NEIL ABERCROMBIE
GOVERNOR

SHAN S. TSUTSUI
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

JO ANN M. UCHIDA TAKEUCHI
DEPUTY DIRECTOR

TO THE
HOUSE COMMITTEE ON
FINANCE

THE TWENTY-SEVENTH STATE LEGISLATURE
REGULAR SESSION OF 2013

Wednesday, February 27, 2013
11:30 a.m.

TESTIMONY ON H.B. NO. 838, H.D. 1
RELATING TO MORTGAGE LOAN ORIGINATION

THE HONORABLE SYLVIA LUKE, 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 ("DCCA") in strong support of administration bill, House Bill No. 838, H.D. 1.

This bill primarily focuses on amendments to Chapter 454F of the Hawaii Revised Statutes ("HRS"), the "Secure and Fair Enforcement for Mortgage Licensing Act" ("Hawaii SAFE Act"). The bill has two major purposes. First, it clarifies licensure requirements for mortgage loan originators and mortgage loan originator companies, and for mortgage servicer companies conducting mortgage loan origination activity.

Second, it adjusts fees for the mortgage loan origination licensees, and it establishes fees for mortgage servicer companies that conduct mortgage loan origination activities. Fee adjustments were discussed with mortgage loan origination industry representatives last summer, and are needed to close the gap on the deficit that the Division of Financial Institutions ("Division" or "DFI") has been covering to meet its statutorily mandated duties to oversee and regulate its licensees.

Mortgage Loan Origination Industry

Mortgage loan originators and mortgage loan originator companies start the process of making residential mortgage loans. They take loan applications from consumers seeking financing for real estate purchases or refinance loans. Loan originators and originator companies often gather and submit documentation that is submitted to underwriting to a consumer's loan application, and they may offer and negotiate loan terms.

In the aftermath of the mortgage industry meltdown, massive fraud and conspiracy in multiple aspects of the industry was exposed, including issues with the mortgage loan origination. In Hawaii, although 88% of mortgages are paid on time, our population is still vulnerable to unscrupulous activity. Recently, several local mortgage loan originators in Hawaii were sentenced for crimes including mortgage fraud and operation of a money laundering scheme. Across the country, federal and state governments are reevaluating their laws in an effort to resurrect the mortgage industry following the $700 billion industry bailout, to prevent future crises, and to better protect consumers.

The Commissioner expects licensees regulated by the Division to operate with a high level of integrity. Still, in view of what has been learned from the nationwide financial crisis, it is submitted that the proper statutory framework and adequate resources are vital for the Commissioner to exercise meaningful oversight over these Chapter 454F industries, to better protect consumer lives, homes and financial futures.

Bill Highlights

- **NMLS Licensing System**

The Commissioner believes that using the "NMLS" system is a cost-effective way to manage all of its Chapter 454F licensees, including the mortgage origination and mortgage servicer industries. It will also enable the Division to use the electronic method to review, oversee and license the mortgage servicer and mortgage loan origination industries. NMLS is a mortgage licensing system for state licensing and registration of state-licensed loan originators as well as other financial services providers. It was originally known as the "Nationwide Mortgage Licensing System" and changed its name when it expanded its services beyond mortgage loan originator registration. As a note, the Division must continue to ask for items outside of the NMLS for the state specific information required by our Hawaii law.

Sections 1 and 2 of the bill update HRS by changing specific references to the "Nationwide Mortgage Licensing System," to "NMLS."

In Section 8, the bill authorizes, rather than requires, the Commissioner to enter into agreements with NMLS or other entities to use NMLS to collect and maintain records and process licensee fees.

In Section 19, the bill establishes a quarterly frequency for Chapter 454F licensees to submit reports of condition to NMLS. A report requirement is already set out in existing law but the frequency is not specified. The report frequency is specified in the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, but not in the Hawaii SAFE Act.

The NMLS system benefits the public which will be able to see which companies are licensed in Hawaii through the NMLS consumer access page. The on-line application and renewal process will benefit licensees who conduct mortgage loan origination activities in more than one state and have the ability to use a nationwide application. As the Division focuses its supervisory, regulatory, and examination authority on these licensees, it anticipates that the industry will be more responsive and compliant with state and federal laws, which will in turn, consumers will be protected.

