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AND
JUDICIARY

THE TWENTY-FIFTH STATE LEGISLATURE
REGULAR SESSION OF 2009

Monday, March 16, 2009
2:00 p.m.

TESTIMONY ON S.B. NO. 1218, S.D.2 - RELATING TO MORTGAGE LOAN
ORIGINATORS

THE HONORABLE ROBERT N. HERKES, CHAIR,
THE HONORABLE JON RIKI KARAMATSU, CHAIR,
AND MEMBERS OF THE COMMITTEES:

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 Senate Bill No. 1218, S.D.2. The Department
opposes the bill, and believes it to be unnecessary.

In each of the past five years, the Department has submitted (or, in one case,
supported) legislative proposals to this committee that it believed would address problems

in the mortgage broker industry and the Hawai'i housing market. We have worked steadily over that time to bring various industry and interest groups together to try to reach consensus on a revised approach to mortgage broker regulation. Consensus, however, proved elusive, and, as a result, legislation did not pass. This past summer, securitized mortgages (promoted largely by mortgage brokers) lost their value, and the United States housing and financial markets spiraled downward.

Mortgage brokers no longer play a central role in the nation's or Hawai'i's housing market. Residential real estate appears largely, once again, under the control of lenders, who define the market and effectively limit the operation of mortgage brokers. In addition, Congress has addressed the subject by enacting the *Secure and Fair Enforcement for Mortgage Licensing Act* (the "SAFE Act"), Public Law 110-289, Part V, which endorses the Nationwide Mortgage Licensing System (NMLS) for residential mortgage loan originators and provides important tools to establish a more robust nationwide mortgage broker (*aka* mortgage loan originator) regulatory and supervisory infrastructure.

The SAFE Act provides that, with few exceptions, everyone who performs mortgage loan originator functions should be licensed. The law also requires federal banking regulators to "register" mortgage loan originators who work for federally regulated depository institutions – e.g., banks, S&Ls etc. – which will provide the "even playing field" for which mortgage broker industry groups have been calling. If states do not implement laws consistent with the SAFE Act by federally established deadlines,

mortgage loan originators in those states will fall under regulation to be provided by the federal Department of Housing and Urban Development ("HUD").

Although the Department previously advocated regulatory reform of the State's mortgage broker industry, a State sponsored initiative now appears untimely, arguably irrelevant, and a questionable use of State funds in the midst of a significant economic slowdown.

The stated purpose of the bill is to allow the Commissioner to regulate, license, and examine mortgage brokers and loan originators, to enforce laws pertaining to those professions, and to repeal Hawaii Revised Statutes ("HRS") Chapter 454, which presently governs the licensing of Mortgage Brokers and Solicitors. The Department opposes the bill for the following five reasons:

Initial Funding Expenses – While Department programs, once established, have historically been self sustaining, initial funds required to start a new program obviously need to come from sources outside the "to-be-established" program. Estimates show an initial cost of \$470,000 to mobilize for program implementation (e.g., hire initial staff, conduct training, purchase furniture, fixtures and equipment, establish the requisite administrative infrastructure, etc.). That \$470,000 does not include either the cost or the time required to join the Nationwide Mortgage Licensing System, both of which will be considerable, and may not run concurrently with the mobilization phase of program implementation. This bill fails to address these and related initial program

implementation costs, for which provision must be made. In addition, it should be noted that a SAFE Act compliant State program, if established, would be expensive for the significantly diminished number of active mortgage loan originators that would be regulated by such a program. We note here that, according to records of the Department's Professional and Vocational Licensing Division, of 688 licensed mortgage brokers eligible to renew their licenses by the December 31, 2008 year end renewal deadline under HRS Chapter 454, only 378 had actually renewed by year end, and of 5,987 mortgage solicitors eligible to renew their licenses at the same time, only 1,693 solicitors in fact renewed by the deadline.

Functionality – While Senate Bill No. 1218, S.D. 2 has been touted as delivering a SAFE Act compliant State statute, it does not, for several critical reasons. First and foremost, it is not functional. States that have enacted and implemented SAFE Act compliant state statutes have done so by providing for the licensing of both mortgage brokers – that is, those entities that employ mortgage loan originators – as well as the mortgage loan originators themselves. The regulatory statute being proposed by Senate Bill No. 1218, S.D.2 neglects that critical element and thus, if passed, would deliver a cumbersome, expensive, and possibly unworkable framework for regulating the mortgage brokerage industry in Hawaii. Other components of the bill – its title, for example – do not comply with the language of federal Public Law 110-289, Title V –

S.A.F.E. Mortgage Licensing Act and thus may arguably not pass HUD scrutiny when reviewed by that federal agency for SAFE Act compliance.

Deadlines – Adopting a SAFE Act compliant State statute to address the issue would impose deadlines that can no longer be met. During the 2008 legislative session, the Department pointed out that, in order to ensure timely State compliance if Hawaii wished to adopt a State program to regulate its mortgage loan originators, it was critical to take immediate steps to enact a State-sponsored mortgage loan originator program that conformed to the federal SAFE Act, then soon to be passed. As the 2008 Session Administration bills failed to obtain passage, neither the initial federally mandated deadlines for compliance with the SAFE Act nor the extended federal deadlines potentially available to those states that can demonstrate that they are making a good faith effort to comply with the federal law, appear realistically achievable.

