

JAN 26 2009

A BILL FOR AN ACT

RELATING TO ESCROW DEPOSITORIES.

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

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

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

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

1 the breach, and restore the reasonable integrity, security, and
2 confidentiality of the data system.

3 **§449- Temporary closures and relocations.** An escrow
4 depository may temporarily close or relocate an office for a
5 period of time up to 180 days, or a longer time period as
6 determined to be necessary by the commissioner in the event of
7 an emergency or for other good cause. For purposes of this
8 section, an "emergency" means a situation of an unusual or
9 compelling urgency that creates a threat to life, public health,
10 welfare, or safety by reason of major natural disaster,
11 epidemic, riot, fire, or such other reason as determined by the
12 commissioner. Written notice of a temporary closure or
13 relocation shall be provided to the commissioner as soon as
14 practicable and notice shall also be provided to the escrow
15 depository's customers in the form of a sign posted in a safe,
16 conspicuous location on or in proximity to the primary public
17 entrance of the office that has been or will be temporarily
18 closed or relocated. The written notices provided to the
19 commissioner and the escrow depository's customers shall state
20 the reasons for the temporary closure or relocation, the
21 expected date of reopening, and information regarding where and
22 how customers of the closed or relocated office will be

1 accommodated during the temporary closure or relocation. Notice
2 of the reopening of the office that was temporarily closed or
3 relocated shall be provided to the commissioner within five days
4 of the reopening."

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

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

20 SECTION 3. Section 449-1.8, Hawaii Revised Statutes, is
21 amended to read as follows:

1 " ~~[f]~~ §449-1.8 ~~[f]~~ Confidential portion of application or
2 records. (a) Information contained in any application or
3 record shall be made available to the public unless that
4 information may be withheld from public disclosure by the
5 commissioner under chapter 92F.

6 (b) The commissioner may also disclose statistical data
7 regarding the number of consumer complaints filed against an
8 escrow depository, the general nature of each complaint, and the
9 resolution of each complaint."

10 SECTION 4. Section 449-4, Hawaii Revised Statutes, is
11 amended to read as follows:

12 "**§449-4 Administrative penalty.** Any person who ~~[wilfully]~~
13 violates any of the provisions of this chapter, ~~[shall]~~ may be
14 subject to an administrative fine of up to \$5,000 for each
15 violation. ~~[No licensee shall be subject to this penalty for a~~
16 ~~violation of section 449-16(b) or (c) if the violation was not~~
17 ~~intentional or resulted from a bona fide error, notwithstanding~~
18 ~~the maintenance of procedures reasonably adopted to avoid that~~
19 ~~error. Examples of bona fide errors include, but are not~~
20 ~~limited to, clerical miscalculations, computer malfunction,~~
21 ~~printing errors, and computer programming errors.]"~~

1 SECTION 5. Section 449-5.5, Hawaii Revised Statutes, is
2 amended to read as follows:

3 "~~§449-5.5~~ **[Net] Tangible net capital**. The tangible net
4 capital of any corporation engaging in the escrow depository
5 business under this chapter shall be not less than [~~\$50,000.~~]
6 \$250,000. A corporation in lieu of the tangible net capital
7 requirement may alternatively file a bond for [~~\$50,000~~] \$250,000
8 conditional upon its satisfactory performance of escrow
9 conditions and satisfaction of all escrow liabilities. The
10 amount of the minimum tangible net capital of [~~\$50,000,~~]
11 \$250,000, or the bond, or a combination of both tangible net
12 capital or bond totalling [~~\$50,000~~] \$250,000 shall be maintained
13 at all times by the licensee.

14 [~~Licenseses in operation on May 24, 1973, pursuant to this~~
15 ~~chapter with a net capital of less than \$50,000 shall increase~~
16 ~~its net capital to \$50,000 or file a bond for \$50,000, or take~~
17 ~~action so that a combination of its net capital and bond totals~~
18 ~~\$50,000, before May 24, 1978.] "~~

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

21 "(b) The application shall contain the following
22 information:

- 1 (1) The corporate name, amount of capital, and office
2 address of the applicant;
- 3 (2) The names of the stockholders, officers, and directors
4 of the applicant;
- 5 (3) Evidence of the character, financial responsibility,
6 experience, and ability of the officers and directors;
7 [and]
- 8 (4) The names of the proposed escrow officers and their
9 qualifications[-]; and
- 10 (5) Information necessary to conduct a criminal history
11 record check in accordance with section 846-2.7 for
12 each of the proposed officers, directors, and escrow
13 officers of the applicant, accompanied by payment of
14 the applicable fee for each record check to be
15 conducted."

