees of home and community-based case management  
17 agencies and operators and other adults, except for  
18 adults in care, residing in foster family homes as  
19 provided by section 346-335;

20 (12) The department of human services on staff members of  
21 the Hawaii youth correctional facility as provided by  
22 section 352-5.5;

S . B . NO . 1398

- 1           (13) The department of human services on employees,  
2                   prospective employees, and volunteers of contracted  
3                   providers and subcontractors in positions that place  
4                   them in close proximity to youth when providing  
5                   services on behalf of the office or the Hawaii youth  
6                   correctional facility as provided by section 352D-4.3;
- 7           (14) The judiciary on employees and applicants at detention  
8                   and shelter facilities as provided by section 571-34;
- 9           (15) The department of public safety on employees and  
10                   prospective employees who are directly involved with  
11                   the treatment and care of persons committed to a  
12                   correctional facility or who possess police powers  
13                   including the power of arrest as provided by section  
14                   353C-5;
- 15           (16) The department of commerce and consumer affairs on  
16                   applicants for private detective or private guard  
17                   licensure as provided by section 463-9;
- 18           (17) Private schools and designated organizations on  
19                   employees and prospective employees who may be in  
20                   positions that necessitate close proximity to  
21                   children; provided that private schools and designated  
22                   organizations receive only indications of the states

1 from which the national criminal history record  
2 information was provided as provided by section 302C-  
3 1;

4 (18) The public library system on employees and prospective  
5 employees whose positions place them in close  
6 proximity to children as provided by section 302A-  
7 601.5;

8 (19) The State or any of its branches, political  
9 subdivisions, or agencies on applicants and employees  
10 holding a position that has the same type of contact  
11 with children, dependent adults, or persons committed  
12 to a correctional facility as other public employees  
13 who hold positions that are authorized by law to  
14 require criminal history record checks as a condition  
15 of employment as provided by section 78-2.7;

16 (20) The department of human services on licensed adult day  
17 care center operators, employees, new employees,  
18 subcontracted service providers and their employees,  
19 and adult volunteers as provided by section 346-97;

20 (21) The department of human services on purchase of service  
21 contracted and subcontracted service providers and  
22 their employees serving clients of the adult and

1 community care services branch, as provided by section  
2 346-97;

3 (22) The department of human services on foster grandparent  
4 program, senior companion program, and respite  
5 companion program participants as provided by section  
6 346-97;

7 (23) The department of human services on contracted and  
8 subcontracted service providers and their current and  
9 prospective employees that provide home and community-  
10 based services under Section 1915(c) of the Social  
11 Security Act (42 U.S.C. §1396n(c)), as provided by  
12 section 346-97; [and]

13 (24) The department of commerce and consumer affairs on  
14 proposed officers, directors, and escrow officers of  
15 the applicant for a license as an escrow depository as  
16 provided by section 449-6; and

17 [~~(24)~~] (25) Any other organization, entity, or the State,  
18 its branches, political subdivisions, or agencies as  
19 may be authorized by state law."

20 SECTION 9. Statutory material to be repealed is bracketed  
21 and stricken. New statutory material is underscored.

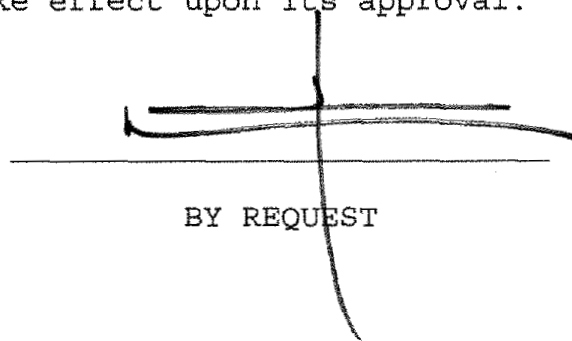
S.B. NO. 1398

1 SECTION 10. This Act shall take effect upon its approval.

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INTRODUCED BY:



4

BY REQUEST

JUSTIFICATION SHEET

DEPARTMENT: Commerce and Consumer Affairs

TITLE: A BILL FOR AN ACT RELATING TO ESCROW DEPOSITORIES.

PURPOSE: The purpose of this bill is to amend chapter 449, Hawaii Revised Statutes ("HRS"), with the goal of improving the strength of escrow depositories in Hawaii and enhancing the procedures for their licensing and regulation by the division of financial institutions ("DFI").

MEANS: Add two new sections to chapter 449, HRS; amend sections 449-1, 449-4, 449-5.5, 449-6(b), 449-15(b), 449-16, and 846-2.7(b), HRS.