Staffing – In order to implement a SAFE Act compliant State statute, the Department would be required to hire up to five new staff members in order to administer the program in accordance with federal standards. The new staff would be particularly specialized and an extended schedule of selective outside recruitment would likely be needed to fill the majority of the positions. This staffing plan, while less costly than that projected in the 2008 Administration bill which was based on 6,000+ licensees, will still necessitate higher fees to cover ongoing fixed costs for the diminished community of mortgage originators than the current HRS Chapter 454 fee

schedule. We estimate ongoing annual costs for these new staff members would be approximately \$375,000.

Relevance – The issues addressed by the proposal are no longer immediate. Lenders, and thus brokers, no longer offer the dangerous “sub-prime”, “non-traditional”, pay option, teaser rate mortgage loans. In addition, mortgage lenders are now extremely cautious about accepting mortgage loans brokered to them from the marketplace and, in most instances, utilize a very discreet number of specific, pre-screened, pre-qualified, and closely supervised mortgage loan originators (either employed or independently contracted) to provide loans for their mortgage pipe lines. The days of accepting brokered mortgage transactions from unvetted sources have ended for the foreseeable future.

Alternatives – Since the proposed measure clearly fails on multiple levels to make adequate provisions to establish a viable State mortgage loan originator regulatory and supervisory program that can comply with SAFE Act requirements within the timeframes permitted under federal law, under the provisions of the SAFE Act, a mortgage loan originator regulatory and supervisory program will be established and administered for the State of Hawaii by HUD. The HUD federal mortgage loan originator regulatory and supervisory program will:

- end the protracted debate over what is or is not appropriate as far as a State mortgage broker statute is concerned;

- result in cost savings for the State, which already reportedly anticipates a budget shortfall of almost two billion dollars over the next several years;
and
- provide a professionally staffed program that will benefit both regulated mortgage loan originators as well as Hawaii's consumers.

The Department therefore recommends that your committees hold this unnecessary measure, allowing Hawaii's consumers, mortgage brokers and mortgage lenders to benefit from a professionally staffed, federal regulatory and supervisory initiative, while at the same time saving Hawaii's taxpayers from initially funding a costly and potentially inadequate State administered program, which in the near term is arguably not needed to address problems that no longer exist in the marketplace and which diverts critical funding from more productive uses in these troubled times.

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

The Honorable Robert N. Herkes, Chair
The Honorable Glenn Wakai, Vice Chair
House Committee on Consumer Protection and Commerce

Hearing : Monday, March 16, 2009, 2:00 p.m.
State Capitol, Conference Room 325

IN SUPPORT OF SB 1218 SD 2 WITH AMENDMENTS

Chair and Members of the Committee:

My name is Ryker Wada, representing the Legal Aid Society of Hawaii'i ("LASH"). I am advocating for our clients who include the working poor, seniors, citizens with English as a second language, disabled and other low and moderate income families who are consumers. We are testifying in support of SB 1218 SD 2 with amendments as it may strengthen protections for consumers in the State of Hawaii.

I supervise a housing counseling program in the Consumer Unit at the Legal Aid Society of Hawaii. The Homeownership Counseling Project provides advice to individuals and families about homeownership issues. Specifically the project provides information on how to prepare yourself before purchasing a home and what to do if you are in danger of losing your home through foreclosure. In the past Fiscal Year we serviced more than 200 clients in our Project and more than 70 in the past 2 months.

SB 1218 SD 2 seeks to delete and make useless Chapter 454 of the HRS, the existing mortgage broker law, transferring regulation of the industry solely to the Department of Commerce and Consumer Affairs (DCCA) under a new Chapter. However, by placing the burden of enforcement entirely on DCCA, SB 1218 SD 2, eliminates significant tools for wronged persons and does not provide enough protection for consumers in the State of Hawaii. SB 1218 SD 2 also seeks to regulate mortgage loan originators.

In light of the current bills weaknesses, The Legal Aid Society of Hawaii proposes the following amendments:

1. Delete Section 8 of the bill thus retaining the current consumer protections enumerated in the current law, HRS Section 454-8. Section 454 declares that contracts made by

unlicensed mortgage brokers or solicitors are void and unenforceable. The protections were upheld by the Supreme Court in Beneficial Hawaii v. Kida. If this section is eliminated as described in SB 1218, an important protection for consumers will have been eliminated. There is no reason that keeping HRS 454 or portions thereof would create a conflict with, or undue burden to either the Department or the mortgage industry.

2. Include language cross-referencing HRS Chapter 480 clarifying that a violation of the chapter constitutes an unfair or deceptive act or practice. Clearly a violation of the prohibited acts of SB 1218 SD 2 are both unfair and deceptive and thus should be actionable under HRS Chapter 480. Similar language is contained in related consumer protection statutes. Previous committees have amended the prohibited acts section of this measure to conform to existing law regarding unfair and deceptive trade practices. However, no specific language has been added to cross-reference HRS Chapter 480, which may create confusion in application of private enforcement of this Act.