16 SECTION 7. Section 449-9, Hawaii Revised Statutes, is
17 amended to read as follows:

18 "**§449-9 Escrow depository's bond.** [~~Before an escrow~~
19 ~~depository's license becomes effective, the]~~ (a) An escrow
20 depository shall [~~give~~] at all times maintain a bond given to
21 the commissioner in the penal sum of not less than [~~\$100,000~~]

1 \$200,000, executed by a surety insurer authorized to do business
2 in this State, conditioned:

3 (1) That the escrow depository will honestly, faithfully,
4 and with diligence apply all funds, other
5 consideration, or property and instruments affecting
6 title in accordance with the instructions under which
7 the same were deposited with it, and will promptly
8 account for the same; and

9 (2) That the escrow depository will satisfy all judgments
10 and decrees which may be recovered against it in any
11 action or proceeding brought under this chapter.

12 (b) The aggregate liability of the surety for all breaches
13 of the conditions of the bond shall, in no event, exceed the
14 penal sum of the bond. In lieu of the bond, an escrow
15 depository may deposit cash~~[, a]~~ or an unconditional and
16 irrevocable letter of credit~~[, or securities acceptable to the~~
17 ~~commissioner]~~."

18 SECTION 8. Section 449-11, Hawaii Revised Statutes, is
19 amended to read as follows:

20 "**§449-11 Fidelity bonds~~[,]~~ or fidelity insurance;**
21 **deposit.** [A] For all of its directors, officers, and employees
22 who have access to money or negotiable securities or instruments

1 in their possession or under their control, a licensed escrow
2 depository shall at all times either:

3 (1) Maintain a fidelity bond [~~executed~~] or fidelity
4 insurance issued by a surety insurer authorized to do
5 business in the State in an amount not less than
6 [~~\$25,000; provided that any bond which is subject to a~~
7 ~~deductible thereunder in excess of \$5,000 per~~
8 ~~occurrence shall require the prior approval of the~~
9 ~~commissioner, who may take into consideration, among~~
10 ~~other factors, the amount of the proposed bond;~~
11 \$125,000; or

12 (2) Deposit an equivalent amount of cash or [~~securities~~
13 ~~under such terms and conditions as are acceptable to~~
14 ~~the commissioner, an unconditional and irrevocable~~
15 ~~letter of credit~~

16 ~~upon all of its directors, officers, and employees who have~~
17 ~~access to money or negotiable securities or instruments in its~~
18 ~~possession or under its control. Notwithstanding the above~~
19 ~~provision, the escrow depository may carry bonds or deposit cash~~
20 ~~or securities above the amounts required by the commissioner.]~~
21 an unconditional and irrevocable letter of credit."

1 SECTION 9. Section 449-12, Hawaii Revised Statutes, is
2 amended to read as follows:

3 "**§449-12 Errors and omissions insurance; deposit.** A
4 licensed escrow depository shall at all times either:

5 (1) Maintain a policy of errors and omissions insurance
6 executed by an insurer authorized to do business in
7 the State in an amount not less than [~~\$100,000,~~
8 ~~provided that any policy which is subject to a~~
9 ~~deductible thereunder in excess of \$10,000, per~~
10 ~~occurrence, shall require the prior approval of the~~
11 ~~commissioner, who may take into consideration, among~~
12 ~~other factors, the amount of the proposed coverage,]~~
13 \$250,000; or

14 (2) Deposit an equivalent amount of cash or [securities
15 ~~under such terms and conditions as are acceptable to~~
16 ~~the commissioner.] an unconditional and irrevocable
17 letter of credit."~~

