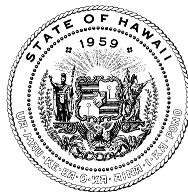

NEIL ABERCROMBIE
GOVERNOR

SHAN S. TSUTSUI
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STATE OF HAWAII
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KEALI`I S. LOPEZ
DIRECTOR

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DEPUTY DIRECTOR

TO THE
HOUSE COMMITTEE ON
CONSUMER PROTECTION AND COMMERCE

THE TWENTY-SEVENTH STATE LEGISLATURE
REGULAR SESSION OF 2013

Monday, March 11, 2013
2:00 p.m.

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

THE HONORABLE ANGUS L. K. MCKELVEY, 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.

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) to adjusts fees for escrow depositories to reflect the risk based approach of supervision and the additional regulation and monitoring required of the Division of Financial Institutions ("Division" or "DFI") as a result of

changes to the federal laws and increasing sophistication of the escrow depository industry, 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. The Division most importantly protects consumer, 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 currently around $600,000 – it is not uncommon for an escrow to involve hundreds of thousands of dollars.

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. Our meetings are continuing and we would like additional time to work on recommended amendments to the bill.

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 meaningful investigation and enforcement tools that this bill provides, to 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.

Modernization of the law

- 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 1 of the bill gives the Commissioner the authority to issue temporary and permanent cease and desist orders against escrow depositories to stop risky or illegal practices. It also sets out standards and procedures for issuance of such orders, with an eye toward balancing consumer protection interests and keeping a company in business. This authority would enable the Commissioner to work with a troubled escrow depository to help stabilize it so it can remain in business. Presumably most escrow depositories would prefer having a chance to recover under the Commissioner's oversight, rather be ordered to close. Closure of an escrow depository could shake consumer confidence in the financial sector as well as cause job loss, and should be a last resort tool of the Commissioner.

- Section 3 adjusts the administrative fine that can be imposed on an escrow depository licensee following notice and an opportunity for a hearing. The law currently authorizes an administrative fine for a "willful" violation of Chapter 449. 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]
- Adjusts the maximum administrative fine from $5,000 per violation, to $10,000 per violation or failure to comply with any order. 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.
- Section 5 requires an escrow depository to give the Commissioner advance notice of change of its business manager designee and branch manager designee(s). Definitions for "branch manager" and "branch office" are set out in Section 2. It is important to have a designated responsible person overseeing the operations at branch offices to confirm all company policies and procedures are followed by staffs who work away from the principal place of business.

Changes 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).

- Section 4 adjusts the minimum net capital requirements of an escrow depository from $50,000, to $100,000.
- Section 6 establishes a fee for the transfer or change in control of an escrow depository license. This fee will help cover the work of the Division to evaluate and analyze the requested transfer or change application.
- Section 7 adjusts the fidelity bond minimum requirement from $25,000 to $100,000, and generally raises the amount of the permissible deductible.
- Section 8 adjusts the errors and omissions insurance from $100,000, to $250,000. The bill gives the Commissioner the flexibility to allow a licensee to deposit a security device such as a bond to satisfy fidelity bond and errors and omissions insurance requirements.
- Section 9 adjusts the rate to $60 per hour for both examinations and investigations, as in the other industries regulated and supervised by the Division.

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 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 tax[2] 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.

[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.

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.
- By FY16, personnel would need to be laid off after being trained.
- 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 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 bring in approximately $23,245 of additional revenue annually, with the adjusted fee schedule and amendments requested. Although the amount of the anticipated revenue will not retire the debt, it will help defray some of the costs of oversight.

The Division would like to have a reasonable reserve fund[3]; 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

[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.

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, and respectfully asks that we be given some time to enable the Commissioner and the escrow depositories industry to reach a consensus this session on recommended amendments to this administration bill. We have another meeting scheduled for Wednesday, March 13.

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

Hawaii Escrow Association
1100 Alakea Street, #501
Honolulu, Hawaii 96813
(808) 532-2977

March 8, 2013

The Honorable Angus L.K. McKelvey, Chair
The Honorable Derek S.K. Kawakami, Vice Chair
House of Representatives
Members of the House Committee on Consumer Protection & Commerce
415 South Beretania Street
Honolulu, Hawaii 96813
Hawaii State Capitol Room 325
Facsimile: (808) 586-8437

RE: SB 1067 Relating to Escrow Depository 2013
DEFER BILL
Notice of Hearing 2:00 p.m. – Monday, March 11, 2013
Conference Room 325

Testifier: Hawaii Escrow Association
William Tanaka, Legislative Chair

Dear Honorable Chairperson Mr. McKelvey, Honorable Vice-Chairperson Mr. Kawakami and Members of the House Committee on Consumer Protection and Commerce:

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