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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. 839, H.D. 1
RELATING TO MORTGAGE SERVICERS

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. 839, H.D. 1.

This bill has two primary purposes. First, it authorizes the Commissioner to examine mortgage servicers, and provides realistic examination and investigation tools. Second, it adjusts the fees for mortgage servicer licensees registering through the NMLS system used by the Division of Financial Institutions, which regulates mortgage servicers under Chapter 454M, Hawaii Revised Statutes (“HRS”). As the Department is self-funded, the Commissioner seeks to have fees for mortgage servicers set at a level that covers the true costs of operating the program and providing the public the protection it needs and that the Legislature intended.

The need for meaningful mortgage servicer oversight is evident from the failure of the nation's mortgage loan systems, and in the wake of last year's landmark $25 billion joint state-federal agreement with the nation's five largest mortgage servicers over foreclosure abuses and fraud, and unacceptable nationwide mortgage servicing practices. Since these events, there has been a reevaluation of laws by every state and the federal government in an effort to address breakdowns in the mortgage servicing industry and better protect consumers.

In Hawaii, mortgage servicers serviced over 35,000 residential loans with an aggregate value of $9.78 billion, according to 2012 licensee renewal data. Mortgage servicers are responsible for billing and collecting mortgage payments from residential homeowner borrowers, and transmitting payments to owners of the mortgage loans. They also typically handle customer service, escrow accounts, collections, loan modifications, and foreclosures. Generally, the borrower has little say in the choice of mortgage servicer. Lenders frequently contract out servicing after the mortgage loan is signed. In the case of reverse mortgages, mortgage servicers make payments to the borrower.

Bill Highlights

Investigation and Examination Authority, Tools and Fees

Many mortgage loans are secured on a borrower's primary residence. Eighty-eight percent of Hawaii mortgage loans are paid on time. The other 12% are over 90 days past due, which classifies them as "delinquent" for purposes of the National Mortgage Settlement. With homes at stake, it is imperative that the Commissioner have the tools to conduct meaningful examinations and investigations of mortgage servicers, and protect consumers. HRS Chapter 454M gives the Commissioner the authority to investigate and act upon written consumer complaints, and investigate a violation of the Chapter. Section 1 of this bill authorizes the Commissioner to conduct examinations, as well as investigations that do not require initiation by a consumer complaint.

The original administration bill, H.B. 839, provides the Commissioner with tools needed to conduct meaningful investigations and examinations. Among others, the bill gives the Commissioner power to subpoena witnesses, require the production of documents and records, take control over documents and records, and retain accountants and other professionals to assist in examinations and investigations, if necessary. It also authorizes the Commissioner to cooperate with other government officials or regulatory associations to improve efficiencies and reduce regulatory burden by sharing resources, documents, records and information.

We expect the mortgage servicers that we regulate to operate with a high level of integrity. Still, in view of what has been learned from the nationwide financial crisis, we submit that it is both realistic and important for the Commissioner to have the investigation tools that this bill provides, in order to protect consumers. As just one example, the federal government recently prosecuted a mainland company alleging that it had conducted a scheme to prepare and file more than one million fraudulently signed and notarized mortgage-related documents, many of which were used in foreclosure proceedings to force homeowners out of their homes. The Commissioner should have the authority to examine mortgage servicers suspected of improper conduct without having to await a consumer complaint, and the Commissioner should have the proper tools to conduct a meaningful investigation.

For these reasons, it is respectfully requests that the Commissioner's investigation and examination authority, deleted by H.D. 1 from H.B. 839 (p. 1, lines 4-13), be restored by inserting the following language on H.B. 839, H.D. 1, page 1, line 4:

Investigation and examination authority. (a) In addition to any other authority under this chapter, the commissioner shall have the authority to conduct investigations and examinations in accordance with this chapter. The commissioner may access, receive, and use any books, accounts, records, files, documents, information, or evidence, the commissioner deems relevant to the inquiry or investigation, regardless of the location, possession, control, or custody of the documents, information, or evidence.

The intent of this provision is that it applies only to licensees and to those who should be licensed under Chapter 454M. What is critical is that the Commissioner have appropriate authority to conduct meaningful examinations and investigations as needed to protect the public, as intended in Chapter 454M.

Licensure Fees, NMLS

H.B. 839 as introduced authorizes the Commissioner to charge an examination or investigation fee and reasonable expenses incurred in the process. Under the bill, if fees and expenses are charged, they will be borne by the party being examined or investigated. This is necessary and appropriate because the Division is self-funded and generates its own revenue to carry out its responsibilities and programs to protect and inform the public, and regulate financial institutions. The original bill also adjusts licensure and license renewal fees. These fee amounts were deleted from H.D. 1.

The Commissioner respectfully requests that fees be restored to those in the original bill, H.B. 839, for reasons explained above including the requirements that both the Department and Division be self-sustaining, and the over quarter million dollar deficiency that the mortgage servicers program has run in just the past two years.

Effective Date and Housekeeping

Section 4 of the bill extends existing licenses for current licensees until December 31, 2013, conforming to the renewal schedule used by NMLS.

Housekeeping amendments in Section 5 reflect the change in the federal regulator from the Housing & Urban Development Department to the Consumer Financial Protection Bureau ("CFPB").

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	2,000,000	2,000,000	2,000,000	2,000,000

in late July @ beginning of new FY)				
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 given increased oversight and regulatory responsibilities and workload resulting from changes in federal laws and sophistication of the financial institution industry. 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 and 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 servicers program ran substantial deficits in FY11 and FY12. To provide the minimum oversight, it cost the Division $114,265 to operate the program in FY2011, while it generated revenue for the Division of $27,500, leaving the Division to cover the $86,765 shortfall. In FY12, the program ran a larger deficit, this time in the amount of $173,942. The most recent results are as follows:

Mortgage Servicers Program	**FY11**	**FY12**
Program Cost to Division	$114,265	$197,942
Less Program Revenues	$27,500	$24,000
Program Deficit to Division	$86,765	$173,942

Clearly, under the fee schedule set by Chapter 454M, HRS, the mortgage servicers program is fiscally unsustainable for the Division. The minimum oversight includes review and examination of the safety and soundness of the company. The Division would like to enhance its program to: (1) provide additional oversight throughout the year to companies who may have compliance issues, (2) provide additional training to the Division's examiners to learn about the risks associated with the new compliance regulations, and (3) conduct examinations.

The Division anticipates that the mortgage servicers program will bring in approximately $7,875 of additional revenue annually, with the restoration of the adjusted fee schedule set out in H.B. 839. 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. After having run an aggregate deficit on the program in just the past two years of more than a quarter million dollars, the Commissioner respectfully submits that requested changes in fees are both necessary and appropriate.

Funding Not Available from Other Programs

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.

Requested Amendments

The Commissioner respectfully requests the following amendments:

1) Restoring the Commissioner's investigation and examination authority by inserting the suggested language on pages 4-5 of this testimony;
2) Restoring the fees and fee adjustments set out in H.B 839; and
3) Changing the effective date back to "on approval," as set out in H.B. 839.

For the reasons stated above, DFI strongly supports this administration bill, House Bill No. 839, H.D.1, and respectfully asks that the measure be passed with the amendments requested.

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