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TO THE
HOUSE COMMITTEE ON
FINANCE

THE TWENTY-SEVENTH STATE LEGISLATURE
REGULAR SESSION OF 2013

Wednesday, March 27, 2013
4:45 p.m.

TESTIMONY ON S.B. NO. 1067, S.D. 2, H.D. 1
RELATING TO ESCROW DEPOSITORIES

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, Senate Bill No. 1067, S.D. 2., H.D. 1.

This bill has two main purposes: (1) it updates the escrow depositories law to more realistically address the responsibilities and operations of escrow depositories as they conduct business today; and (2) it adjusts fees for escrow depositories to reflect

the risk based approach of supervision, and the additional regulation and monitoring required of the Division as a result of changes to the federal laws and increasing sophistication of the escrow depository industry.

Since last summer, I met with the industry members to try to modernize this law which has not been changed for 25 years. **The current proposal is the compromised version of the bill.** The Division focuses on protecting consumers, since for most consumers, a home purchase is their single largest financial transaction. With the high value of Hawaii real estate – and the median price of a single family home on Oahu is currently around \$600,000 – it is not uncommon for an escrow to involve hundreds of thousands of dollars. As regulators, I know our viewpoint is different from the industry; however, our main focus as regulators is to balance the protection of consumers and business activities of the industry.

We expect the escrow depositories that we regulate to operate with a high level of integrity. Still, in view of the large sums of money they continuously handle, and taking into account observations from the nationwide financial crisis, the Commissioner needs the provisions of this bill to better protect consumers. In other states, escrow depositories and agents have been involved in perpetrating, aiding or abetting mortgage fraud schemes and stealing from escrow accounts, as well as being duped into wiring millions of dollars from an escrow account to an unauthorized recipient. We do not want this to happen in Hawaii.

Areas of policy decisions

- This bill would authorize the Commissioner to investigate and conduct hearings regarding possible violations of Chapter 449, whether or not the investigation stems from information furnished by an escrow depository applicant. **This authority would be similar to the authority already vested in the Commissioner with respect to financial institutions, money transmitters, and the mortgage loan origination industries, pursuant to Chapters 412, 489D, and 454F, HRS.**
- Section 3 requires that a licensee have notice and an opportunity to be heard before the Commissioner can impose an administrative fine for a violation of Chapter 449. It removes the prerequisite that the violation be “willful.” In other industries regulated by the Division, the Commissioner has the authority to impose fines on other licensees in the same manner; if a law is violated, an administrative fine may be imposed.¹
- The bill adds a special civil penalty of up to \$10,000 if a violation is targeted at or injures an elder. This focus on protecting elders is in line with a recent report by the Honolulu Prosecutor’s Office that most crimes against elders involve financial fraud, and that crimes against elders doubled between 2009 and 2012.

All other changes in the bill have been agreed to by the industry.

¹ Mortgage loan originator law (HRS Sec. 454F-12); mortgage servicer (HRS Sec. 454M-10); money transmitter (HRS Sec. 489D-28); and financial institutions (HRS Sec. 4122-609, 412:2-609.5).

Self-Funding Requirement Necessitates Requested Fee Changes

The chart below shows that the escrow depository program ran increasing substantial deficits in FY11 and FY12.

ESCROW DEPOSITORIES PROGRAM	FY11	FY12
Program Cost to Division	\$234,544	\$293,914
Less Program Revenues	\$35,205	\$43,455
Program Deficit to Division	(\$199,339)	(\$250,459)

The Division anticipates that the escrow depositories program will generate approximately \$23,245 of additional revenue annually, with the adjusted fee schedule and amendments requested. Although the amount of the anticipated revenue will not cover the cost of supervision, it will help defray some of the costs of oversight.

The bond adjustments will be in effect from January 1, 2014, however, in recognition that the insurance companies will not adjust the bond amount for the companies, DFI will allow the companies to use their usual renewal date. In all cases, the bonds must be at the higher statutory level by July 1, 2014. These bonds will protect consumers from bad act by escrow companies.

DCCA has been financially self-sufficient since 1999. 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 the Department.

As you will see in the chart below, current projections are that at the end of FY15, the Division will have a reserve of just over \$600,000, 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 tax² infuses funds critically needed by the Division in late July of each year, for the **previous** fiscal year. During the fiscal year, DFI spends the franchise tax allocation on salaries and expenses, and it relies on franchise tax revenues being re-infused in July of the following fiscal year. The Division needs to have sufficient cash

² 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.

reserves on hand to fund its annual program costs while awaiting deposit of the franchise tax monies.

The chart above anticipates that the Division is fully staffed with the 34 permanent positions that the Legislature has authorized. The Division has been experiencing an increased workload between the greater oversight and regulatory responsibilities it has been given, changes in federal laws, and sophistication of the financial institution industry. Since 2006, the Division has been given three new programs which do not collect adequate revenue to appropriately supervise those programs. Below is a list of how the Division has operated within its budget:

- The Division has refrained from filling its six staff vacancies.
- The last application took 11 months to process because of the staffing resources.
- The Division has a current 120 to 180 day backlog in processing licensing work.
 - Delay in the Division's licensing and examination work is contrary to the best interests of consumers and business.
 - It means delays in opening of new businesses and their hiring of employees which would contribute to the State's economy.
 - It means a delay in issuing license renewals rendering licensees with expired licenses unable to lawfully conduct business
 - We have not been able to fully examine our licensees which handle billions of dollars of consumer financial transactions annually, and in discovery of

licensees that could benefit from the Division's assistance and monitoring to help them restore their financial viability and strength.

- Delays mean questionable licensee conduct goes undiscovered in time to avert massive financial harm to the public.

The Division would like to have a reasonable reserve fund³; it is currently headed toward a fiscal cliff absent an increase in revenues. It 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.⁴

Proper Staffing Levels Are Required to Maintain Appropriate Supervision

A revenue shortfall in one Division program impacts all of its other programs. The shortfall keeps the Division from hiring staff. Yet industry licensees and applicants still need to be served. We believe that with a fully staffed Division, we can provide the services requested and expected by our escrow depositories licensees as well as provide the appropriate oversight for consumers.

DFI strongly supports this administration bill, Senate Bill No. 1067, S.D. 2, H.D. 1, and respectfully requests that it is passed out of committee.

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

³ 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. See Hawaii Insurers Council v. Lingle, 201 P.3d 564, 580 (2008) (hereinafter "HIC v. Lingle").

⁴ See HIC v. Lingle, 201 P.2d at 580.