The Legal Aid Society of Hawaii supports the intent of SB 1218 SD 2, would fully support the bill with the proposed amendments, and supports its efforts to protect the consumers in the State of Hawaii. The Legal Aid Society of Hawaii urges the Committees to consider the suggested language.

Conclusion:

We appreciate these committees' recognition of the need to protect consumers in the State of Hawaii. SB 1218 SD 2 attempts to strengthen protections for consumers by regulating the mortgage broker industry, however SB 1218 SD 2 needs to be amended as it would eliminate the current statute and along with that, one of the strongest protections for consumers. We support SB 1218 SD 2 with amendments and its attempts to protect homeowners in the State of Hawaii. Thank you for the opportunity to testify.

HAWAII FINANCIAL SERVICES ASSOCIATION

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Rep. Robert N. Herkes, Chair
and members of the House Committee on Consumer Protection & Commerce
Rep. Jon Riki Karamatsu, Chair
and members of the House Committee on Judiciary
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **Senate Bill 1218, SD 2 (Mortgage Loan Originators)**
Hearing Date/Time: Monday, March 16, 2009, 2:00 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 are regulated by the Hawaii Commissioner of Financial Institutions under the Code of Financial Institutions (Chapter 412, Article 9 of the Hawaii Revised Statutes).

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

The purpose of this Bill is to allow the Commissioner of Financial Institutions to regulate, license, examine, and enforce laws regulating mortgage loan originators. This Bill repeals Chapter 454 of the Hawaii Revised Statutes ("HRS").

Background:

This Bill is an expansion of an effort that began a few years ago to regulate mortgage brokers. The most recent activity was during the 2008 legislative session with House Bill 2408, HD 1, SD 2 (Mortgage Brokers). Because of irreconcilable differences among the testifiers in 2008 regarding that 62 page mortgage broker bill, that bill did not move out of the Conference Committee.

After the 2008 Hawaii Legislative Session adjourned, Congress passed and President Bush later signed into law on July 30, 2008 the Housing and Economic Recovery Act of 2008 (Public Law 110-239). One component of that Act is the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 ("SAFE Act"). The SAFE Act establishes a uniform licensing and registration system for all loan originators, including mortgage brokers and loan officers. All loan originators at depository institutions will have to be registered (but not licensed) through the nationwide system. All other loan originators will be required to be licensed by a state or through a Housing and Urban Development ("HUD")-backup system if a state does not establish a licensing system.

Under the SAFE Act, a "loan originator" is an individual who for compensation or gain takes a residential mortgage loan application or offers or negotiates the terms of a residential mortgage loan. Loan originators fall into two categories:

1. One category is an individual who, simply stated, is an employee of a depository institution (such as a bank or a credit union). That individual is called a "registered loan originator" and will need to be registered with the Nationwide Mortgage Licensing System ("NMLS").

2. The other category is an individual who is a loan originator but is not an employee of a depository institution. That individual will need to be licensed by a state or by HUD

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and registered with the NMLS. This individual is called a "licensed loan originator". An example of a licensed loan originator is an individual who is a mortgage broker or mortgage solicitor. Mortgage brokers and solicitors are currently regulated in Hawaii under Chapter 454, Hawaii Revised Statutes ("HRS").

Another example of a "licensed loan originator" is an employee of a non-depository financial services loan company. Financial services loan companies are Hawaii financial institutions under the Code of Financial Institutions (HRS Chapter 412). Financial services loan companies make mortgage loans and personal loans just like other Hawaii financial institutions under HRS Chapter 412. It should be noted that HRS Chapter 454, relating to mortgage brokers and solicitors, does not currently apply to employees of financial services loan companies which are exempt from HRS Chapter 454. However with the passage of the SAFE Act, an individual who is a loan originator and is an employee of a non-depository financial services loan company would be put in the same category as an individual who is a mortgage broker or mortgage solicitor. That individual would need to be licensed by the state or by HUD.

Within 12 months from the July 30, 2008 enactment of the SAFE Act, Hawaii and other states should develop licensing requirements to ensure applicants meet minimum standards including educational requirements, background checks, and testing. However, if a state does not establish a licensing system that meets the minimum requirements, HUD is directed to establish a licensing system for loan originators in the state.

In conjunction with the passage of the SAFE Act, two organizations of regulators, the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR"), prepared model legislation for states to consider enacting ("CSBS/AARMR model state legislation").

Because the SAFE Act was enacted after Hawaii's 2008 Legislative Session adjourned in May 2008, perhaps it's fortunate that the Legislature had the foresight not to pass the 2008 Hawaii mortgage broker bill. If that 2008 bill had become law, a substantial portion of it would have to be changed and rewritten during this 2009 legislative session.

Comparison between this Bill and House Bill 1438:

H.B. 1438 (Mortgage Loan Originators) as introduced, is identical to this Bill as introduced. Both bills generally followed CSBS/AARMR model state legislation. But there were about a half dozen substantive differences from the CSBS/AARMR model state legislation. The bills omitted substantive provisions which were in the CSBS/AARMR model state legislation. And the bills added substantive provisions which were not in the CSBS/AARMR model state legislation. There were also typographical errors in the bills.

In the interest of continued discussion, the House didn't change H.B. 1438 except to put in a "defective" effective date.