- **Mortgage Servicer Licensees**

In Section 2, the bill clarifies that for purposes of Chapter 454F, a "mortgage servicer company," refers to a mortgage servicer company that employs at least one person who conducts mortgage loan origination activity. Such a mortgage servicer company must be registered and licensed through NMLS, per Sections 7 and 14 of the bill. As previously mentioned, the Commissioner believes that using the NMLS system will be a cost-effective way to manage all of its Chapter 454F licensees, and it will enable the Division to use the electronic method to review, oversee and license its licensees.

In Section 14, the Commissioner is authorized to establish licensing requirements for mortgage servicer companies by administrative rule. Section 12 of the bill adds minimum standards for license renewal for a mortgage servicer company. Basically, the company must continue to meet the minimum standards for licensure set out in Section 454F-5, and pay license renewal fees. Licensing fees for mortgage servicer companies to maintain a mortgage loan originator license are set out in Section 22. Mortgage servicer companies are required to pay specified amounts toward the mortgage loan recovery fund under Section 24. Such a payment is already required of mortgage loan originator companies.

- **Branch Supervision**

It is important to have a designated responsible person overseeing the operations at branch offices to ensure that company policies and procedures are followed by staff who work away from the principal place of business. Therefore, Section 15 of the bill clarifies that a branch manager must be physically present in the branch office of a mortgage loan originator company, to oversee it. It also clarifies that a mortgage loan originator company that maintains its headquarters in Hawaii must designate a qualified individual as branch manager who is physically present in the company's principal place of business to oversee that office. If a mortgage loan originator company seeks to relocate its office, Section 15 of the bill requires that it apply to the Commissioner for approval at least 30 days in advance of relocating.

- **Education**

The mortgage loan origination industry continues to undergo many significant regulatory changes, much of which focuses on better protecting the public and improving industry practices. Professionals offering mortgage loan origination services need ongoing education to be aware of these changes so they can implement them and stay in compliance with State and federal law.

Accordingly, in Section 10, the bill enhances pre-licensing educational requirements for mortgage loan originator license applicants, by adding three hours of State law and rules education to the existing requirement pre-education. To maintain relevance, the bill requires that education hours be completed within twelve months before a mortgage loan origination application is submitted.

The bill specifies in Sections 12 and 13 that for licensed mortgage loan originators, one hour of education on state laws and rules must be included in the eight hours of continuing education required annually. Licensees would need to satisfy the annual continuing education requirements before requesting a license renewal.

- **Fee Adjustments**

Representatives of the mortgage loan origination industry met with the Commissioner in 2012, and agreed to the fee adjustments for their industry set out in H.B. 838 as originally introduced. The fee adjustments in H.B. 838 are necessary in view of heightened levels of regulation, investigation, supervision and investigation that Hawaii law now requires DFI over mortgage loan originators, mortgage loan originator companies, and mortgage servicers. DFI has further regulatory responsibilities over these licensees resulting from federal amendments to Privacy Laws, Bank Secrecy Act/Anti-Money Laundering Program laws, and Consumer Financial Protection Bureau guidance and regulations. The fee structure is adjusted by H.B. 838 to take into account the additional supervision, regulation, and examination of these licensees.

H.D. 1 changed to an unspecified amount all adjusted fees for mortgage loan originators and mortgage loan originator companies, and all fees established for mortgage servicer companies that conduct mortgage loan origination activities. As explained above, both the Department and Division are self-funded, and consequently programs that the Division oversees and supervises, including the mortgage loan origination program, must generate sufficient revenues to cover the cost of those legislated mandates. Therefore, the Commissioner respectfully requests that this committee restore fee adjustments as they were set out in the original administration bill, H.B. 838.

- **Clarifying Amendments**

This bill clarifies terms that are already used in Chapter 454F. Section 2 adds new definitions for "loan modification", "mortgage call report", "NMLS", and "principal place of business." Section 2 amends a number of definitions in Chapter 454F, including the following. “Branch manager" is amended to include those responsible for the company's principal place of business. “Branch office" is amended to clarify that a mortgage loan originator company headquartered out-of-state may designate a branch office as its principal place of business. “Exempt registered mortgage loan originator" is amended to remove from the definition an individual who is an employee an insured depository institution subsidiary. “Licensee" is amended to include certain mortgage servicer companies and exclude certain nonprofits. “Mortgage loan originator” is amended to include an individual who offers or negotiates a mortgages loan secured on specified family property, and who does so no more than three times a year.

