Hawaii Escrow Association
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February 21, 2013

The Honorable Senator David Y. Ige, Chair
The Honorable Senator Michelle N. Kidani, Vice Chair
Members of the Senate Committee on Ways and Means

415 South Beretania Street
Honolulu, Hawaii 96813
Hawaii State Capitol Room 211

RE: SB 1067 Relating to Escrow Depository 2013
DEFER BILL
Notice of Decision Making 9:00 a.m. – Friday, February 22, 2013
Conference Room 211

Dear Honorable Chairperson Mr. Ige, Honorable Vice-Chairperson Ms. Kidani and Members of the Senate Committee on Ways and Means:

Thank you for allowing the Hawaii Escrow Association (the "Association") to testify on Senate Bill 1067 related to the Escrow Depository Statute (Hawaii Revised Statutes Chapter 449). The Association represents the following licensed escrow depositories in the State of Hawaii, with branches on all major islands:

- Fidelity National Title & Escrow of Hawaii, Inc.
- First American Title Company, Inc.
- First Hawaii Title Corporation
- Guardian Escrow Services, Inc. (dba Premier Escrow)
- Hawaii Escrow & Title, Inc.
- Old Republic Title & Escrow of Hawaii
- Title Guaranty Escrow Services, Inc.

WHY THE ASSOCIATION IS REQUESTING TO DEFER THE ESCROW BILL

1. *DFI Is Attempting To Enforce And Regulate Federal Law*

Section 1 ("Power of commissioner") Paragraph 8 allows the DFI Commissioner to require escrow companies to comply with ***any*** rule, guideline, statement, or supervisory policy "***issued or adopted by the federal authority*** or in the alternative ***any policy position of the Consumer Financial Protection Bureau***." This is overly broad and far-reaching. Escrow companies cannot possibly be expected to comply with ***any*** federal regulations which the DFI Commissioner chooses

to enforce. Moreover, the Consumer Financial Protection Bureau is a federal agency which is focused on regulating banks, credit unions, mortgage-servicers, payday lenders and other financial companies – ***not*** escrow companies. At this point, the Association urges that this federal authority section be deleted in its entirety.

2. *Cease & Desist Sections Have Serious Due Process Ramifications*

Section 1 ("Cease and desist orders") authorizes the DFI Commissioner to issue a cease and desist order to an escrow company if the DFI Commissioner "finds or has reasonable cause to believe: "(1) Is violating, has violated, or ***is about to violate*** this chapter . . .[or] (3) Is engaging, has engaged, or ***is about to engage*** in an illegal, unauthorized, unsafe, or unsound practice; . . ." We have serious issues with these overbroad language in the cease and desist sections. There are no detailed procedures or definitions set forth in the bill to afford *Due Process* to the escrow companies.

The entire Cease and Desist Sections is a cut and paste from the banking statute. Escrow companies are different from banks as we serve as neutral 3rd parties to the buyer and seller in a real estate transaction and act on instructions from the parties. Before we can move forward with the Cease and Desist sections, specific provisions must be made for issues such as how pending escrows and deposits will be handled (especially those scheduled for imminent closing, the delay of which will prejudice the consumer); whether a Cease and Desist order affects the title operation of the affected company; whether there would be a designation of a DFI "on-call" person with responsibility to act as liaison during the Cease and Desist process and period.

While we appreciate the DFI's focus on consumer protection as a basis to add these powers and authority, the Association would like the committee and DFI to consider that the escrow companies collectively employee ***over 700*** people across the state. Four out of the seven escrow companies are locally owned and operated. If, for example, the DFI implements a cease and desist order to shut down one of the small business escrow operation for even a couple of days, that escrow company will very likely be out of business permanently.

Therefore, we would like further discussions with the DFI Commissioner on revising this section to possibly include a probation period and mandatory meet and discuss sessions between the escrow companies and the DFI Commissioner prior to issuance of a Cease & Desist order, unless the DFI Commissioner specifically finds that such a meeting procedure would result in immediate and irreparable harm to the consumer.

3. *Administrative Penalty*

Section 3 ("Administrative penalty") Paragraphs (a) and (b) increases the administrative fine from $5,000 to a maximum of $10,000 and removes the term "willfully violate." The Association's position is to have the penalty at a "maximum of $5,000" and keep the term "willfully violate." We would also consider other terms to be included after further discussions with the DFI Commissioner.