On the other hand, for this Bill (S.B. 1218), the Senate made revisions in Senate Draft 1 by putting in 5 provisions from the CSBS/AARMR model state legislation which had been omitted by the drafter of this Bill. But the Senate didn't remove certain additions made by this Bill's drafter which are not in the CSBS/AARMR model state legislation. Those additions are described below.

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Senate Draft 2 added a “defective” effective date.

How this Bill should be improved:

Section 1 of this Bill from pages 1 through 41 contain provisions to implement the SAFE Act’s registration and licensing provision for mortgage loan originators who are not employed by a depository institution. Much, but not all, of what is in the first 41 pages of this 53 page bill is identical to the CSBS/AARMR model state legislation.

We support the parts of this Bill which are identical to the CSBS/AARMR model state legislation. We oppose the parts that are not in the CSBS/AARMR model state legislation. The provisions that are not in the model state legislation . . . those “add ons” by the drafter of this Bill. . . can be dealt with in a later session since we are unaware of any provision in the SAFE Act or in any HUD rule that prevents amendments once the basic state law is in place.

Accordingly, here are our suggestions for improving this Bill:

1. This Bill would title the new chapter as “Mortgage Brokers and Loan Originators” (see page 1, line 5). Yet there is no definition of “mortgage brokers” anywhere nor does this new chapter license or regulate “mortgage brokers”. Only “mortgage loan originators” are covered. The CSBS/AARMR model state legislation suggested using the title of “[State] Secure and Fair Enforcement of Mortgage Licensing Act of 2009”. Perhaps the title of the new chapter can read: “Hawaii Secure and Fair Enforcement of Mortgage Licensing Act.”

2. There are some people within the banking community who are advocating the passage of this Bill as drafted even though bank employees who are mortgage loan originators would be totally exempt from this Bill under Sec. -2. On the other hand, non-depository financial services loan companies (the members of the Hawaii Financial Services Association) have a sincere and genuine interest in this Bill because they employ mortgage loan originators who would be covered by this Bill.

Under this Bill, the mortgage loan originators working for non-depository financial services loan companies are subject to the prohibited practices provisions in this Bill. Yet under this Bill, the mortgage loan originators working for state banks would not be subject to the same prohibited practices.

As stated above, non-depository financial services loan companies are Hawaii financial institutions under the Code of Financial Institutions (HRS Chapter 412). They make mortgage loans just like Hawaii banks and other financial institutions under HRS Chapter 412. Financial services loan companies are required to comply with certain capital requirements just like banks. They are regulated and examined by the Commissioner of Financial Institutions just like banks. And, just like banks, they are directly responsible and accountable for the actions of their employees, including any of their employees who are mortgage loan originators.

As a matter of public policy, to protect Hawaii’s consumers, all mortgage loan originators, whether or not employed by a bank or other depository institution, must be subject to the same prohibited practices listed in Sec. -18 beginning on page 33. Even if a bank’s mortgage loan originator employees are to be exempt from the licensing and continuing education provisions of this

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Bill, to protect consumers, a bank's mortgage loan originator employees should not be exempt from the prohibited practices provisions. Prohibited practices must apply equally to the extent possible to all mortgage loan originators regardless of their employer.

The federal SAFE Act does not preempt or prohibit states from establishing prohibited practices that apply to all mortgage loan originators.

The Hawaii Bankers Association's written testimony before the House Finance Committee on March 2, 2008 was in "strong support" of H.B. 1438 (Mortgage Loan Originators), which is the companion version of this Bill. On page 2 of their testimony, the Hawaii Bankers Association said that Section 17 of that bill which contains the prohibited practices:

"...is the section prohibiting fraudulent activity and basically is a: be honest, do not lie, cheat or steal provision. They are the heart of the anti-fraud provisions which are integral to one of the goals of the SAFE Act which is to promote consumer protection. ... **It is not a burden to comply with an "act honestly" provision.**" (Emphasis added.)

If it's not be a burden for mortgage loan originators who are employed by financial services loan companies and by other companies to comply with the prohibited practices provision (i.e. the "act honestly" provision), it should not be a burden for a bank's mortgage loan originators to comply with an "act honestly" provision.

The SAFE Act, the CSBS/AARMR model state legislation, and this Bill focus on individuals ... and on not their employers. We have complete confidence in the honesty of Hawaii banks. But there have been publicized incidents in which individuals working for more than one bank committed dishonest acts such as stealing monies from elderly customers and were charged with embezzlement, bank fraud, theft or identity theft. It is not inconceivable that an individual mortgage loan originator working for a bank will act dishonestly. That is why prohibited practices ("act honestly" practices) should apply to all individuals who are mortgage loan originators regardless of their employer.

Accordingly, this Bill should be revised by putting in two references to mortgage loan originators in the Code of Financial Institutions, which is in HRS Chapter 412. Here is how the two revisions should read:

SECTION ____ . Section 412:1-109, Hawaii Revised Statutes, is amended by adding a new definition to be appropriately inserted and to read as follows:

"Mortgage loan originator" means an individual who for compensation or gain or in the expectation of compensation or gain:

(1) Takes a residential mortgage loan application; or

(2) Offers or negotiates terms of a residential mortgage loan."

