

SB 1067

Measure Title: RELATING TO ESCROW DEPOSITORIES.

Report Title: Escrow Depositories

Description: Requires escrow depositories to report any change of their corporate designated escrow officer or branch manager to the Commissioner of Financial Institutions; establishes a statutory fee for the transfer or change in control of an escrow depository license; increases the fidelity bond maintained by escrow depositories to a minimum of \$100,000; increases the errors and omissions policy amount escrow depositories are required to carry to not less than \$250,000; increases fees; provides powers for the commissioner to supervise and regulate the industry; and empowers the commissioner to issue cease and desist orders; increases net capital requirement to \$100,000.

Companion: [HB836](#)

Package: Gov

Current Referral: CPN/JDL, WAM

Introducer(s): KIM (Introduced by request of another party)

<u>Sort by</u> <u>Date</u>		Status Text
1/24/2013	S	Introduced.
1/24/2013	S	Passed First Reading.
1/24/2013	S	Referred to CPN/JDL, WAM.
2/1/2013	S	The committee(s) on CPN/JDL has scheduled a public hearing on 02-12-13 9:30AM in conference room 229.
2/11/2013	S	The committee(s) on CPN/JDL has rescheduled its public hearing to 02-12-13 9:30AM in conference room 016.



NEIL ABERCROMBIE
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TO THE
SENATE COMMITTEES ON
COMMERCE AND CONSUMER PROTECTION
AND
JUDICIARY AND LABOR
THE TWENTY-SEVENTH STATE LEGISLATURE
REGULAR SESSION OF 2013
Tuesday, February 12, 2013
9:30 a.m.

TESTIMONY ON S.B. NO. 1067
RELATING TO ESCROW DEPOSITORIES

THE HONORABLE ROSALYN H. BAKER, CHAIR,
THE HONORABLE CLAYTON HEE, CHAIR,
AND MEMBERS OF THE COMMITTEES:

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 this administration bill, Senate Bill No. 1067.

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.

In an escrow transaction, an escrow depository is hired to receive, hold, and deliver money and instruments affecting title to real property in accordance with an agreement of the transacting parties. Real estate purchase contracts typically require that funds be deposited with an escrow company prior to closing in an amount covering the full purchase price of the property. Escrow depositories also handle proceeds of mortgage loan refinance transactions. 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. For luxury home transactions and commercial real estate transactions, multi-millions of dollars may be entrusted to escrow depositories.

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.

Under current law, the Commissioner has the power to investigate information furnished by an escrow depository applicant, Section 449-7, Hawaii Revised Statutes ("HRS"). This bill would expand this power and 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. It would also give the Commissioner the authority to subpoena witnesses and documents, receive affidavits and oral testimony, and conduct contested case hearings. As well, it authorizes the Commissioner to hire qualified persons to help with the implementation or investigation of any claims. This 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.

This bill also provides enforcement powers. For most consumers, a home purchase is their single largest financial transaction. As escrow depositories are entrusted with significant amounts of consumer funds in these transactions, the Commissioner must be able to take swift action to protect the public should the need arise. 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.

Section 3 changes 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. The "willful" standard is not defined by statute, but it typically connotes an intentional or malicious result or an act done with an unlawful intent. This is inconsistent with an escrow depository's legal responsibility of a "trustee" for all moneys and instruments received.

The "willful" violation standard is also much more generous than the level of conduct allowed by other industries that the Division regulates, and the Commissioner sees no justification or need for this. For example, the Commissioner has the authority to impose fines on other licensees as follows: for a false or misleading statement made negligently or knowingly by a mortgage loan originator (HRS Sec. 454F-12); for

misrepresentation or concealment by a mortgage servicer (HRS Sec. 454M-6); for a money transmitter's failure to make a report or statement lawfully required by the Commissioner (HRS Sec. 489D-23); and for a financial institution's material violation of law or a rule (HRS Sec. 412:2-609).

Consequently, this bill removes the "willful" violation requirement for imposition of an administrative fine. It should be noted that a separate provision of existing law exonerates escrow depositories from certain unintentional violations of law. This bill also increases 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.