4. ***Elder Section Needs To Be More Clearly Defined***

Section 3 ("Administrative penalty") Paragraph (d) provides that any violation that is "directed toward, targets, or injures an elder may be subject to an additional civil penalty not in excess of $10,000 for each violation . . ." We have several issues with this section. First, the term "elder" needs to be defined. Second, this section needs to include language to reflect that the violation was "willfully" carried out. Escrow companies do not choose the customers; but rather, the buyers and sellers choose us. As mentioned, escrow companies serve as neutral 3rd parties to the transaction and take instructions from the parties to the transactions, so it would be unreasonable if an escrow company was fined for additional amounts under this section simply because the customer happened to be an "elder." There must be intentional wrongdoing on the part of the escrow company to apply this additional penalty.

5. ***Unsound Business Practice To Provide 15-Day Termination Notice To DFI***

Section 5 (§449-7.5) requires the escrow depositories to give a 15-day advance notice of a branch manager's potential termination to the DFI. This places the escrow depositories in a very difficult situation since terminations at that level are generally executed immediately, and there is always the possibility that the terminations may not happen after giving notice to the DFI. This provision is over-reaching and simply an impractical business approach. The DFI is attempting to micro-manage our business. A suggestion may be a requirement to give notice to the DFI within 5 days after termination. This adds to our examples of why we need more time to work on to balance the State's requirement with how we do business, and which can also have severe ramifications on the entire escrow industry.

THE ASSOCIATION AGREED TO SUPPORT MOST FEE INCREASES

Significantly, as the Association previously informed the DFI Commissioner in November 2012, the Association has agreed to substantial increases across the board, including increases of **100%** in net capital and **300%** in fidelity bond requirements, and increase of **150%** in errors and omission insurance requirement. In addition, the Association is also agreeable to considerable increases in various fees from **100%** to **2,000%**,as well as DFI's injection of new fees ranging from **$100 to $2,000**. Furthermore, the Association is also agreeable to the proposed **50%** increase in its examination fee from **$40 to $60 per hour**.

More specifically, the Association is agreeable to the following increases and proposals in SD 1067, except as noted:

Section 4
- §449-5.5 "Net Capital" – Increase the net capital requirement from $50,000 to $100,000 **[Increase of 100%]**

Section 6
- §449-8.6 "Sale or transfer of license or change in control" – Apply new fee of $2,000 for transfer and/or change in control of escrow depository **[New fee of $2,000]**

Section 7
- §449-11 "Fidelity bonds; deposit" –

- (1) Increase the fidelity bond amount from $25,000 to 100,000, and also increase the deductible amount from $5,000 to $10,000; **[Increase of 300%]**
- (2) Add "or other security device."

Section 8

- §449-12 "Errors and omissions insurance; deposit" –
  - (1) Increase the errors and omissions insurance amount from $100,000 to $250,000, and also increase the deductible amount from $10,000 to $100,000; **[Increase of 100%]**
  - (2) Add "or other security device."

Section 9

- §449-14 "Fees" -
  - (a)(1) Please note that the Association is not agreeable to increasing the new applicant fee from $2,000 to $5,000. As previously discussed at our meeting, the Association would like to keep the new applicant fee at $2,000.
  - (a)(2) Apply new fee of $100 to establish a branch office.**[New fee of $100]**
  - (a)(3) Apply new fee of $100 to relocate an existing office or branch.**[New fee of $100]**
  - (a)(4) Increase annual renewal fee for escrow depository from $100 to $2,000.**[Increase of 2,000%]**
  - (a)(5) Increase annual renewal fee for branch office from $50 to $100.**[Increase of 100%]**
  - (a)(6) Increase in fee for reissuance of license for change in business address from $25 to $50, provided that changes by the U.S.P.S. shall not be assessed a fee.**[Increase of 100%]**
  - (a)(7) Maintain $0.00 fees for application for approval to cease business.
  - (b)(1) Increase "examination fee" from $40 to **$60 per hour**. **[Increase of 50%]** Please note that the Association is not agreeable to charging an "investigation fee" at this point. Similarly, the Association is not agreeable to inserting the term "or investigation" under section (b)(1) through (b)(3).

The Association has given 100% cooperation and has substantially ratified all of the DFI's requests for increases in fees across the board in an effort to move the intended bill forward and appreciates the DFI's understanding of the current changes in our industry in regards to insurance and bonding requirements.

As we did last year, the Association is ready, willing and able to work together with the DFI Commissioner to submit bill that would benefit the consumer, the State and the escrow industry. The Association would like to work with the DFI regarding the remaining proposals in SD 1067 regarding the DFI Commissioner's power, regulatory authority and enforcement provisions, as follows:

Various members of the Association have been working in or managing escrow companies in Hawaii for over 30 to 40 years. We are proud to say that during those decades, we are not aware of any serious defalcations that have occurred in our industry which we have not been able

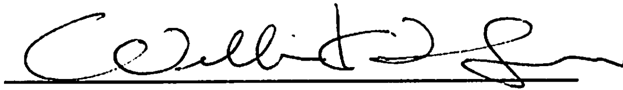
to work out together as an industry. The Association members meet on a monthly basis to address, among other things, industry-wide concerns, compliance issues and legislative issues.

