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TO THE
HOUSE COMMITTEE ON CONSUMER PROTECTION AND COMMERCE
THE TWENTY-FOURTH STATE LEGISLATURE
REGULAR SESSION OF 2008

Wednesday, January 30, 2008
2:00 p.m.

TESTIMONY ON H.B. NO. 2408 - RELATING TO MORTGAGE BROKERS

THE HONORABLE ROBERT N. HERKES, 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"). We appreciate the opportunity to testify on House Bill No. 2408 relating to mortgage brokers.

The Department opposes this bill, which we feel is a cosmetic amendment to an existing, and, in light of the current national climate, arguably deficient statute, the historic objective of which has been to serve as a simple and non-selective registry for industry

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participants. As such, it is inadequate as a foundation for a program to meet the challenges of today's increasingly complex mortgage markets.

The Department instead recommends that this Committee give serious consideration to House Bill No. 3088, which provides well thought out, wide ranging solutions for the regulatory and supervisory framework necessary to ensure that the mortgage brokerage industry here in Hawaii operates for the benefit of brokers and consumers alike.

While the intent of House Bill No. 2408 is reportedly to improve the regulation of mortgage brokers and mortgage solicitors, which are referred to as "loan originators", the bill falls significantly short of providing the robust regulatory and supervisory framework which has been the hallmark of effective state consumer protection programs, and which are now, in the midst of the most damaging mortgage loan crisis in memory, being mandated by Federal legislative initiatives which have been passed by the U.S. House of Representatives and are under consideration in the U.S. Senate.

The Federal H.R. 3915, *The Mortgage Reform and Anti-Predatory Lending Act of 2007*, if enacted, would require the Secretary of Housing and Urban Development ("HUD") to provide for the establishment and maintenance of a Federal program for states that do not have in place a system for regulation and licensing that meets Federal requirements. The program envisioned by House Bill No. 2408 does not meet these Federal requirements. A review of the bill reveals the following major shortcomings:

- There is no provision for Hawaii's participation in the Nationwide Mortgage Licensing System ("NMLS"), as would be required upon passage of Federal H.R. 3915. This system, which became operative in 2008, is the backbone of state and federal mortgage broker/loan originator programs, and states that do not participate would become immediate targets for HUD's further scrutiny. We therefore strongly urge this Committee to ensure that any proposed mortgage broker related bill should include specific provisions establishing this State's participation in the NMLS as expeditiously as possible. House Bill No. 3088, drafted by the Department, contains provisions providing for State membership and participation in a uniform multi-state licensing system.
- A new section entitled "Employer-employee relationship" states that nothing in the chapter shall be deemed to create an employer-employee relationship between mortgage brokers and independent contractors and that the Commissioner has the power to regulate such relationships. This power is not only statutorily beyond the Commissioner's authority¹, but would be a significant diversion from the primary duties and responsibilities of the Division of Financial Institutions ("DFI"), which are

¹ This provision may present legal issues in terms of existing labor and tax laws, in that the Hawaii Supreme Court has specifically addressed what does and does not create an employer-employee relationship, and no such disclaimer can change such relationships. It is also beyond the Commissioner's statutory authority to regulate such relationships.

focused on safety and soundness and consumer protection. House Bill No. 3088, drafted by the Department, focuses on issues related to appropriate industry practices and consumer protection issues and does not address initiatives beyond the scope of a regulatory and supervisory framework necessary to ensure that the mortgage brokerage industry here in Hawaii operates for the benefit of brokers and consumers alike.

- A new Subsection (e), pertaining to suspension and revocation of a license, which is being added to Section 454-5, Hawaii Revised Statutes ("HRS"), is unacceptable as it requires the Commissioner to obtain a court order to enforce the section. This appears to conflict with the Commissioner's existing rights to bring a Chapter 91 proceeding, and also is not in accord with the normal and customary process of financial institution regulation and supervision, which places a premium on prompt and decisive action with respect to unsafe and unsound conduct or violations of consumer protection statutes. House Bill No. 3088, drafted by the Department, retains the Commissioner's existing rights to bring a Chapter 91 proceeding, in accord with the normal and customary process of financial institution regulation and supervision, which places a premium on prompt and decisive action with respect to unsafe and unsound conduct or violations of consumer protection statutes.

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In addition to the numerous unremarked lapses, oversights and contradictions in House Bill No. 2408, there are three major deficiencies in this bill which essentially disable the initiative:

- The effective date of House Bill No. 2408, with the exception of Section 454-A, is envisioned as “upon approval”. DFI research and planning on this issue indicates that given the significant logistical challenges associated with moving an ongoing program from one division to another, any implementation of such a transition would involve a far longer time horizon. House Bill No. 3088, drafted by the Department, adheres to a realistic, process driven timeline focused on addressing all elements of this significant shift of functional, regulatory, and supervisory oversight, from PVL/RICO to DFI which involves, at a minimum, the drafting and approval of administrative rules, the hiring and training of new licensing staff, the implementation of a new application process and format compatible with the NMLS and the increased pre-licensing requirements, the development and sub-contracting of pre-licensing testing and continuing education programs, the arrangement of programs and processes for criminal background checks and the development, staffing and training of a field examination team.