The bill increases minimum net capital requirements of an escrow depository from \$50,000, to \$100,000, in Section 4. It also removes the performance bond alternative for satisfying the net capital requirement. The Commissioner submits that this provision was agreed to by the escrow companies who met during the summer/fall meetings.

In Section 7, the bill increases the fidelity bond minimum requirement from \$25,000 to \$100,000, and generally raises the amount of the permissible deductible.

Section 8 increases errors and omissions insurance from \$100,000, to \$250,000. With increases in real estate values and escrows in the past 25 years, potential claims and losses have increased as well, warranting the higher bonding and insurance requirements. 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. The Commissioner submits that these changes have been agreed to during the summer/fall meetings with the escrow depositories.

Section 5 of the bill 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 staff who work away from the principal place of business.

In Section 6, the bill establishes a fee for the transfer or change in control of an escrow depository license. This fee will help cover the work of the Commissioner and the Division which must evaluate and respond to the required transfer or change application. In Section 9, fees for maintaining a license, various approvals, examinations and investigations are increased or specified. The current statutory examiner rate of \$40 per hour was established in 2001, and this bill seeks to raise the rate to \$60 per hour for both examinations and investigations, with a view toward having

the licensee and escrow depositories program contribute toward the Division's cost to service an escrow depository and the industry.

Representatives of the escrow depository industry met with the Commissioner in 2012, and indicated their agreement with the increased bonding requirements and fee schedule changes proposed in this bill.

Self-Funding Requirement Necessitates Requested Fee Changes

To provide context for the fee changes proposed by this bill, the Commissioner submits the following. 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.

Overall, the Division's revenues are inadequate to fully fund its operations, including the filling of all authorized positions and covering the Division's share of the departmental overhead. Notwithstanding the extraordinary efforts of Division staff, the Division is currently backlogged between 120 and 180 days in its licensing work due to understaffing. The Division appreciates having previously been allocated 34 staff

positions to carry out its responsibilities. However, the current fee HRS fee structure generates revenue that is sufficient to fill only 28 positions. Consequently, six allocated positions, all of which are "permanent," are vacant. So while there is a clear need for additional staff to appropriately carry out the Division's mandates and to protect the public, the Division is not in a position to cover the ongoing cost of these permanent positions until its revenue streams are changed and made sustainable.

Division's staff vacancies adversely affect the State's economy and the public's security 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.

The Division needs more funds to appropriately carry out its mission. In determining the best way to generate the funds, a guiding principle is that the revenues from each of program must be sufficient to cover the Division's cost of operating that program. Revenues schedules for program fees and rates are predetermined for the Division, as they are set out in the Hawaii Revised Statutes.

With specific regard to the escrow depositories program, it 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)

Clearly, under the fee schedule set by Chapter 449, HRS, the escrow depositories program is fiscally unsustainable for the Division. The minimum oversight includes

review of the safety and soundness of the company and examination of a company on an 18 to 24 month cycle. The Division would like to enhance its program to: (1) provide additional oversight throughout the year to companies who may have compliance issues, and (2) provide additional training to the Division's examiners and licensees to learn about the risks associated with the new compliance regulations.

The Commissioner submits that the fees changes for the escrow depositories program set out in this bill is a compromise and will not cover the cost of oversight and this industry will continue to be subsidized by the other industries. After having run an aggregate deficit on the program in just the past two years of nearly \$450,000, the Commissioner respectfully submits that requested changes in fees are both necessary and appropriate.

As the Division focuses supervisory, regulatory, and examination attention on State licensees, it expects the industry to be more responsive and compliant with state and federal laws, and that in turn, consumers will be better protected.

For many years, the Division has executed oversight of the escrow depositories industry taking into account federal policy set out by the federal government agencies and most recently by the Consumer Financial Protection Bureau ("CFPB"), and increasing federal government regulations. With financial transactions becoming increasingly sophisticated and scammers targeting our population, the Commissioner submits that changes to the Hawaii escrow depositories law proposed by this bill are

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needed to better protect consumers and promote greater soundness of escrow depositories.

For these reasons, DFI strongly supports this administration bill, Senate Bill No. 1067, and respectfully asks that the measure be passed.