To be clear, the Association is not completely opposed to providing the DFI Commissioner with more powers and regulatory authority, or to clarify that authority. However, we need additional time to review these proposals and will continue to work with the DFI on the specific language, which was not previously discussed in detail during our three months of meetings. Due to the complexity and possible ramifications of the new language, the Association requests that the above-mentioned sections are omitted in the current bill to allow for further discussions. We would like to be able to submit a bill that both the department and the Association members will give their full endorsement to.

We appreciate the Chairs and the Committee for allowing our testimony. Thank you for your consideration.

Sincerely,

HAWAII ESCROW ASSOCIATION



William Tanaka
On Behalf of Members of the Hawaii Escrow Association

LATE

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TO THE
SENATE COMMITTEE ON
WAYS AND MEANS

THE TWENTY-SEVENTH STATE LEGISLATURE
REGULAR SESSION OF 2013

Friday, February 22, 2013
9:00 a.m.

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

THE HONORABLE DAVID Y. IGE, 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. 1.

This bill has two main purposes. First, it updates the escrow depositories law to more realistically address the responsibilities and operations of escrow depositories as they conduct business today. Second, it authorizes the Commissioner to investigate and conduct hearings on possible violations of the escrow depositories law, and it provides remedies to stop unlawful actions that would endanger the public. These

changes are needed to better regulate the industry and protect consumers in view of the higher stakes posed by larger and more sophisticated financial transactions handled by today's escrow depositories. Since the last significant revision to the State escrow depositories law was more than 25 years ago, I invited all the escrow companies to meet with me during the summer and fall of 2012 to discuss modernization amendments for this law.

Self-Funding Requirement Necessitates Requested Fee Changes

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 a special-funded program within the Department, the Division of Financial Institutions ("Division" or "DFI") must generate sufficient revenues to fully fund its operations, and align the timing of revenue receipts with expenditures. The Division is rapidly approaching a fiscal cliff. 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 tax[1] 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 reserves on hand to fund its annual program costs while awaiting deposit of the franchise tax monies. On its current trajectory, in FY14, the Division will not have enough funds to pay for its staff if all positions are filled, as discussed below. In FY15,

[1] 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.

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.

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. Up to now, the Division has refrained from filling its six staff vacancies because at current revenue levels, by FY16, personnel would need to be laid off after being trained. Not hiring, however, is unrealistic given the current 120 to 180 day backlog in processing licensing work, despite best efforts of existing staff. Delay in the Division's licensing and examination work is contrary to the best interests of consumers and business, and it potentially means delays in opening of new businesses and their hiring of employees which would contribute to the State's economy, in issuing license renewals rendering licensees with expired licenses unable to lawfully conduct business, in examination of 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. In an extreme case, delays due to a staffing shortage could mean

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

Proper Staffing Levels Are Required to Maintain Consumer Protection

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, so staff time is stretched thinner and thinner to the point that the Division is now 120 to 180 days backlogged in licensing work – this is the amount of time it is taking before staff can typically begin working on an application. 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. It is the only entity that monitors the regulatory compliance, safety and soundness of these industries – the federal government does not provide such oversight – and the Division carries out its duties in order to protect the rights and funds of depositors, borrowers, consumers and other members of the public. Each program needs to bring in revenue sufficient to cover the Division's costs of oversight and supervision.

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, revenues from each

program must be sufficient to cover the Division's cost of operating that program. The Division needs approximately $500,000 additional revenue annually to adequately meet its cash reserves to support its operations and facilitate its ability to appropriately carry out its mission.

The escrow depositories program ran extremely large deficits in FY11 and FY12. To provide the minimum oversight, it cost the Division $234,544 to operate the program, while it generated revenue for the Division of $35,205, leaving the Division to cover the $199,339 shortfall. In FY12, the program ran a larger deficit, this time in the amount of $250,459. The most recent results are as follows:

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 bring in approximately $23,245 of additional revenue annually, with the adjusted fee schedule and amendments requested in the last section of this testimony. 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.

Finally, while the Division would like to have a reasonable reserve fund[2], 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.[3] In short, the Division is self-funded and its programs need to be self-sustaining. This bill will help close the deficit that the financial institutions program has been running, and will help the Division carry out the responsibilities pertaining to financial institutions that it has been given.

The Division strongly supports this administration bill, Senate Bill No. 1067, S.D. 1, and respectfully asks that the measure be passed out of committee. We continue to meet with representatives of the escrow depositories industry regarding this bill in anticipation of further hearings this session.

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

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[2] 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").

[3] *See* HIC v. Lingle, 201 P.2d at 580.