In Section 4, the concept of ‘presumption of control’ over a mortgage loan originator company is explained in terms voting rights, and the power to direct the sale of a class of voting securities of the company. The concept is also extended to apply to a mortgage servicer company.

These changes will help avoid ambiguity as to the Commissioner's authority and duties, and licensee responsibilities.

- **Housekeeping and Conforming Amendments**

Housekeeping changes include Sections 1, 3, 5, 6, 9, 11, 16, 17, 20, 21, and 23, which make conforming amendments and update and clarify current provisions.

The Division has been executing its oversight of the mortgage loan origination program and particular mortgage servicers who perform mortgage loan activities taking into account federal policy set out by the federal government agencies and most recently by the Consumer Financial Protection Bureau, and increasing federal government regulations. With financial transactions becoming increasingly sophisticated, billions of dollars being transacted by licensees involved in mortgage loan origination activities, and with our population having shown its vulnerability, the Commissioner submits that changes to the Hawaii's mortgage loan origination and related laws as proposed by this bill are needed to better protect consumers and promote greater soundness of the mortgage loan origination industry and mortgage loan originator companies.

Requested Amendments

The Commissioner respectfully requests that the following amendments be made to H.B. 838, H.D. 1:

1) **Restore all fees as per H.B. 838.** As explained above, both the Department and Division are self-funded, and consequently programs that the Division oversees and supervises, including the mortgage loan origination program, must generate sufficient revenues to cover the cost of legislated mandates. In the past two fiscal years, revenues from the mortgage loan origination program have exceeded costs by more than a quarter million dollars. The fee adjustments in H.B. 838 as originally introduced were intended to help reduce the deficit, after discussions with the industry. Therefore, it is respectfully requested that this committee restore fee adjustments as they were set out in the administration bill, H.B. 838.
2) **Restore the bill's "on approval" effective date, as per H.B. 838.**

Self-Funding Requirement Necessitates Requested Fee Changes

To provide context for the fee changes proposed by this bill, the Commissioner submits the following. In 1999, DCCA became financially self-sufficient. This means that its operations are not funded by the Legislature's general fund, but instead by the persons and entities who are regulated by DCCA or who receive services from DCCA. (*See* Hawaii Insurers Council v. Lingle, 120 Haw. 51, 201 P.3d 564 at 567 (2008) ("HIC v. Lingle").

As a special-funded program within the Department, the Division of Financial Institutions is responsible for generating sufficient revenues to fully fund its operations. As such, the Division is tasked with aligning its revenues with expenditures to ensure that it is self-sustaining. Its mission of overseeing much of the financial business sector is critical to consumer confidence and the conduct of business in the State. Specifically, the Division is responsible for the licensure, examination and supervision of state-chartered and licensed banks, trust companies, savings and loan associations, financial services loan companies, credit unions, escrow depositories, money transmitters, mortgage servicers, mortgage loan originators and mortgage loan originator companies.

- **Fiscal Cliff**

To fully meet its total operating costs, the Division must manage a cash reserve that is sufficient to meet direct operating costs, overhead costs and unanticipated contingency costs/accrued liabilities as they are actually due. The chart below shows that the Division is quickly approaching a fiscal cliff. Current projections are that at the end of FY15, the Division will have a reserve of just over $600,000, which is less than two month’s operating expenses. By the end of FY16, the Division will be unable to meet payroll, and will actually be short by $212,838.

DFI CASH FLOW PROJECTION				
Source	**FY13 (estimated)**	**FY14 (estimated)**	**FY15 (estimated)**	**FY16 (estimated)**
Beginning Cash Balance	5,043,246	4,265,971	3,450,942	2,629,452
Plus Program Generated Revenues	1,230,700	1,190,400	1,190,800	1,170,000
*Less Expenditures	4,007,975	4,005,429	4,012,290	4,012,290
Cash Balance @ June 30	2,265,971	1,450,942	629,452	(212,838)
Plus Franchise Tax (received in late July @ beginning of new FY)	2,000,000	2,000,000	2,000,000	2,000,000
Equals Ending Cash Balance	4,265,971	3,450,942	2,629,452	1,787,162

Figures are based on Report on Non-General Fund Information for Submittal to the 2013 Legislature, Program ID CCA-104, Fund Name CRF-Financial Institutions. *Expenditures are based on Appropriation Ceiling and include 34 authorized permanent staff positions and DFI share of DCCA overhead.

