

SB 1218



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TO THE SENATE COMMITTEE ON WAYS AND MEANS
THE TWENTY-FIFTH STATE LEGISLATURE
REGULAR SESSION OF 2009

Tuesday, March 3, 2009
9:30 a.m.

TESTIMONY ON S.B. NO. 1218, S.D.1 - RELATING TO MORTGAGE LOAN
ORIGINATORS

THE HONORABLE DONNA MERCADO KIM, 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 Senate Bill No. 1218, S.D.1. 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 that 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 is untimely, arguably irrelevant, and an inappropriate use of State funds in the midst of a significant economic slowdown.

The stated purpose of the bill is to allow the Commissioner of Financial Institutions to regulate, license, examine and enforce laws regulating mortgage brokers and loan originators, 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:

Relevance – The issues addressed by the proposal are no longer pressing. Lenders no longer offer the dangerous "sub-prime", "non-traditional", pay option, teaser rate mortgage loans which were the products that needed to be addressed. 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.

Initial Funding Expense – 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 entirely fails to address these and related program implementation costs, for which provision must be made. In addition, a SAFE Act compliant State program would be expensive for the significantly diminished number of active mortgage loan originators that would be regulated by such a program.

Staffing – In order to implement a SAFE Act compliant State statute, the Department would 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 outside recruitment would likely be needed to fill the majority of the positions. We estimate ongoing annual costs for these new staff members would be approximately \$375,000.

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 achievable.

Alternatives – Since the proposed measure clearly fails 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 automatically 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 and essentially unproductive debates over what is or is not appropriate as far as a State mortgage broker statute is concerned;
- result in significant 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, up-and-running program that will immediately benefit both regulated mortgage loan originators as well as Hawaii's consumers.

The Department therefore recommends that your committees defer this unnecessary measure, allowing Hawaii's consumers, mortgage brokers and mortgage lenders to benefit from a professionally staffed, up-and-running 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 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.



March 1, 2009

To: The Honorable Donna Mercado Kim, Chair - Committee on Ways and Means
The Honorable Shan S. Tsutsui, Vice Chair - Committee on Ways and Means
Members of the Senate Committee on Ways and Means

Re: S.B. 1218 – Relating to Mortgage Loan Originators

I am Greg Ravelo, President of the Hawaii Association of Mortgage Brokers. The Hawaii Association of Mortgage Brokers (HAMB), a 200+ member organization, actively works to improve the mortgage broker industry since its charter in 1992.

We support passage of S.B. 1218

After the close of the 2008 Hawaii legislative session, the US Congress passed legislation known as the Title V – the SAFE Act, which when fully implemented will register all mortgage loan originators in the United States. It establishes a national registry of mortgage loan originators (MLOs) and will issue a permanent ID that will remain with individual MLOs through out their working careers. For MLOs not employed by government supervised depositories (e.g. Banks and S & Ls), the legislation requires background checks, pre-licensing education, testing and ongoing continuing education. This program will be will be administered by state regulators in most cases, however the federal Department of Housing and Urban Development (HUD) is required to implement the program in any state that does not adopt the federal program.

S.B. 1218 provides the legislative authority and direction to allow the Hawaii DCCA to modify the existing state program dealing with Mortgage Brokers (HRS Chap. 454) and expand it to include other covered MLOs while meeting the standards of the SAFE Act.

We understand that DCCA is opposed to operating the program based upon costs. They base costs upon a “from scratch” development rather than the costs to implement a set of federal standards. While it won’t be easy, we believe that DCCA and industry representatives can, given sufficient time, come back to the legislature with a reasonable cost program that is acceptable to both groups.

We believe it is in the interest of the consumers of Hawaii to have the program operated by the state, rather than a federal agency.

Sincerely,

Greg Ravelo
President
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March 3, 2009

Senator Donna Mercado Kim, Chair
and members of the Senate Committee on Ways & Means
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **Senate Bill 1218, SD 1 (Mortgage Loan Originators)**
Hearing Date/Time: Tuesday, March 3, 2009, 9:30 A.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 brokers and 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 and Registry ("NMLSR").

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 and registered with the NMLSR. 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.

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Mortgage brokers and solicitors are currently regulated in Hawaii under Chapter 454, Hawaii Revised Statutes.

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, 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. Other groups such as the American Financial Services Association, of which the Hawaii Financial Services Association is a member, have proposed various amendments to the 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.

How this Bill should be improved:

Much, but not all, of this Bill is identical to the CSBS/AARMR model state legislation. We support the provisions which are identical to the model legislation. But we have suggestions for improving this Bill:

1. 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.

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

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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.

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.

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 employee is to be exempt from the licensing and continuing education provisions of this Bill, to protect consumers, no mortgage loan originator should 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.

Here is how the Bill should be revised:

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

- (1) A registered mortgage loan originator, when acting for an insured depository institution, a subsidiary of an insured depository institution regulated by a federal banking agency, or an institution regulated by the Farm Credit Association; provided that a registered mortgage loan originator employed by a financial institution as defined in chapter 412 shall comply with section -18 regarding prohibited practices;”

2. This Bill deviates from the CSBS/AARMR model state legislation by omitting certain provisions. However, one major deviation is for the prohibited practices. To ensure that this Bill follows the model state legislation, Sec. -18 beginning on page 33 should only have the 14 prohibitions in the model state legislation. Those prohibitions are in subsections (1) through (14) of Sec. -18. Subsections (15) through (19), which are not in the model state legislation, should be removed.

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

- a. Correct a typographical error in subsection (13) on page 13:

“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;”

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b. Delete subsections (15) through (19) on pages 36 through 37 which are not in the model state legislation. (Note that subsection (19) already duplicates subsection (8).)

3. 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.

Sec. -16 beginning on page 29 should be deleted. 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.

4. 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 7 on page 50 would completely repeal HRS Chapter 454. As a result of this repeal, entities which are mortgage brokers and which employ mortgage loan originators (i.e. mortgage solicitors) would not be subject to any of the requirements in HRS Chapter 454 or any of the restrictions in this Bill. Under this Bill, these entities which are mortgage brokers and which employ mortgage loan originators would be unregulated.

Repealing HRS Chapter 454 is not in the 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.

HRS Chapter 454 should not be repealed. Section 7 on page 50 should be deleted.

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.)

Thank you for considering our testimony.


MARVIN S.C. DANG
Attorney for Hawaii Financial Services Association

(MSCD/hfsa)