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TO THE
HOUSE COMMITTEE ON FINANCE

THE TWENTY-SIXTH STATE LEGISLATURE
REGULAR SESSION OF 2011

Friday, February 25, 2011
12:30 p.m.

TESTIMONY ON H.B. NO. 803 RELATING TO TAXATION

THE HONORABLE MARCUS R. OSHIRO, CHAIR,
AND MEMBERS OF THE COMMITTEE:

My name is Iris Ikeda Catalani, Commissioner of Financial Institutions ("Commissioner"), testifying on behalf of the Department of Commerce and Consumer Affairs ("Department") in opposition to House Bill No. 803. The Department opposes this bill which has, among its stated purposes, the temporary repeal of the requirement that $2,000,000 of the tax revenues from banks and other financial corporations be deposited into the Compliance Resolution Fund, and temporary authorization for the Commissioner to expedite the imposition of new fees on banks and other financial corporations.

The bill, in part, diverts the primary funding source for the Department's Division of Financial Institutions ("Division"). Specifically, the bill would, for four years, divert $2 million from the Compliance Resolution Fund and redirect those monies to the general fund. To compensate for the loss of those monies to fund the operations of the Division, the bill would authorize the Commissioner to adopt new rules, or amend existing rules to impose or increase fees authorized to be charged to banks and other financial corporations under Hawaii Revised Statutes ("HRS") Chapter 412, without regard to public notice and public hearing requirements of section 91-3, HRS, the small business impact review requirements of HRS Chapter 201M, or the limit on fee increases under section 92-28, HRS.

Our first objection relates to the proposed amendment of section 241-7, HRS, which was enacted by the Legislature in 1999, to provide a stable, financial services industry-derived source of funding, independent of the general fund, for the operations of the Division, to meet the Accreditation Guidelines of the Conference of State Bank Supervisors (CSBS). As part of the Department's initiative to become fully self-sufficient, the transfer of funds from the taxes paid by banks and other financial corporations to the Compliance Resolution Fund (CRF) was established in 1999 in order to provide the Division with the necessary revenues to support all of its operations. Self-sufficiency was also part of the Division's continuing efforts to achieve and maintain its accredited status by the Conference of State Bank Supervisors ("CSBS"). The CSBS accreditation program, which recognizes those state banking departments that meet the highest

standards and practices in state banking supervision, requires that a banking department have adequate funding to supervise and regulate its banks and recommends that a banking department be self-supporting.

Removing this assured, stable source of funding for the Division's operations, and replacing it with a fee-based alternative source of funds ignores the CSBS requirement that accredited bank regulators need a secure source of funding, leaving the Division instead to the uncertainty and unpredictability of funding that would somehow have to be derived from new or increased fees established by rule.

Additionally, although the measure would allow the Commissioner to increase fees for banks and other financial institutions to recover the losses, the Division's mission is broader than just banks and financial institutions. The Division also licenses and supervises escrow depositories, money transmitters, mortgage servicers, mortgage loan originators and mortgage loan originator companies. In fairness, these fees would also need to be considered in the imposition of new or increased fees.

From a policy standpoint, the imposition of new or increased fees, or both, while maintaining the requirement that banks and other financial corporations continue to pay the tax required under section 241-4, HRS, a tax which, incidentally, would be further increased under House Bill No. 802, is inconsistent with the Department's long standing focus on reducing the cost of doing business in Hawaii. Because the Division would have to make up the loss of these funds through new or increased fees, the net result is that the affected financial institutions would face a $2 million increase in their cost of

doing business. Ultimately, that must be balanced against the need for additional general fund revenues.

If the $2 million is not deposited into the Compliance Resolution Fund (CRF) and the revenue from the increased fees does not generate $2 million, the Division will be required to significantly reduce its operations (including reducing staffing levels) since personnel expenditures comprise approximately 85% to 90% of the Division's expenditures. This could be potentially damaging to Hawaii's consumers and State licensed or chartered financial institutions because:

- Division examinations, investigations, and complaints processing involving State licensed or chartered financial institutions have resulted in administrative enforcement actions that directly benefited Hawaii consumers, with more than $8 million refunded or returned to consumers and the State since 2006. Should the Division be required to significantly reduce staffing levels, no resources will be available to examine Hawaii financial institutions in order to enforce compliance with State and federal consumer protection statutes.
- The recent economic situation, which has affected Hawaii's banks for the past two years, has also significantly affected the Division. The Division, along with the federal regulators, increased the frequency and scope of on-site examinations and off-site supervisory oversight. Examinations and supervisory efforts regarding banks and depository financial institutions

are most often conducted jointly by the Division and its regulatory colleagues from the Federal Reserve Bank ("FRB") and the Federal Deposit Insurance Corporation ("FDIC"). However, should the Division be required to significantly reduce staffing levels, State resources would not be available to examine Hawaii financial institutions, provide oversight activities with the federal regulators and provide a "local voice" how financial institutions have been affected by the national and global economic situation.