18 SECTION 10. Section 449-15, Hawaii Revised Statutes, is
19 amended by amending subsection (b) to read as follows:

20 "(b) The audited financial statements shall be prepared in
21 accordance with generally accepted accounting principles and the
22 examination by the independent certified public accountant shall

1 be performed in accordance with generally accepted auditing
2 standards. The financial statements and the independent
3 certified public accountant's report shall include but not be
4 limited to the following:

- 5 (1) An unqualified opinion on the fair presentation of the
6 financial statements taken as a whole. To the extent
7 that this is not possible, then a detailed footnote
8 explaining the reason why an unqualified opinion could
9 not be given shall suffice;
- 10 (2) A direct verification of escrow funds and escrow
11 liabilities. If less than a one hundred per cent
12 verification is performed, there shall be a separate
13 letter from the independent certified public
14 accountant indicating: the number of accounts
15 verified; the percentage of the verification; the
16 basis for determining the sample size; the method used
17 in selecting the sample items to verify; a description
18 of the sampling technique used; the discrepancies
19 noted; and how the discrepancies were resolved;
- 20 (3) Footnotes to the audited financial statement showing
21 the escrow funds and escrow liabilities and, to the

1 extent that these amounts differ, a reconciliation of
2 the amounts; [~~and~~]

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

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

12 SECTION 11. Section 449-16, Hawaii Revised Statutes, is
13 amended to read as follows:

14 "**§449-16 Accounting for moneys, property, etc.** (a) Every
15 licensee under this chapter shall have the responsibility of a
16 trustee for all moneys, other consideration, or instruments
17 received by it. No licensee shall [~~mingle~~] commingle any such
18 moneys or other property with its own moneys or other property,
19 or with moneys or other property held by it in any other
20 capacity. All moneys held by a licensee in escrow as herein
21 defined shall be deposited in financial institutions, payable on
22 demand. Under this chapter, deposits in financial institutions

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

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

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

12 (A) The United States government;

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

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

18 periodically recredited to the sweep account; and

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

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

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

13 ~~(2) No licensee shall disburse funds from the escrow~~
14 ~~account with respect to an item drawn on a financial~~
15 ~~institution until the licensee confirms that~~
16 ~~sufficient collected funds are on deposit in the~~
17 ~~drawer's account.~~

18 ~~(c) A licensee may deliver any money, consideration, or~~
19 ~~instrument affecting the title to real property prior to funds~~
20 ~~becoming available for disbursement under subsection (b) if it~~
21 ~~has received the written consent of the parties to the~~
22 ~~transaction.] make a disbursement on behalf of a specific escrow~~

1 unless sufficient collected funds have been received for that
2 escrow."

3 SECTION 12. Section 846-2.7, Hawaii Revised Statutes, is
4 amended by amending subsection (b) to read as follows:

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

6 (1) The department of health on operators of adult foster
7 homes or developmental disabilities domiciliary homes
8 and their employees, as provided by section 333F-22;

9 (2) The department of health on prospective employees,
10 persons seeking to serve as providers, or
11 subcontractors in positions that place them in direct
12 contact with clients when providing non-witnessed
13 direct mental health services as provided by section
14 321-171.5;

15 (3) The department of health on all applicants for
16 licensure for, operators for, and prospective
17 employees, and volunteers at one or more of the
18 following: skilled nursing facility, intermediate
19 care facility, adult residential care home, expanded
20 adult residential care home, assisted living facility,
21 home health agency, hospice, adult day health center,
22 special treatment facility, therapeutic living

S.B. NO. 887

1 program, intermediate care facility for the mentally
2 retarded, hospital, rural health center and
3 rehabilitation agency, and, in the case of any of the
4 above-related facilities operating in a private
5 residence, on any adult living in the facility other
6 than the client as provided by section 321-15.2;

7 (4) The department of education on employees, prospective
8 employees, and teacher trainees in any public school
9 in positions that necessitate close proximity to
10 children as provided by section 302A-601.5;

11 (5) The counties on employees and prospective employees
12 who may be in positions that place them in close
13 proximity to children in recreation or child care
14 programs and services;

15 (6) The county liquor commissions on applicants for liquor
16 licenses as provided by section 281-53.5;

