REVISED TESTIMONY

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
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

KEALI'I S. LOPEZ
DIRECTOR

TO THE HOUSE COMMITTEES ON
ECONOMIC REVITALIZATION & BUSINESS
AND
HOUSING

THE TWENTY-SIXTH STATE LEGISLATURE
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11:40 a.m.

TESTIMONY ON H.B. 2103
RELATING TO THE BANK OF THE STATE OF HAWAII

TO THE HONORABLE ANGUS L.K. MCKELVEY, CHAIR,
THE HONORABLE RIDA T.R. CABANILLA, CHAIR,
AND MEMBERS OF THE COMMITTEES:

My name is Iris Ikeda Catalani, Commissioner of Financial Institutions ("Commissioner"). I appreciate the opportunity to provide comments in support of the concept of a State Bank on behalf of the Department of Commerce and Consumer Affairs ("Department") on H.B. 2103 relating to the proposed Bank of the State of Hawaii (the "Bank").

To briefly summarize, H.B. 2103 creates a Bank of the State of Hawaii for the following purposes: 1) to support economic development by increasing access to capital for businesses and farms within the State; 2) to provide support and stability to the local financial community without competing with it; 3) to provide stability to the local housing market and reduce the number of wrongful and fraudulent foreclosures; 4) to reduce the costs of banking services for the State; and finally 5) to return profits to the State general fund. A major initiative of the Bank is to create a short-sale program for problematic mortgages with the purpose of purchasing residential property at a discount when mortgagees cannot demonstrate the right to collect on a mortgagor's indebtedness or when the mortgagee does not have the right to foreclose on a property. Presumably, the Bank is then able to turn a profit by either selling or renting these properties.

The Department supports the concept of the establishment of a State Bank to address the complex issues surrounding mortgage foreclosure, the financial impact on homeowners, the global financial situation and the federal actions that impact financial institutions. The establishment of a State Bank is a novel idea to address a practical problem of mortgage foreclosures as the bill provisions seek to provide stability in the local economy. The financial impact on homeowners, who may not have fully understood that they could not afford the adjustable rate mortgages and the repricing structure, is an issue DFI continues to grapple with. The global financial situation impacted consumers with closing of some businesses or re-structuring of businesses, which caused consumers to become unemployed or under-employed and could not make their mortgage payments. Lastly, the federal response to this financial situation has been to impose additional rules and regulations on financial institution as it makes new loans to homeowners or tries to refinance or enter into loan modifications with homeowners. Consequently, we recognize there is no easy solution to this complex situation.

Accordingly, the Department would like to respectfully raise certain concerns about the establishment of the Bank of the State of Hawaii. Given time and space limitations, I will focus on our areas of greatest concern: 1) management experience, 2) legal and regulatory conflicts, 3) feasibility, and 4) Hawaii's differing set of facts as compared to the State Bank of North Dakota.

First, strong management teams play an integral part of any successful bank, particularly a de novo bank, and the requirements and qualifications set forth in this bill do not provide the guidance for a strong management team. Banking is a heavily regulated and highly specialized industry, made especially challenging in this current economic climate. Under this bill, no member of the Board of Directors ("Board") will have any experience running a bank and only one executive ("President") at the Bank is required to have banking industry. There is a provision for a separate Advisory Board of Directors requiring that two members be bank officers, however, these officers must possess the banking knowledge to run and manage a bank. Moreover, there is no one required to have any experience in any of the Bank's other intended areas of operation, such as short sales and real property transactions, mortgage servicing, property management, clearinghouse functions and such. To have a Bank managed by a team inexperienced in banking and its intended areas of business operations may not achieve the stated goals.

Second, some of proposed activities either directly run afoul of or raise issues with current federal and State banking laws and regulations, while others place unrealistic expectations on the State's already limited resources. For example, the bill requires that bank examination results be made public, yet State laws require that they must be kept confidential. The bill empowers the Bank to buy and sell federal funds, but that is a power available only to banks that are Federal Deposit Insurance Corporation ("FDIC") insured or part of the Federal Reserve Bank system. The bill proposes allowing the Bank to become the "physical office" for foreign mortgage servicers, which was not the intent of the state statutes, and moreover this could result in violations of federal privacy regulations by allowing another institution receive service of process or consumer complaints. The nature of the short sale program will require the Bank to place a significant amount of its funds in illiquid real property investments which may not be allowable for use for general funds. State banking laws also require banks to keep a certain amount of assets in liquid and less volatile investments. The bill allows for the

Bank to issue stock to other financial institutions. The bill also requires the Bank be examined on a quarterly basis and that the short sales loan reviews take place by a certain time, however the Department may not be able to meet the examination requirements with its current resources.

Third, it is unclear whether the activities contemplated under this bill are feasible for the State to embark on. One of the primary purposes of the Bank is to generate a profit for the State, yet no financial projections have been provided to demonstrate when and if this might happen. It took the State Bank of North Dakota ("BND") 26 years to return a dividend to North Dakota, and that was in an environment more suitable for a state bank. Also under the bill, the Bank does not have the power to purchase or take title to real property, which seriously precludes the Bank's ability to operate the short sale program. The Bank also plans to issue stock to other financial institutions, but in reality regulators are unlikely to approve the purchase of the stock of any de novo bank, especially one that could become a competitor with other financial institutions in Hawaii, as a suitable investment.

Finally, comparisons to the success of the only other state with a state-owned bank, the BND, are raised, but they must be taken in context. Established in 1919, the BND was established primarily to help agricultural borrowers obtain financing needed to operate their businesses. Although agricultural loans are considered risky loans, the agricultural industry in North Dakota was its main economic resource, thus the bank had some expertise in the agricultural industry and made a fully informed decision to enter into the marketplace. This is in stark contrast to here where the Bank Board and management would not be required to have banking experience or experience in any of the chosen areas of operation of the Bank.

It is also important to note that while BND facilitated financing for agricultural borrowers, there is no objective evidence that it was instrumental in correcting severe credit shortfalls or that it stabilized North Dakota's economy during the recent credit crisis. Rather than BND, the more likely cause is that one of North Dakota's top agricultural products is oil and oil production remained steady while the price of oil increased, thus increasing the revenues to the state. Similarly, establishing a State Bank is no guarantee it will help stabilize Hawaii's economy. Essentially, North Dakota's economy is supported by agricultural activities and populated by a large number of isolated banks. Conversely, the Hawaiian economy is substantially supported by the tourist industry and governmental activities, and has few and comparatively large banks, several of which have numerous branches throughout the State that already adequately serve the public.

There may be unintended consequences to the financial community if the State established its own bank. First, if the State withdraws funds from local banks to deposit State monies in the State-owned bank, it would significantly decrease capital reserves of existing local banks and threaten the safety and soundness of the local banks, which are the backbone of Hawaii's financial institutions. Second, this may compromise the security and availability of the State's funds. Funds deposited by the State in our local banks are secured with bonds to ensure the security and availability of the funds at all times. It is not clear whether the Bank of the State of Hawaii will also issue bonds to secure the availability of the funds. If not, the safety of those funds would be at risk. Our Department notes that the language of this Bill requires the Department of Budget and Finance to deposit moneys from the general fund in an amount that the Department of Budget and Finance determines is necessary to allow the Bank to fulfill its duties under this chapter. Our Department believes the capital contribution would not be considered state funds, but would be an investment of the State. If all State funds, such as general and special funds, are required to be deposited in the Bank, then the legislature must consider whether the State should require that those funds be secured.

Thank you for the opportunity to provide these comments on House Bill No. 2103 as we continue to seek solutions to this mortgage foreclosure situation. I will be available to respond to any questions.