SECTION ____ . Chapter 412, Hawaii Revised Statutes, is amended by adding a new section to be

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appropriately designated and to read as follows:

“§412-_____ Mortgage loan originator employed by financial institution. A mortgage loan originator employed by a financial institution shall comply with the written agreements requirements in chapter -16 and shall not do any of the prohibited practices in chapter -18.”

3. This Bill deviates from the CSBS/AARMR model state legislation in Sec. -18 which is the prohibited practices section. To ensure that this Bill follows the CSBS/AARMR model state legislation, Sec. -18 beginning on page 33 should only have the 14 prohibitions in the model state legislation. Those model prohibitions are in paragraphs (1) through (14) of Sec. -18. Paragraphs (15) through (19), which are not in the CSBS/AARMR model state legislation, should be removed. (Note: paragraph (19) already duplicates paragraph (8).)

One of the prohibited practices that is in this Bill, but not in the CSBS/AARMR model state legislation, is directed against individuals who are mortgage loan originators who deliver a misleading or deception communication. This is in paragraph (15). A portion of that paragraph relates to misusing the name or trademark of a financial institution. There is already a similar, but not identically worded, provision in the Code of Financial Institutions in HRS Sec. 412:2-606.5 which prohibits any “person” from misusing the name or trademark of a financial institution. So adding it in paragraph (15) seems unnecessary. Yet there is nothing in the Code of Financial Institutions similar to the rest of paragraph (15) that prohibits individuals who are mortgage loan originators from delivering “a misleading or deceptive communication ... whether written, electronic, or oral, when ... soliciting a residential mortgage loan.”

There are three additional prohibited practices which are in this Bill, but which are not in the CSBS/AARMR model state legislation: paragraph (16) regarding soliciting mortgage loans without prearranged appointments, paragraph (17) regarding filling in blanks on a mortgage loan application, and paragraph (18) regarding filling in blanks in mortgage loan documents. These three prohibited practices are not in the Code of Financial Institutions.

Because the prohibited practices in paragraphs (15) through (18) are not in the Code of Financial Institutions, a bank’s mortgage loan originators wouldn’t be subject to these restrictions. Yet, these are the same restrictions that the Hawaii Bankers Association says would be not be a burden to comply with for mortgage loan originators who don’t work for banks. Perhaps it’s best to just delete these “add on” provisions from this Bill.

Here is how the Bill should be revised in Sec. -18:

a. Make the following revision to correct a drafting error in paragraph (13) on page 35 to make the wording consistent with the CSBS/AARMR model state legislation:

“Cause or require a borrower to obtain property insurance coverage in an amount that exceeds the replacement cost of the improvements as established by the property [owner;] insurer.”

b. Delete paragraphs (15) through (19) on pages 36 through 37 which are not in the CSBS/AARMR model state legislation. (Note: paragraph (19) already duplicates paragraph (8).)

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4. The written agreements provision in Sec. -16 beginning on page 29 is not in the CSBS/AARMR model state legislation. While two of the three provisions are in the existing mortgage broker law (HRS Chapter 454), a third provision is taken from last year's failed mortgage broker bill. Yet none of these provisions are in the Code of Financial Institutions.

Perhaps it's best to just delete from this Bill the "add on" written agreements provisions in Sec. -16 beginning on page 29. In the alternative, your Committee should revise Sec. -16 (written agreements) to mirror HRS Sec. 454-3.1 (written agreements) of the existing mortgage broker law. Your Committee should delete provision (3), which is not in HRS Sec. 454-3.1, and reword provision (2). This way, Sec. -16 will be identical to the existing HRS Sec. 454-3.1. Nothing more. Nothing less. And, these provisions should apply to all mortgage loan originators including those who work for depository institutions.

5. HRS Chapter 454 regulates mortgage brokers and solicitors. Entities which act as mortgage brokers and which employ mortgage solicitors are licensed under HRS Chapter 454. Those entities, as employers of mortgage solicitors, are currently subject to all the requirements of HRS Chapter 454 including bonds, prohibited acts, and penalties.

However, Section 8 on page 53 of this Bill would completely repeal HRS Chapter 454. One consequence of this repeal is that entities which are mortgage brokers and which employ mortgage loan originators (i.e. mortgage solicitors) will not be licensed and will not be subject to any of the requirements in HRS Chapter 454 or any of the restrictions in this Bill. With the repeal, the entities which are mortgage brokers and which employ mortgage loan originators will be unregulated.

Repealing HRS Chapter 454 is not be in the best interest of consumer protection. For consumer protection purposes, there must continue to be a regulatory scheme for mortgage broker entities which employ mortgage loan originators. The federal SAFE Act does not preempt or prohibit states from regulating mortgage broker entities which employ mortgage loan originators.

Section 8 on page 53 should be removed so that HRS Chapter 454 is not repealed.

This situation is different for employers which are financial institutions, such as financial services loan companies and banks, which employ mortgage loan originators. These financial institutions are exempt from HRS Chapter 454 and should continue to be exempt from HRS Chapter 454 because they are, and will continue to be, regulated under the Code of Financial Institutions which is in HRS Chapter 412. (But, as stated above, all mortgage loan originators who work for financial institutions should be subject to the prohibited practices in this Bill.)