17 (7) The department of human services on operators and
18 employees of child caring institutions, child placing
19 organizations, and foster boarding homes as provided
20 by section 346-17;

S.B. NO. 887

- 1 (8) The department of human services on prospective
2 adoptive parents as established under section 346-
3 19.7;
- 4 (9) The department of human services on applicants to
5 operate child care facilities, prospective employees
6 of the applicant, and new employees of the provider
7 after registration or licensure as provided by section
8 346-154;
- 9 (10) The department of human services on persons exempt
10 pursuant to section 346-152 to be eligible to provide
11 child care and receive child care subsidies as
12 provided by section 346-152.5;
- 13 (11) The department of human services on operators and
14 employees of home and community-based case management
15 agencies and operators and other adults, except for
16 adults in care, residing in foster family homes as
17 provided by section 346-335;
- 18 (12) The department of human services on staff members of
19 the Hawaii youth correctional facility as provided by
20 section 352-5.5;
- 21 (13) The department of human services on employees,
22 prospective employees, and volunteers of contracted

S.B. NO. 887

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

1 information was provided as provided by section 302C-
2 1;

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

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

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

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

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

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

7 (23) The department of human services on contracted and
8 subcontracted service providers and their current and
9 prospective employees that provide home and community-
10 based services under Section 1915(c) of the Social
11 Security Act (Title 42 United States Code Section
12 1396n(c)), or under any other applicable section or
13 sections of the Social Security Act for the purposes
14 of providing home and community-based services, as
15 provided by section 346-97;

16 (24) The department of commerce and consumer affairs on
17 proposed directors and executive officers of a bank,
18 savings bank, savings and loan association, trust
19 company, and depository financial services loan
20 company as provided by section 412:3-201;

21 (25) The department of commerce and consumer affairs on
22 proposed directors and executive officers of a

1 nondepository financial services loan company as
2 provided by section 412:3-301;

3 (26) The department of commerce and consumer affairs on the
4 original chartering applicants and proposed executive
5 officers of a credit union as provided by section
6 412:10-103;

7 (27) The department of commerce and consumer affairs on:

8 (A) Each principal of every non-corporate applicant
9 for a money transmitter license; and

10 (B) The executive officers, key shareholders, and
11 managers in charge of a money transmitter's
12 activities of every corporate applicant for a
13 money transmitter license,

14 as provided by section 489D-9; [and]

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

19 [~~+28~~] (29) Any other organization, entity, or the State,
20 its branches, political subdivisions, or agencies as
21 may be authorized by state law."

S.B. NO. 887

1 SECTION 13. Statutory material to be repealed is bracketed
2 and stricken. New statutory material is underscored.

3 SECTION 14. This Act shall take effect upon its approval;
4 provided that sections 6 and 12 shall take effect on July 2,
5 2009, and sections 5, 7, 8, and 9 shall take effect on January
6 1, 2010.

7
8
9

INTRODUCED BY: _____

BY REQUEST

Report Title:

Escrow Depository Law

Description:

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

JUSTIFICATION SHEET

DEPARTMENT: Commerce and Consumer Affairs

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

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

MEANS: Add three new sections to chapter 449, HRS, and amend sections 449-1, 449-1.8, 449-4, 449-5.5, 449-6(b), 449-9, 449-11, 449-12, 449-15(b), 449-16, and 846-2.7(b), HRS.

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

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

chapter.

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

A new section is added to address the temporary closure or relocation of a Hawaii escrow depository's office due to an emergency or for other good cause.

An amendment is made to the section concerning the confidentiality of DFI's records relating to escrow depositories to clarify that DFI may disclose statistical data regarding the number of complaints against escrow depositories processed by DFI, as well as information regarding the general nature and resolution of such complaints.

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

flexibility is presently unavailable to the Commissioner under the statute.

The current minimum net capital requirement of \$50,000 for an escrow depository has not been modified since it was enacted in 1973, with the result that today, 36 years later, escrow depositories are seriously undercapitalized in relation to the size and volume of the escrow transactions that they routinely handle. To remedy this deficiency, the minimum net capital requirement is being increased from \$50,000 to \$250,000, in order to maintain an adequate level of protection for consumers in view of the average dollar amounts of present day real estate escrow transactions in Hawaii. An escrow depository that does not have the new required minimum net capital on the effective date of the Act will be given until July 1, 2010 to meet the \$250,000 requirement.