The franchise tax infuses needed funds to the Division in late July of each year for the **previous** fiscal year. This means that during the fiscal year, DFI spends the franchise tax allocation on salaries and expenses relying on the infusion of the franchise tax revenues in July of the next fiscal year. This is a tax paid by the financial institutions, and the mortgage loan originators and mortgage loan originator companies, deposited with the director of Finance by June 30 of each fiscal year, pursuant to HRS sec. 241-7. On its current trajectory, in FY 14, the Division will not have enough revenue to pay for its staff if all positions were filled. In FY15, the Division will be operating on a very thin margin, and hopes to make the payroll during the month of July before the infusion of the franchise tax revenue. By FY16, the Division will run out of funds. As such, adequate cash reserves need to be maintained in order to fund the annual program costs while awaiting the deposit of the monies.

The projections in the chart above anticipate that the Division is fully staffed with the 34 permanent positions that the Legislature has authorized. Up to now, the Division has refrained from filling its six staff vacancies – this is because the chart shows that by FY16 there will be insufficient funds to maintain that staffing level and after investing funds to train personnel, personnel would need to be laid off.

Not hiring, on the other hand, is unrealistic as there is currently a 120 to 180 day backlog in processing licensing work. This is an untenable situation as the Division has been given increased oversight and regulatory responsibilities and workload resulting from changes in federal laws and sophistication of the financial institution industry. The Division's staff vacancies adversely affect the State's economy and the public's interests in a number of ways. Businesses that are otherwise ready to open may have to wait months to obtain approval on their initial license applications, despite best efforts of the Division and its staff. They must postpone hiring employees and generating revenue that would increase the State's tax base. Licensees who do not apply for license renewals well before the end of the year may end up in a similar predicament, unable to lawfully conduct business after their license expires, and in limbo until the

Division can confirm satisfaction of license renewal requirements and issue a license renewal. For the public, the Division's personnel shortage means potentially months of delay in its examination of licensees which handle billions of dollars of consumer financial transactions annually. It also potentially means months of delay in the Division's discovery of licensees that could benefit from the Division's assistance and monitoring to help them restore their financial viability and strength. In an extreme case, a staff shortage could mean that the Division cannot discover and investigate questionable licensee conduct and circumstances in time to avert massive financial harm to the public.

- **No Excessive Reserve**

Clearly, the Division is not creating a large reserve fund. To the contrary, it is headed toward a fiscal cliff in FY16 when it will run out of money without a revenue increase, and to avoid this it clearly needs additional revenue. Running 120 to 180 days behind in license processing indicates that trying to save money by refraining from hiring or cutting staff positions is not a realistic option for the Division.

Indeed, the Hawaii Supreme Court has recognized that it is reasonable for a regulatory division to have a reserve fund, which can be essential to the division's regulatory function. The high court has noted that there can be an "unpredictability of potential contingencies and fluctuations in the amount of funds available to the… division through assessments and other means," and that a reserve fund can be a regulatory agency's reasonable strategy for securing its continued ability to serve its public function. HIC v. Lingle, 201 P.3d at 580. In that case, the Insurance Division of DCCA maintained a practice of collecting assessments beyond its operating costs in order to develop a reserve fund to protect against unforeseen emergency situations, such as the unplanned rehabilitation and liquidation of insurers or natural disasters, as well as to cushion the division's operating budget from yearly fluctuations in revenue. Id. at 580. The Court held in part that the portion of the assessments paid by the insurance council to the Insurance Division that ultimately went to support the overhead of DCCA and the Department of budget of Finance, along with a portion of assessment that the Insurance Division applied toward creating a reserve fund, did not amount to unconstitutional taxes. Id. at 583.