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- While the stated intent of this bill is to shift the responsibility of regulating mortgage brokers and loan originators from the Professional and Vocational Licenses Division ("PVL") to DFI, the provisions of Chapter 436B, HRS, the Uniform Professional and Vocational Licensing Act, which apply under Chapter 454, HRS when PVL is the licensing authority, are not relevant should DFI become the licensing authority, as mandated in this bill, since DFI is not now, nor has it ever been, a board or commission contemplated by, and subject to, Chapter 436B, HRS. As a result, DFI, although nominally responsible for the regulation and supervision of mortgage brokers, would have no authority to engage in a significant number of administrative, regulatory and supervisory actions contemplated by House Bill No. 2408. House Bill No. 3088, drafted by the Department, creates a new section of HRS which clearly and fully establishes responsibilities and provides appropriate authority to implement and carry out the provisions of the new statute.
- House Bill No. 2408 makes no provision at all for the staffing and funding necessary to implement its provisions, leaving the transferred program essentially dead on arrival. House Bill No. 3088, drafted by the Department, provides for an appropriate phase in of a staffing and

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financial plan adequate to fund the operations of the program
contemplated by the bill.

Therefore, while the intent of House Bill No. 2408 may be commendable, the approach taken to reach its objective – reportedly to improve the regulation of mortgage brokers and mortgage solicitors – does not do the job. This measure is clearly inadequate as a foundation for a program to meet the challenges of today’s mortgage markets.

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

**HOUSE COMMITTEE ON
CONSUMER PROTECTION AND COMMERCE**

January 30, 2008

House Bill 2408 Relating to Mortgage Brokers

Chair Herkes and members of the House Committee on Consumer Protection and Commerce, I am Rick Tsujimura, representing State Farm Insurance Companies, a mutual company owned by its policyholders.

State Farm supports House Bill 2408 Relating to Mortgage Brokers as drafted and urges its passage.

Thank you for the opportunity to present this testimony.



January 29, 2008

To: The Honorable Robert N. Herkes, Chair
The Honorable Angus L. K. McKelvey, Vice Chair
Members of the House Committee on Consumer Protection & Commerce

Re: H. B. No. 2408 – Relating to Mortgage Brokers

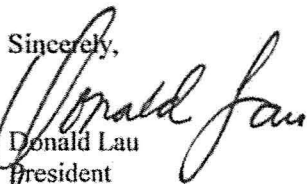
I am Donald Lau, President of the Hawaii Association of Mortgage Brokers. The Hawaii Association of Mortgage Brokers (HAMB), a 450+ member organization, actively works to improve the mortgage broker industry since its inception in 1992. After the 2007 State Legislature, HAMB with the other key financial industry stakeholders developed HB 2408 which re-codifies the existing mortgage broker statutes by amending Chapter 454 on Mortgage Brokers and which is supported also by the Mortgage Bankers Association of Hawaii, the Hawaii Bankers Association, the Financial Services Group, Hawaii Credit Union League and other stakeholders. We support legislation that strikes a balance between effective new regulatory requirements without damaging the industry and borrowing public.

The bill would improve the residential mortgage broker industry and give the Department of Financial Institutions enforcement authority to protect consumers with the following requirements:

1. Pre-licensure examination
2. Background checks of brokers and loan originators
3. Continuing education requirement for brokers and loan originators
4. Examination audits by the DFI Commissioner
5. Increase of bond amounts depending on the size of the brokerage firm
6. Written agreements: 1. loan commitment letter to name the lender and 2. mortgage brokerage agreement be executed within 3 days of a completed loan application.
7. Prohibition of certain kinds of advertising
8. Increase in monetary penalty amount

The Hawaii Association of Mortgage Brokers supports passage of HB 2408 by the House Committee on Consumer Protection and Commerce because the bill provides significant improvement in consumer protection by establishing standards of professionalism that will reassure the public that they are dealing with knowledgeable practitioners. Also it prepares Hawaii for compliance with proposed current congressional legislation, yet does not contain lending prohibitions that would be unique to Hawaii and affect available credit products.

Sincerely,


Donald Lau
President



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January 29, 2008

The Honorable Robert N. Herkes, Chair
House Committee on Consumer Protection & Commerce
State Capitol, Room 325
Honolulu, HI 96813

Chair Herkes and members of the Committee:

H.B. No. 2408, *Relating to Mortgage Brokers*

My name is Mike Leach, Legislative & Regulatory Manager for the Hawaii Credit Union League (HCUL). I am testifying on behalf of HCUL as the local trade association for Hawaii's 93 federally and state-chartered credit unions to support the general intent of H.B. No. 2408.

HCUL has worked with the Commissioner of Financial Institutions and Hawaii's financial services community, particularly Neal Okabayashi of First Hawaiian Bank, for several years to consider alternative approaches to improve the state oversight of mortgage brokers. Based on discussions with Mr. Okabayashi, HCUL concurs with what we believe will be his comments.