To ensure that there isn't a duplicate regulatory scheme over individuals if you don't repeal HRS Chapter 454, and to ensure that mortgage broker entities continue to be licensed and regulated, we recommend the following amendment to this Bill:

SECTION ____ . §454-2, Hawaii Revised Statutes, is amended to read as follows:

"§454-2 Exemptions. This chapter does not apply to the following:

- (1) Banks, operating subsidiaries of a bank established and operating under section 412:5-203, trust companies, savings associations, pension trusts, credit unions, insurance companies,

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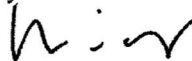
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financial services loan companies, or federally licensed small business investment companies, authorized under any law of this State or of the United States to do business in the State;

- (2) A person making or acquiring a mortgage loan with one's own funds for one's own investment without intent to resell the mortgage loan;
- (3) A person licensed to practice law in the State, not actively and principally engaged in the business of negotiating loans secured by real property, when the person renders services in the course of the person's practice as an attorney;
- (4) A person licensed as a real estate broker or salesperson in the State, not actively engaged in the business of negotiating loans secured by real property, when the person renders services in the course of the person's practice as a real estate broker or salesperson;
- (5) An institutional investor negotiating, entering into, or performing under a loan purchase agreement for its portfolio, for subsequent resale to other institutional investors, or for placement of the mortgages into pools or packaging them into mortgage-backed securities. As used in this paragraph, "loan purchase agreement" means an agreement or arrangement under which a bank, savings and loan, credit union, financial services loan company, or other financial institution registered to do business in the State of Hawaii agrees to sell mortgage loans or obtain funding therefor, with or without the transfer of servicing rights, to an institutional investor;
- (6) Foreign lender as defined in section 207-11; and
- (7) A person licensed under chapter 467 as a real estate broker or salesperson selling time share interests on behalf of a time share plan developer that is licensed as a mortgage broker under this chapter; provided that:
 - (A) The acts or conduct of a developer's authorized representative shall be deemed to be the acts or conduct of the developer for the purposes of section 454-4; and
 - (B) If the person engages in acts or conduct prohibited under section 454-4(a), the acts or conduct shall constitute grounds for disciplinary action under section 467-14[.];
- (8) An individual licensed as a mortgage loan originator under chapter . . .”

A recap of all of the above changes is attached to this testimony.

Thank you for considering our testimony.



MARVIN S.C. DANG

Attorney for Hawaii Financial Services Association

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and members of the House Committee on Consumer Protection & Commerce
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RECAP OF EIGHT PROPOSED CHANGES

1. Change the title of the new chapter from "Mortgage Brokers and Loan Originators" (see page 1, line 5) to "Hawaii Secure and Fair Enforcement of Mortgage Licensing Act."

2. Add:

SECTION ____ . Section 412:1-109, Hawaii Revised Statutes, is amended by adding a new definition to be appropriately inserted and to read as follows:

"Mortgage loan originator" means an individual who for compensation or gain or in the expectation of compensation or gain:

(1) Takes a residential mortgage loan application; or

(2) Offers or negotiates terms of a residential mortgage loan."

3. Add:

SECTION ____ . Chapter 412, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"§412-_____ Mortgage loan originator employed by financial institution. A mortgage loan originator employed by a financial institution shall comply with the written agreements requirements in chapter -16 and shall not do any of the prohibited practices in chapter -18."

4. Correct a drafting error in paragraph (13) on page 35 to make the wording consistent with the CSBS/AARMR model state legislation:

"Cause or require a borrower to obtain property insurance coverage in an amount that exceeds the replacement cost of the improvements as established by the property [owner;] insurer."

5. Delete the prohibited practices in paragraphs (15) through (19) on pages 36 through 37 which are not in the CSBS/AARMR model state legislation. (Note that paragraph (19) already duplicates paragraph (8).)

(more)

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6. Delete Sec. -16 (Written Agreements) beginning on page 29 which is not in the CSBS/AARMR model state legislation.

7. Remove Section 8 on page 53 so that HRS Chapter 454 is not repealed.

8. Add:

SECTION ____ . §454-2, Hawaii Revised Statutes, is amended to read as follows:

“§454-2 Exemptions. This chapter does not apply to the following:

- (1) Banks, operating subsidiaries of a bank established and operating under section 412:5-203, trust companies, savings associations, pension trusts, credit unions, insurance companies, financial services loan companies, or federally licensed small business investment companies, authorized under any law of this State or of the United States to do business in the State;
- (2) A person making or acquiring a mortgage loan with one's own funds for one's own investment without intent to resell the mortgage loan;
- (3) A person licensed to practice law in the State, not actively and principally engaged in the business of negotiating loans secured by real property, when the person renders services in the course of the person's practice as an attorney;
- (4) A person licensed as a real estate broker or salesperson in the State, not actively engaged in the business of negotiating loans secured by real property, when the person renders services in the course of the person's practice as a real estate broker or salesperson;
- (5) An institutional investor negotiating, entering into, or performing under a loan purchase agreement for its portfolio, for subsequent resale to other institutional investors, or for placement of the mortgages into pools or packaging them into mortgage-backed securities. As used in this paragraph, "loan purchase agreement" means an agreement or arrangement under which a bank, savings and loan, credit union, financial services loan company, or other financial institution registered to do business in the State of Hawaii agrees to sell mortgage loans or obtain funding therefor, with or without the transfer of servicing rights, to an institutional investor;
- (6) Foreign lender as defined in section 207-11; and
- (7) A person licensed under chapter 467 as a real estate broker or salesperson selling time share interests on behalf of a time share plan developer that is licensed as a mortgage broker under