JUSTIFICATION: Revisions to the escrow depository law are needed to: (1) clarify which escrow transactions are covered by the statute and which are not; (2) update the statute in order to adequately reflect the present day size of the transactions routinely handled by the industry; (3) provide for more flexibility in supervising and regulating the industry; and (4) ensure adequate protection for the consumer.

The statute currently defines "escrow" as any transaction affecting title to real property. That definition is being amended to emphasize that chapter 449, HRS, does not apply to transactions that affect title to personal property. In addition, the statute presently contains no express recognition of the fact that many licensed escrow depositories routinely handle escrow transactions affecting title to personal property. Therefore, a new section is added to require that an escrow depository disclose to all parties involved in a transaction involving personal property that



the transaction is not covered by this chapter.

In light of the enactment, in 2006, of chapter 487N, HRS, relating to protection of individuals from security breaches, the definition of a "security breach" used in that statute is now incorporated by reference into chapter 449, HRS, in a new section that mandates that a licensed escrow depository notify DFI promptly in the event of a security breach at a licensed escrow depository involving the personal information of individuals. Such notification will enable DFI to monitor, as necessary, any remedial action taken by the affected escrow depository.

The section pertaining to administrative penalties is amended to provide that an administrative fine of up to \$5,000 may be imposed, rather than a fixed fine of \$5,000 in all cases; and that an administrative fine is not limited solely to instances of a wilful violation of a provision of the chapter. These amendments will afford the Commissioner of Financial Institutions (the "Commissioner") reasonable discretion and flexibility in evaluating the intent and severity of a particular violation, and will thereby enable the Commissioner to assess an administrative fine that is appropriate to the circumstances. This discretion and flexibility is presently unavailable to the Commissioner under the statute.

The current minimum net capital requirement of \$50,000 for an escrow depository has not been modified since it was enacted in 1973, with the result that, 34 years later, escrow depositories are seriously undercapitalized in relation to the size and volume of the

escrow transactions that they routinely handle. To remedy this deficiency, the minimum net capital requirement is being increased, by amendment, from \$50,000 to \$500,000, in order to maintain an adequate level of protection for consumers in view of the average dollar amounts of present day real estate escrow transactions in Hawaii. An escrow depository that does not have the new required minimum net capital on the effective date of the Act will be given until July 1, 2008 to meet the \$500,000 requirement.

A new requirement is added to address a long-standing deficiency in the statute in connection with the application process for an escrow depository license. An amendment to the statute will now require proposed directors and officers, including escrow officers of an applicant, to submit necessary personal information, along with the requisite fee, to obtain a criminal history record check for each such individual.

This requirement reflects the same prudential standards imposed under current federal laws for employees of depository financial institutions who routinely have access to customer funds. While escrow depositories are not federally regulated, they have fiduciary obligations that are quite similar to those of depository institutions, in that escrow depositories must preserve, intact, their customers' funds in an escrow depository account. This amendment will put in place a requirement for a criminal history background check for those individuals in the company who are likely to have routine access to, responsibility for, and control of these

funds.

The audited statements provision is amended to require that the auditor's report determine whether the escrow depository is in compliance with chapter 523A, HRS, relating to unclaimed property. The absence of such a requirement is considered by the Commissioner to be a deficiency in the current statute.

Section 449-16, HRS, is amended by amending subsection (b), including the deletion of numbered paragraphs (1) and (2) thereof, because those two paragraphs have created undesirable ambiguity in construing the law; and by deleting subsection (c), which is now perceived to be directly antithetical to the regulatory purpose of the statute, namely, to safeguard a consumer's property and funds while in the custody of an escrow depository.

Section 846-2.7(b), HRS, is amended to authorize the Department of Commerce and Consumer Affairs to conduct criminal history record checks on those individuals expressly identified in section 449-6(b)(5), HRS.

Impact on the public: This amendment provides improved regulatory oversight of the escrow depositories industry by the department and DFI, thereby enhancing protection of the consumer, and maintenance of public confidence in this industry. An escrow depository that does not meet the new minimum net capital requirement by July 1, 2008, will either need to raise additional capital or incur additional cost because it will be required to post a bond in an amount equivalent to its net capital deficiency.

Impact on the department and other agencies:

It is not expected that the department or other agencies would be adversely impacted by enactment of this proposal. Supervision and regulation of the escrow depositories industry will continue.

GENERAL FUND: None.

OTHER FUNDS: None.

PPBS PROGRAM  
DESIGNATION: CCA-104.

OTHER AFFECTED  
AGENCIES: Hawaii Criminal Justice Data Center.

EFFECTIVE DATE: Upon approval.