- Additional federal requirements added local programs to the Division. The mortgage loan originator and mortgage loan originator company licensures dramatically increased the workload. Although positions were allocated by the Legislature last year, the Division prudently did not fill all the positions and instead attempted to shift resources within the Division to process the thousands of license requests. However, since the effective date of the new law, the Division has not been able to process the license requests in the manner that licensees expect and now must fill positions using the funding from the Compliance Resolution fund.

It should be noted that a significant reduction in staffing cannot be considered a "temporary" downsizing of the Division since trained and experienced examiners will not be easily replaced when and if the Division is able to hire again. The Division currently employs 27 staff, a significant percentage of whom joined the Division within the past five years.

The Division's financial institution examiners, who comprise the majority of the Division's staff, generally have an undergraduate degree in accounting, finance, or related fields when they join the Division. They are then required, particularly in the case of field examiners, to attend a variety of formal schools, administered by either the FRB or the FDIC, and to undergo on-the-job training under the guidance of either a senior Division examiner or FRB/FDIC examiners, before they are ready to take on independent financial services industry examinations on their own. This formal classroom training process takes from three to five years, with an additional two to three years of on-the-job training before a field examiner is fully qualified in their position. Should funding for the Division's operations be redirected to the general fund and revenue from new or increased fees fall short of $2 million, resulting in a significant reduction in the Division's ability to fulfill its mission, those examiners could doubtless find employment in the private sector or with the federal government; however, the State has invested a significant amount of time and money training its existing Division staff and that investment should be preserved, rather than lost.

For these reasons, the Division opposes House Bill No.803, and respectfully asks that the measure be held.

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

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: BANKS AND FINANCIAL INSTITUTIONS, Disposition of funds

BILL NUMBER: HB 803

INTRODUCED BY: Say

BRIEF SUMMARY: Amends HRS section 241-7 to suspend the deposit of $2 million into the compliance resolution fund and provide that the tax on banks and other financial institutions shall be deposited into the general fund between July 1, 2011 and December 31, 2015.

Directs the commissioner of financial institutions, between July 1, 2011 and December 31, 2011, to adopt rules to impose or increase fees authorized to be charged to banks and other financial corporations without regard to the public notice and public hearing requirements of HRS chapter 91, the small business regulatory review requirements of HRS chapter 201M, or the limit on fee increases under HRS section 92-28.

This act shall be repealed on December 31, 2015; provided that HRS 241-7 shall be reenacted in the form in which it read on the day before the effective date of this act.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: It appears that this measure temporarily suspends the deposit of $2 million into the compliance resolution fund in an attempt to generate additional revenues to address the state's financial crisis. In a down economy, taxpayers are examining their spending priorities and paring back their spending - a concept that state government has to adopt to regain control of their finances.

The fees charged banks and other similar charges levied on other professions and activities used to go into the general fund until the last financial crisis when the department of commerce and consumer affairs came up with the idea of raising these regulatory oversight fees and putting the proceeds into special funds, arguing that then these fees would be earmarked to conduct the regulatory oversight with which the department is charged. Unfortunately for the various industries and professions, the fees levied were substantially more than was needed to conduct the oversight activities, and within a half dozen years, the department was generating annual operating surpluses equal to the department's annual operating budget.

Not wanting to identify which fees were generating surpluses, the proceeds were then channeled in the "compliance resolution" fund where they were all lumped together so that the public could not discern how much belonged to which industry or profession. As this fund began to grow, it became a very large target for the legislature to raid when things turned south in the general fund after 9/11. This prompted the insurance industry to sue, claiming that the fees they paid were to be used only for the regulation of their industry and not to supplement the state general fund. The courts agreed.

While some believe that this decision rules out the return of the fee proceeds to the general fund, it should be remembered that this is how the regulatory fees were handled prior to the 1990's. Fees were paid into the general fund, lawmakers then reviewed the requests for funding the various regulatory programs of the department and determined whether or not the fees being charged covered the cost of the program and either adjusted the fees or made recommendation in order to bring the fees in line with the cost of the program. Thus, there was a public airing of the fees charged and the services provided for those fees.

While this proposal would temporarily suspend the deposit of $2 million of the banks and financial institutions tax into the compliance resolution fund, that carving out of what used to be general fund receipts underscores the bad public policy it represents. Putting former general fund receipts into special funds reduces the flexibility of lawmakers to utilize all resources to address the core needs and services of the state. It precludes the ability to move funds from one program or service to another as the money in special funds can only be used for the designated purpose.

Consideration should be given to making permanent the disposition of the banks and financial institutions tax proceeds as, receipts of the state general fund.

Digested 1/28/11

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TO: Representative Marcus Oshiro
Chair, Committee on Finance
VIA FACSIMILE: 586-6001

FROM: Gary M. Slovin / Mihoko E. Ito

DATE: February 24, 2011

RE: **H.B. 803 – Relating to Taxation**
Hearing: Friday, February 25, 2011 at 12:30 p.m., Room 308

Dear Chair Oshiro and Members of the Committee on Finance:

I am Gary Slovin representing USAA, an insurer that has a long history in Hawaii.

