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TO THE
HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE
AND THE
HOUSE COMMITTEE ON JUDICIARY

THE TWENTY-FIFTH STATE LEGISLATURE
REGULAR SESSION OF 2010

Wednesday, January 27, 2010
2:00 p.m.

TESTIMONY ON H.B. NO. 2112 RELATING TO EXCHANGE ACCOMMODATION

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").
The purpose of the bill is to amend Hawaii Revised Statutes ("HRS") chapter 449, the law
that governs the licensing and regulation of Escrow Depositories by amending the
definition of "escrow" to include "exchange accommodation". An "exchange
accommodation" is defined by the bill as "any real estate transaction that involves the

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exchange of real property subject to section 1031 of the Internal Revenue Code, as amended”.

The Department opposes the bill as drafted for the reasons outlined below.

The Department has been advocating reform of chapter 449, HRS, since 2004 to reflect developments in the way the industry operates and the growth in the size of transactions that are routinely handled by Hawaii’s escrow depositories, many of which are undercapitalized. Hawaii’s consumers are not adequately protected by the existing statute, which has not been updated in 36 years and does not provide either consumers or escrow depositories with a contemporary framework to administer the escrow transactions conducted in today’s marketplace. The addition of yet another category of real estate transaction, an “exchange accommodation”, would only exacerbate an already unsatisfactory situation.

Another consideration is the fact that this bill calls for a significant expansion of the Department’s Division of Financial Institutions’ (DFI) responsibilities with respect to administering the expected additional workflow resulting from the bill’s provisions. As often reported over the years to these committees, the fees historically charged by the State for administering the provisions of chapter 449, HRS have not been adequate to cover the expenses associated with the existing program, which currently is not adequately staffed to accommodate the new responsibilities that enactment of this bill would create. Hiring of additional staff would be a prerequisite for appropriate

supervision and examination of the activities associated with the administration of Hawaii licensed escrow depositories that would now handle real estate transactions that involve the exchange of real property subject to section 1031 of the Internal Revenue Code, as amended.

Further, it is also our understanding that an exchange accommodation transaction requires that the exchange accommodator acquire title to the properties in the transaction. This requirement directly contradicts the definition of an escrow in Section 449-1, HRS, as a transaction where the escrow depository is specifically prohibited from acquiring title to the property. Because an exchange accommodation transaction is fundamentally different from an escrow transaction in that key respect, further study is needed as to whether the various safeguards in the existing Chapter 449, HRS (which, as noted above, are already inadequate given the changes in the escrow and real estate industries) are appropriate to the regulation of exchange accommodations, or whether additional or different safeguards should be required for persons engaged in exchange accommodations.

Again, as we have noted in past legislative sessions, the existing statute does not provide either consumers or escrow depositories with a contemporary legal framework in which to conduct current escrow transactions. Adding another significant component to this already deficient program does not appear to be a wise course of action.

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



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January 26, 2010

The Honorable Robert N. Herkes, Chair
House Committee on Consumer Protection & Commerce
The Honorable Jon Riki Karamatsu, Chair
House Committee on Judiciary
State Capitol, Room 325
Honolulu, Hawaii 96813

RE: H.B. 2112 Relating to Exchange Accommodation

HEARING: Wednesday, January 27, 2010 at 2:00 p.m.

Aloha Chair Herkes, Chair Karamatsu, and Members of the Join Committees:

I am Myoung Oh, Government Affairs Director, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,800 members in Hawai'i. HAR supports the intent of H.B. 2112 which regulates the profession of exchange accommodators.

A 1031 exchange, otherwise known as a tax deferred exchange, is a method for selling a qualified property, and then proceeding with an acquisition of another qualified property within a specific time frame. 1031 exchanges are unique because the entire transaction is treated as an exchange for tax purposes, not as a simple sale.

In a 1031 exchange, the property owner has 180 days from the sale of the first property to find a second "like kind" property to receive in exchange. Generally, property owner sells his or her property to a purchaser and buys a different property from another seller of equal or greater in value than the first property. Otherwise, the difference in value between the two properties will be treated as a gain and will be taxed.

During the exchange process, the property owner can not receive the proceeds from the first sale. Rather, the funds must go into an account maintained by an exchange accommodator (also known as a "qualified intermediary"). It is at this point in the transaction that an investor's funds can sometimes become vulnerable.

HAR supports the regulation of exchange accommodators, but requests that this measure does not unintentionally include out-of-state exchange accommodators. That is, if the property owner is out-of-state and the owner retains an out-of-state intermediary, the owner should be allowed to proceed with a 1031 exchange in Hawaii, without requiring licensure of the out-of-state exchange accommodator.

Mahalo for the opportunity to testify.

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