We commend the Chair for introducing this bill and for holding this hearing. H.B. No. 2408 provides a good vehicle for all parties to express and consider legitimate concerns.

Thank you for the opportunity to ask for your favorable consideration of this measure.

Sincerely,

Mike Leach
Legislative & Regulatory Manager

cc: Dennis K. Tanimoto, President



First Hawaiian Bank

Neal K. Okabayashi
Vice President & Attorney

Presentation to the
House Committee on Consumer Protection & Commerce
Wednesday, January 30, 2008 at 2:00 p.m. Room 325

HB2408 Relating to Mortgage Brokers

Representative Robert N. Herkes, Chair
and members of the House Committee on Consumer Protection & Commerce

My name is Neal Okabayashi of First Hawaiian Bank, and I testify in support of HB 2408. Many of us have attempted over the years to amend the mortgage broker chapter to provide for regulatory oversight of mortgage brokers. While I recognize that this bill is a work in progress, and its final form may be different, the core of the bill regarding:

- testing
- licensure
- continuing education and renewal of licensure
- transfer of jurisdiction to the commissioner of financial institutions
- enhanced examination and supervisory powers of the commissioner of financial institutions
- principal mortgage broker
- required disclosures
- restrictions on misleading advertising and door to door sales
- limiting the mortgage broker chapter to residential mortgages
- elimination of the impact of the Kida bill
- limited exemptions

should not be altered materially.

There is no need to amplify on the multitude of studies and analysis which have demonstrated that one failing of our regulatory system on residential mortgage lending is that mortgage brokers are unregulated on the federal or state level. This measure should be viewed as a step towards filling that void so that we would have effective state supervision and regulation of mortgage brokers, which is necessary especially in light of the pending federal legislation which relies on state supervision and regulation of mortgage brokers.

We believe that this measure reflects a balance between industry needs and consumer needs, and we applaud the industry for stepping up to the plate on this issue.

I note that certain persons are exempt from chapter 454 either because their mortgage brokering role is either very limited, they are investors who buy mortgages rather than

interact with potential mortgage borrowers or they are already subject to federal banking regulatory supervision and oversight. Exempting those subject to federal banking regulatory supervision and oversight is consistent with the concept that you should be subject to either federal or state banking regulatory supervision and oversight but not free from both federal and state supervision and oversight.

Last year, this legislature amended section 454-2 on Exemptions to provide that an operating subsidiary of a bank or savings association would be exempt from chapter 454. That amendment reflected the legal reality that an operating subsidiary is deemed for all purposes to be part of the bank or savings association and is thus subject to examination for compliance, safety and soundness, and consumer credit compliance by a federal banking regulator. That exemption continues in this bill by including the operating subsidiary as part of the definition of an insured depository institution.

HB 2408 would also exempt an individual who is an exclusive agent of a bank or savings association. Page 13, lines 11 and 12. Exempting exclusive agents is the logical outgrowth of last year's measure because like an operating subsidiary, exclusive agents are deemed part of the bank or savings association and thus subject to federal banking regulatory supervision and oversight. This exemption is consistent with the concept that if you are subject to federal banking regulatory supervision and oversight, there is no need to replicate that supervision on the state level and thus, we support this exemption.

However, we would strongly object to any attempt to exempt those who are exclusive agents of a bank affiliate because such persons are not subject to federal banking regulatory supervision and oversight because they are not part of a bank or savings association. A bank affiliate is not a bank; it is what we call a nonbank subsidiary. If exempted from Hawaii law, those exclusive agents would not be subject to any banking regulatory supervision and oversight, state or federal, and any exemption would not be consistent with the rationale for exemption.

Some states have mistakenly believed that if you are a bank affiliate, you are subject to federal banking regulatory supervision and oversight. That is simply not true because those states have failed to take into account the changing landscape of bank affiliates after Gramm-Leach-Bliley and the unintended consequence of exempting exclusive agents of bank affiliates. Under the Gramm-Leach-Bliley Act, bank affiliates may engage in insurance and securities underwriting, and even before Gramm-Leach, a bank affiliate could engage in data processing, IT work, administrative services, and many other nonbanking activities. For example, one of the largest bank holding companies in the United States, Citigroup, has over 260 nonbank affiliates and a large securities operation reflecting the operations of Smith Barney, Lehman Brothers and Salomon Brothers as well as a large insurance arm which reflects the insurance operations of Travelers and other insurance entities. Under Gramm-Leach, the functional regulator of those companies is not a federal banking regulator but may well be the SEC and/or FINRA.

The net result is that the person acting as a mortgage broker and as an exclusive agent for a bank affiliate, meaning a nonbank, would be subject to no banking supervision and oversight, and thus we would strongly oppose any measure to expand the exemptions to agents for bank affiliates.

On page 10, lines 16-18, there is a reference to government sponsored housing enterprises subject to the oversight of the Office of Federal Housing Enterprise Oversight (OFHEO). That is a reference to FNMA and Freddie Mac.

We realize that this bill will need to be amended to fold in matters such as the mortgage broker registry, a more effective timeline and I am ready to assist as I can.

Thank you for this opportunity to testify and I will be happy to answer any questions you may have.