USAA opposes H.B. 803, which repeals a requirement that $2,000,000 of tax revenues from banks and other financial corporations be deposited into the compliance resolution fund. This bill also authorizes the commissioner of financial institutions to expedite the imposition or increase of fees on banks and other financial corporations, effective July 1, 2011 and with a sunset on December 31, 2015.

The ABA believes that a bank tax is ill-conceived regardless of the economic cycle. It is, however, not a good idea to assess a tax at this time when a credit availability is so important to future economic growth and jobs are badly needed in this economy. In fact, implementing any tax now would likely ***lead to a greater withdrawal of recourses in a shorter period of time than is appropriate or prudent***, particularly given the nascent economic recovery. The bank tax would mean higher borrowing costs and less credit availability for consumers and businesses, while pushing financial activity to unregulated non-bank sectors.

Even a tax imposed only on large banks has broad consequences for small banks as well. By disrupting and increasing the cost of funding markets, the bank tax would make it more difficult for community banks to make new loans. Borrowers and other customers, particularly in small communities that have limited borrowing alternatives, would feel the impact of the tax more keenly as they would be faced with limited credit on less favorable terms – even if the lending institution is not directly subject to the tax.

For the foregoing reasons, USAA opposes H.B. 803.

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February 25, 2011

Rep. Marcus R. Oshiro, Chair,
and members of the House Committee on Finance
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **House Bill 803 (Taxation)**
Hearing Date/Time: Friday, February 25, 2011, 12:30 P.M.

I am the attorney for the **Hawaii Financial Services Association** ("HFSA"). The HFSA is a trade association for Hawaii's consumer credit industry. Its members include Hawaii financial services loan companies (which make mortgage loans and other loans and which are regulated by the Hawaii Commissioner of Financial Institutions), mortgage lenders, and financial institutions.

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

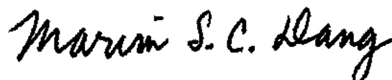
This Bill: (1) repeals the requirement that $2 million of tax revenues from banks and other financial corporations be deposited into the Compliance Resolution Fund; (2) authorizes the commissioner of financial institutions to expedite the imposition or increase of fees on banks and other financial corporations; and (3) takes effect on July 1, 2011 and sunsets on December 31, 2015.

The Hawaii franchise tax is paid by various financial institutions such as banks, savings and loan associations, financial services loan companies, and other entities. Currently $2 million of the franchise tax collected annually goes to the credit of the Compliance Resolution Fund of the Department of Commerce & Consumer Affairs ("DCCA"). The Compliance Resolution Fund is used to fund the operations of the DCCA, including the Division of Financial Institutions ("DFI"). The $2 million is earmarked for the DFI.

Under Sections 2 and 5 of this Bill, the $2 million franchise tax would be diverted from the DCCA to the Hawaii General Fund until December 31, 2015. As a result, the revenue of the DFI will be negatively impacted. To make up the shortfall in revenue, the fees that Hawaii financial institutions currently pay to the DFI will probably be increased. Those increased fees could be expeditiously imposed on financial institutions by the DFI between July 1, 2011 and December 31, 2011 using the authority of Section 3 of this Bill. Any fee increases by the DFI would be by rules that are made without public notice and without public hearings. There would not be a cap on the amount of the fee increases.

The HFSA understands Hawaii's challenging fiscal situation. However, the fees could increase to the extent where they will financially burden Hawaii financial institutions which need to maintain capital levels and add to reserves. Any added costs of doing business in Hawaii could ultimately be passed on by the financial institutions (lenders) to Hawaii consumers (borrowers). All these increases will hinder Hawaii's economic recovery.

Thank you for considering our testimony.



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Presentation to the House Committee on Consumer Protection & Commerce

Monday, January 31, 2011, at 2:00 pm

Testimony on House Bill 803 Relating to Taxation

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

My name is Neal Okabayashi of the Hawaii Bankers Association (HBA). HBA opposes HB 803, which proposes to permit an increase in fees paid by only certain banks to an unknown figure by a mechanism without checks and balances, notice, hearing rules, guidelines and limits.

HB 803 proposes to divert franchise tax paid by all banks, whether state or federally chartered, into the state general funds, and to replace the lost revenue, permits the commissioner of financial institutions to increase fees charged only to state chartered banks without hearing or notice, and without regard to the limit on fee increases.

Because this fee increase will only be imposed on state chartered banks, American Savings Bank, Territorial Savings Bank and Hawaii National Bank will be not be affected by this proposal. The unfairness of this proposal is obvious.

Although two million dollars is being diverted from the compliance resolution fund, the commissioner may increase fees far more than two million dollars. That is unfair.

The bill provides that the commissioner may increase fees without public notice and public hearing. That we believe to be unfair.

The bill provides that the fee increase will not be subject to HRS section 92-28 which not only places a ceiling on fee increases but it also provides that there be a "reasonable relation" between the fee and the value of the service provided. Because there is no cap on the fee nor any requirement that it be reasonable and will be only imposed on certain banks, we believe it to be unfair.

We also note that this fee increase is a disguised tax increase on some but not all banks, and raises legal issues which are best avoided.

We thank you for allow us to testify and for your consideration of this matter.