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this chapter; provided that:

- (A) The acts or conduct of a developer's authorized representative shall be deemed to be the acts or conduct of the developer for the purposes of section 454-4; and
- (B) If the person engages in acts or conduct prohibited under section 454-4(a), the acts or conduct shall constitute grounds for disciplinary action under section 467-14[.];

(8) An individual licensed as a mortgage loan originator under chapter .”



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Presentation to the House Committee on Consumer Protection & Commerce and House
Committee on Judiciary
Monday, March 16, 2009, at 2:00 PM

Testimony for SB 1218 Relating to Mortgage Loan Originators

TO: The Honorable Robert N. Herkes, Chair
The Honorable Glenn Wakai, Vice Chair
Members of the House Committee on Consumer Protection & Commerce

The Honorable Riki Karamatsu, Chair
The Honorable Ken Ito, Vice Chair
Members of the House Committee on Judiciary

My name is Neal Okabayashi and I testify for the Hawaii Bankers Association in strong support of HB 1438. We believe that though the bill is a work in progress because transitional matters must be addressed in conference but other than technical amendment, section 1 of the bill should be adopted "as is".

Last year, in response to ample evidence of the role played by some mortgage brokers in creation of the credit crisis, the United States adopted the SAFE Act which outlines the parameters states must use in creating a regulatory format to regulate individual mortgage brokers, now called mortgage loan originators. States were given until August 1, 2009 to adopt a state law regulating mortgage brokers which is compliant with the SAFE Act or be penalized by having HUD (Department of Housing and Urban Development) take over a state's regulatory oversight of loan originators.

Contrary to some suggestions, adoption of this bill will not cost the State any general funds because it will be funded by fees paid by loan originators, and the costs of becoming a member of the Nationwide Mortgage Licensing System ("System") will have to be paid anyway because even if HUD is the de facto state regulator, Hawaii will have to join the System. The only issue on fees is: do the originators pay fees to the State or to HUD?

To assist states, the CSBS and the American Association of Residential Mortgage Regulators drafted a model act which has been approved by HUD as compliant with the SAFE Act. This bill is based on the model act. On March 11, the Conference of State Bank Supervisors ("CSBS") testified before Congress that they expect all 50 states to adopt the model act before the August 1 deadline. The CSBS also decried the efforts of "unfortunate efforts by industry associations to frustrate, weaken or delay the passage of this important Congressional mandate." HBA is not one of those industry associations as it strongly supports this bill. Unfortunately, one of those associations is the Hawaii Financial Services Loan Association ("HFSA").

The SAFE Act requires all loan originators, including those who work for a bank and credit union, obtain a unique valid identifier (think of it as a social security number). Using the identifier, each state regulator must enter into the System the disciplinary history of an originator, and thus all other state regulators as well as the public can research the disciplinary history of an originator applying for a license or one that a person is about to do business with.

Unfortunately, this legislation has led to several misleading inferences and comments which needs to be corrected, some by HFSA whose members are financial services loan companies, known in the old days as industrial loan companies (“finance companies”).

First, bank and credit union employees are not exempt from the SAFE Act. Under the SAFE Act, bank/credit union employees are regulated on the federal level by their federal banking regulator. All other loan originators who are not regulated by a federal banking regulator will be regulated on the state level. The reason for this dichotomy is best understood by the words of Representative Barney Frank who said: “Reasonable regulation of mortgages by the bank and credit union regulators allowed [that] market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis.” These words echo the words of the Treasury Department who wrote in the Blueprint for a Modernized Financial Regulatory Structure last March: “Federally regulated mortgage lenders and their employees are subject to an extensive scheme of federal supervision of their lending practices and compliance with applicable law and regulations.” Therefore, the Treasury recommended “subjecting” originators who “are not employees of federally regulated depository institutions (or their subsidiaries) to uniform licensing qualification standards.” The Treasury noted the contrast with state regulate entities and wrote: “Brokers and lenders not subject to federal oversight have repeatedly been cited as the source of abusive subprime loans with adverse and profound consequences for consumers, the mortgage markets and the financial system as a whole.”

This perspective is supported by the fact that the three largest predatory lending settlements in history were made by state regulated lenders, and at least two of them were finance companies.

Second, it is not true that bankers and credit unions have no vested interest in this bill. Other than existing mortgage brokers and solicitors, no group has a greater vested interest in this bill than bankers and credit unions.

The economic crisis which resulted substantially from the acts of mortgage brokers and state regulated lender like finance companies has impacted banks. Banks do best in a booming economy which we don't have, and the economic downturn has directly contributed to costs which banks must bear. This economic crisis has reduced the monies in the FDIC deposit insurance fund which led the FDIC to propose a special assessment on banks (think of this as a special premium or tax increase) as well as an increased deposit insurance premium to pay for the increased FDIC coverage necessary to assure a nervous public that their money is safe in an FDIC insured bank.