For similar reasons, amendments are proposed that will increase the minimum amount of errors and omissions insurance coverage from \$100,000 to \$250,000, increase the required escrow bond from \$100,000 to \$200,000, and increase the minimum fidelity insurance coverage from \$50,000 to \$125,000.

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

This requirement reflects the same prudential standards imposed under current federal laws for employees of depository financial institutions who routinely have

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

The audited statements provision is amended to require that the auditor's report determine whether the escrow depository is in compliance with chapter 523A, HRS, relating to unclaimed property.

Section 449-16, HRS, is amended by amending subsection (b) to delete numbered paragraphs (1) and (2) thereof, and by deleting subsection (c). The language proposed to be deleted has been the source of considerable ambiguity and uncertainty for industry members and is to be replaced by language that is more meaningful and more widely and readily understood as accepted terminology within the industry relating to the determination of when "good" funds have been received by an escrow depository so that disbursements can safely be made. These amendments will serve to further strengthen the protection of a consumer's property and funds while in the custody of an escrow depository.

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

Impact on the public: This amendment provides improved regulatory oversight of the escrow depositories industry by the

department and DFI, thereby enhancing protection of the consumer, and maintenance of public confidence in this industry. An escrow depository that does not meet the new minimum net capital requirement by July 1, 2010, will either need to raise additional capital or incur additional cost because it will be required to post a bond in an amount equivalent to its net capital deficiency. Likewise, an escrow depository that does not currently meet the new escrow depository bond, fidelity insurance, and errors and omissions insurance minimum requirements will likely incur some additional cost to increase its required coverage under its escrow depository bond and insurance policies.

Impact on the department and other agencies:

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

GENERAL FUND: None.

OTHER FUNDS: None.

PPBS PROGRAM
DESIGNATION: CCA-104.

OTHER AFFECTED
AGENCIES: Hawaii Criminal Justice Data Center.

EFFECTIVE DATE: Upon approval; provided that sections 6 and 12 shall take effect on July 2, 2009, and sections 5, 7, 8, and 9 shall take effect on January 1, 2010.



LINDA LINGLE
GOVERNOR
JAMES R. AIONA, JR.
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
335 MERCHANT STREET, ROOM 310
P.O. Box 541
HONOLULU, HAWAII 96809
Phone Number: 586-2850
Fax Number: 586-2856
www.hawaii.gov/dcca

LAWRENCE M. REIFURTH
DIRECTOR
RONALD BOYER
DEPUTY DIRECTOR

TO THE
SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION
THE TWENTY-FIFTH STATE LEGISLATURE
REGULAR SESSION OF 2009

Monday, March 2, 2009
10:00 a.m.

TESTIMONY ON S.B. NO. 887 - RELATING TO ESCROW DEPOSITORIES

THE HONORABLE ROSALYN H. BAKER, 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").
The Department strongly supports this Administration bill relating to escrow depositories.

The purpose of the bill is to amend and update Hawaii Revised Statutes ("HRS")
chapter 449, the law that governs the licensing and regulation of Escrow Depositories.
The Department has been advocating reform of this statute since 2004 to reflect
developments in the way the industry operates and the growth in the size of
transactions which are routinely handled by Hawaii's escrow depositories, many of

TESTIMONY ON SENATE BILL NO. 887

March 2, 2009, 10:00 a.m.

Page 2

which are arguably undercapitalized. Hawaii's consumers are not adequately protected by the existing statute, which has not been updated in 36 years as to minimum capital requirements. The current statute is also outdated in many other aspects, and does not provide either consumers or escrow depositories with a contemporary framework to conduct escrow transactions.

At a minimum, certain revisions to the escrow depository law are critical to clarify which escrow transactions are covered by the statute and which are not; to update the statute in order to accommodate the significantly larger transactions routinely handled by the industry; to provide for more flexibility in supervising and regulating the industry; and to ensure adequate protection for the consumer.