The Commissioner respectfully submits that it is appropriate for the Division to have reasonable operating reserves, and that current projections show that it is headed toward a fiscal cliff. As a self-funded division in a self-funded department, fee increases are needed in order for the Division to continue to meet its legislated responsibilities and maintain the CSBS accreditation standards.

- **Shortfall in Financial Institutions Program Revenues**

As the Division strives to maintain the delicate balance between fee setting and cash reserve management for its special-funded programs, a guiding principle is that the revenues from each program must be sufficient to cover the Division's cost of operating that program. The Division estimates that it will need additional revenues of approximately $500,000 a year to adequately meet its cash reserves needed to support the Division's operations and facilitate its ability to appropriately carry out its mission.

The mortgage loan origination program ran substantial deficits in FY11 and FY12. To provide the minimum oversight in FY11, it cost the Division $932,161 to operate the program, while it generated revenue for the Division of $760,021, leaving the Division to cover the $172,140 shortfall. In FY12, the program ran a deficit of $94,321. The most recent results are as follows:

Mortgage Loan Origination Program	**FY11**	**FY12**
Program Cost to Division	$932,161	$716,791
Less Program Revenues	$760,021	$622,470
Program Deficit to Division	($172,140)	($94,321)

The Division anticipates that the mortgage loan origination program will bring in approximately $10,000 of additional revenue annually, with the adjusted fee schedule. We believe that with a fully staffed Division, we can provide the services requested and expected by our financial institution licensees as well as provide the appropriate oversight for consumers.

- **Funding Not Available from Other Programs**

Finally, the Commissioner respectfully submits that under HIC v. Lingle, an assessment needs to be used for the regulation or benefit of the parties upon whom the assessment is imposed. Id., 201 P.3d at 580. As such, the Division cannot expect to receive funding in excess of what its own programs have generated, from funds generated by programs of other divisions that are held in the DCCA Compliance Trust Fund.

For these reasons, DFI strongly supports this administration bill, House Bill No. 838, H.D. 1, and respectfully asks that the measure be passed with the amendments requested above.

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

HAMB

THE HAWAII ASSOCIATION OF MORTGAGE PROFESSIONALS

February 26, 2013

TO: COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Scott Nishimoto, Vice Chair
Representative Aaron Ling Johanson, Vice Chair

FROM: Jodie V. Tanga, President
Hawaii Association of Mortgage Brokers

RE: H.B. 838 Relating to Mortgage Loan Origination
Position: Comments only

Chair Luke, Vice Chairs Nishimoto, Johanson and members of the Committee:

I am Jodie Tanga, President of the Hawaii Association of Mortgage Brokers (HAMB), a non-profit organization that is dedicated to promoting high standards of professionals in the mortgage industry through education and representation. We are a state affiliate of NAMB "The Association of Mortgage Brokers." HAMB's comments on the bill are limited to the proposed fee increases.

As I testified last year, HAMB remains concerned this request to increase fees without greater transparency with respect to the use of those fees. We believe that with the implementation of the NMLS system, there should be cost-savings, not increases. The DCCA's 2012 Compliance Resolution Fund Report states, "This online system is designed to replace individual state's existing mortgage licensing application forms, systems, and processes." (page 49)

We have repeatedly requested information on how the fees collected are being utilized and expended. Recently, the dialogue has improved, but we still have not received the relevant information on the budget. While we note that in testimony before the Senate Ways and Means Committee the Commissioner provided the top line budget numbers, we would like more detail of the costs and revenues. Specifically, we pay fees for the mortgage loan recovery fund, but there is no reporting of the balance in the fund. We would request that reporting of the balance in that fund be included in DCCA's annual Compliance Resolution Fund Report.

We appreciate the costs decreased last year and we would like to work with the Commission on exploring other cost-containment measures. With the economy in recovery and 226 more MLOs receiving licenses in 2012 than 2011, we support the non-fee related proposed changes.

We support the inclusion of an education component on Hawaii law and requiring a local representative is present in the state.

We ask that you keep in mind that we are basically small business owners and that the fees listed in this bill are not the only costs to renew our licenses. We must also pay NMLS and pay for the data to submit to NMLS. For most of us, this adds up to more than $1,000 per year. We hope to work with you and the Commissioner to ensure that we are not before you next year discussing yet another proposed fee increase.

Thank you for the opportunity to submit testimony.