Banks also have a direct interest in this bill for the simple reason that brokers may sell and arrange a loan but generally do not make loans; they take the loan to a lender, sometimes a bank, who actually makes the loan. So we have a vested interest that the broker who brings us a loan is a competent, qualified and honest professional. Jamie Dimon, CEO of JP Morgan Chase, said

last week that the worst mistake of his professional life was not closing the bank's mortgage broker division which basically made the loans brought to Chase by a mortgage broker.

In fact, the number of loans made by banks as a result of brokered loans is greater than the loans made by HFSA's non-federally regulated members (last year, the market share of its non-federally regulated lenders was in the range of 2.7% at best but more likely closer to 1.1%) and given the small number of originators they will have (probably less than 5%), it can easily be said that banks have a greater vested interest in this bill than HFSA.

Third, it is not correct to say finance companies and state banks are the same because both are regulated by a state regulator. That argument is like saying that humans and fish are alike because both have two eyes. There are vast differences between the regulatory oversight of banks and finance companies.

As stated earlier, all banks, whether federal or state, are regulated by a federal banking regulator who is the bank's primary regulator. State banks also happen to be regulated by a state regulator who plays a secondary role in examination matters. A state bank, such as First Hawaiian Bank, is subject to annual examinations by the FDIC. Can finance companies say the same?

It has also been argued falsely that finance companies are like banks because both are subject to capital requirements. What HFSA does not tell you is that the capital requirements are quite different. HFSA members only need to have a certain dollar amount of capital, regardless of size or the nature of their assets, even if they have risky assets. By contrast, all banks are required to have capital, the amount of which depends on the asset size of the bank and the nature of the assets the bank has. For banks, there are four capital categories: well capitalized, adequately capitalized, undercapitalized, and critically deficient. For HFSA members, there are no similar categories. For banks, if you are not well capitalized, there are restrictions on your activities; fortunately, over 90% of banks are well capitalized, including all the local banks. There are no similar restrictions on finance companies for capital deficiencies.

There is a reason Congress views federally regulated lenders and state regulated lenders, like finance companies differently: banks and credit unions have not been part of the problem. In a recent letter to Elizabeth Warren, chair of the Congressional Oversight Panel, John Dugan, the Comptroller of the Currency which regulates national banks, said that there are "many, many federal consumer protection laws, rules and supervisory guidance applicable to national banks" and pointed out that "the overwhelming preponderance of toxic subprime mortgages were originated by companies subject only to state regulation." The OCC also conducted a study of ten areas with the highest foreclosure rates in the period 2005-2007, and of the 21 firms comprising the worst ten, 12 firms which accounted for nearly 60% of the non-prime mortgage loans and foreclosures were exclusively regulated by a state. The Comptroller went on to write "the market leaders for these products were nonbank brokers and lenders regulated exclusively by the states."

Even the CSBS recognized the gap in regulation. In testimony before Congress on March 4, 2008, a representative of CSBS testified that federal banking regulators had issued or proposed two guidances on nontraditional mortgage product risk and subprime lending which are not applicable to the many state lenders that they supervised, including no doubt members of HFSA. The CSBS tried to fill the gap by drafting sample parallel guidance which a state could issue

with respect to the nondepository lenders that it supervised. In fact, federal banking regulatory guidances on subprime and predatory lending dates back to 1997.

Thus, HFSA's attempts to subject employees of state banks to this bill should be soundly rejected as not being based on applicable facts. While HFSA pretends that they want state bank employees to be subject only to the prohibited practices, prohibited practices 6, 8 and 10 directly support the SAFE Act which, on the state level, applies only to originators not regulated by a federal banking regulator. For example, prohibited practice 6 prohibits an originator from conducting business without a state license so inherently, HFSA is directly advocating that state bank employees be tested and licensed under the state law.

There are critical issues to be addressed but it requires the cooperation of DCCA. DCCA is not funded by general funds but by fees paid by those who are regulated by DCCA. Thus, their input on application and license fees is critical. For now, either the fees are left blank or mirror the fees in last year's administration mortgage broker bill.

In last year's administration mortgage broker bill, DCCA requested an appropriation of \$140,000 from the Compliance Resolution Fund for start up costs but in this bill, the amount is left blank since no input has been received from DCCA.

In conference, we also need to provide for transitional matters. HUD envisions implementation by July 31, 2010 for those who presently do not have a license and for those with an existing license, the deadline is December 31, 2010, which happens to the day existing licensees will see their licenses expire. It has been 7.5 months since the SAFE Act was adopted. DCCA needs to begin work on implementing the SAFE Act. Since we cannot have two regulatory frameworks on loan originators to exist side by side, at some point between the effective date and July 31, 2010, chapter 454 must be repealed but we cannot repeal it until the State is ready to license originators under the new law, otherwise, no one could become licensed as a loan originator. Next session will be a better time to decide on the repeal date of chapter 454 (or in the alternative, limit its reach only to companies) and also give us the time to make technical amendments as well as conforming changes in the law. However, the basic law, as set forth in this bill, must be passed this year.

In summary, HBA strongly supports this bill and urges its passage.