Specifically, this measure includes the following amendments to chapter 449, HRS:

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

- In light of the enactment, in 2006, of chapter 487N, HRS, relating to protection of individuals from security breaches, the definition of a "security breach" used in that statute is now incorporated by reference into chapter 449, HRS, in a new section that mandates that a licensed escrow depository notify the Division of Financial Institutions ("DFI") promptly in the event of a security breach at a licensed escrow depository involving the personal information of individuals. Such notification will enable DFI to monitor, as necessary, any remedial action taken by the affected escrow depository;
- A new section is added to address the temporary closure or relocation of a Hawaii escrow depository's office due to an emergency or for other good cause.
- An amendment is made to the section concerning the confidentiality of DFI's records relating to escrow depositories to clarify that DFI may disclose statistical data regarding the number of complaints against escrow depositories processed by DFI, as well as information regarding the general nature and resolution of such complaints.
- The section pertaining to administrative penalties is amended to provide that an administrative fine of up to \$5,000 may be imposed, rather than a fixed fine of \$5,000 in all cases; and that an administrative fine is not limited solely to instances of a wilful violation of a provision of the chapter. These amendments will afford the Commissioner reasonable discretion and flexibility in evaluating

the intent and severity of a particular violation, and will thus enable the Commissioner to assess an administrative fine that is appropriate to the circumstances. This discretion and flexibility is presently unavailable to the Commissioner under the statute;

- The current minimum net capital requirement of \$50,000 for an escrow depository has not been modified since it was enacted in 1973, with the result that 36 years later, the law no longer requires a sufficient minimum level of capitalization in relation to the size and volume of the escrow transactions that escrow depositories routinely handle. We conservatively estimate that housing prices in Hawaii, broadly speaking, are greater today by a factor of 10, as compared to prevailing prices in 1973. To remedy this deficiency, the minimum tangible net capital requirement is being increased, by amendment, from \$50,000 to \$250,000, in order to maintain an adequate level of protection for consumers in view of the average dollar amounts of present day real estate escrow transactions in Hawaii. An escrow depository that does not have the new required minimum net capital on the effective date of the Act, should now be given until July 1, 2010 to meet the \$250,000 requirement;
- In a similar vein, to better reflect the size and volume of present day escrow transactions, amendments are offered that will increase the minimum amount of errors and omissions insurance coverage from \$100,000 to \$250,000, increase

the required escrow bond from \$100,000 to \$200,000, and increase the minimum fidelity insurance coverage from \$50,000 to \$125,000, all effective as of July 1, 2010.

- An amendment is made to address a long-standing deficiency in the statute in connection with the application process for an escrow depository license. The statute will now require proposed directors and officers, including escrow officers of an applicant, to submit necessary personal information, along with the requisite fee, to obtain a criminal history record check for each such individual. This requirement reflects the same prudential standards imposed under current federal laws for employees of depository financial institutions who routinely have access to customer funds. While escrow depositories are not federally regulated, they have fiduciary obligations that are quite similar to those of depository institutions, in that escrow depositories must preserve, intact, their customers' funds in an escrow depository account. This amendment will put in place a requirement for a criminal history background check for those individuals in the company who are likely to have routine access to, responsibility for, and control of these funds. A corresponding amendment to section 846-2.7, HRS, is made to complete the formal requirements to authorize the Department to conduct a criminal history record check on the specified individuals;

TESTIMONY ON SENATE BILL NO. 887

March 2, 2009, 10:00 a.m.

Page 6

- Section 449-15, HRS, is amended to require that an escrow depository's audited financial statements include an auditor's determination of whether an escrow depository is in compliance with chapter 523A, HRS, relating to unclaimed property. The absence of such a requirement is deemed by the Commissioner to be a deficiency in the present statute;
- Section 449-16, HRS, is amended by amending subsection (b), including the deletion of numbered paragraphs (1) and (2), because those two paragraphs have created undesirable ambiguity in construing the law; and by deleting subsection (c), which is now perceived to be directly antithetical to the regulatory purpose of the statute, namely, to safeguard a consumer's property and funds while in the custody of an escrow depository.

The Department strongly supports this bill and asks for your favorable consideration. Thank you for the opportunity to testify. I would be happy to respond to any questions you may have.