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

February 11, 2013

The Honorable Senator Rosalyn H. Baker, Chair
The Honorable Senator Brickwood Galuteria, Vice Chair
Members of the Senate Committee Commerce and Consumer Protection

The Honorable Senator Clayton Hee, Chair
The Honorable Senator Maile S.L. Shimabukuro, Vice Chair
Members of the Senate Committee on Judiciary and Labor

415 South Beretania Street
Honolulu, Hawaii 96813
Hawaii State Capitol Room 229

RE: SB 1067 Relating to Escrow Depository 2013
Supports in part, Opposes in part
Hearing Date: 9:30 a.m. – Tuesday, February 12, 2013
Conference Room 229

Testifier: Hawaii Escrow Association
William Tanaka, Legislative Chair

Dear Honorable Chairperson Ms. Baker, Honorable Vice-Chairperson Mr. Galuteria and Members of the Senate Committee Commerce and Consumer Protection and Honorable Chairperson Mr. Hee, Honorable Vice-Chairperson Ms. Shimabukuro and Members of the Senate Committee on Judiciary and Labor:

Thank you for allowing the Hawaii Escrow Association (the "Association") to testify on Senate Bill 1067 (SB 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.

At the outset, we respectfully submit that the parts of the bill that both the Association and DFI agree upon represent monumental and historic progress in the escrow law. There are significant increases in bonding and insurance requirements as well as to the increases and additions of virtually all the fees requested by the DFI Commissioner. We worked cooperatively with the DFI on those changes over the course of several years. The parts of the bill that we currently oppose are significant, substantive changes in the law. These sections that we oppose have serious *Due Process* implications that could potentially ruin and close down escrow depositories. As such, we respectfully submit that we have not had sufficient time to consider them and work on a reasonable solution. We want to continue to work closely with the DFI Commissioner to continue to make progress on the amendment of the escrow statute by having comprehensive discussions after this legislative session.

The Association understands that one of DFI's objectives during the legislative session in 2012 was to increase the escrow depositories' fees to cover its costs in the regulation of the escrow industry. During the 2012 legislative session, the Association had expressed to the legislative committees and the DFI that drastic increases in capital, insurance and bonding requirements as well as increases in costs associated with license fees, fines and other costs would cause undue hardship to the escrow industry. Our escrow depositories are diverse in size and financial strengths, as some are operating as small businesses while others are national companies. These major increases would have heavily impacted the small business escrow depositories. During the 2012 legislative session, former Chairperson Mr. Robert N. Herkes had asked the Association to work with the DFI Commissioner to draft a bill that was agreeable with all.

Over the course of several months last summer, the members of the Association and the DFI Commissioner met three times to discuss amendments to the existing escrow statute that would mutually benefit our escrow industry and the needs of the State of Hawaii. After the DFI's draft proposed bill was presented to the Association in October 2012, the Association members came to an agreement on what would be considered monumental changes that will benefit consumers by increasing net capital requirements and insurance and bonding requirements, and support the State by increasing fees that we pay to do business in Hawaii, including fees we pay for State audits, licensing renewals and applications.

HAWAII ESCROW ASSOCIATION AGREED TO SUPPORT 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.

HAWAII ESCROW ASSOCIATION IS READY, WILLING AND ABLE TO WORK WITH DFI ON ITS AUTHORITY AND ENFORCEMENT PROVISIONS

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:

Section 1

- §449-___ Powers of commissioner
- §449-___ Cease and desist orders; grounds for issuance
- §449-___ Permanent cease and desist orders; procedure; hearing; enforcement
- §449-___ Temporary cease and desist orders; effective date; hearing; enforcement

Section 2

- §449-1 Definitions of "Branch manager" and "Branch office"

Section 4

- §449-4 Administrative penalty

Section 5

- §449-7.5 Provision to add 15-day notice requirement in change of designated escrow officer

Section 9

- §449-14(b) Provision to add "investigation fees and expenses"

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 depositories collectively employ over 700 people across the state. Four out of the seven escrow depositories are locally owned and operated, employing over one-half of the total number of state-wide employees. If, for example, the DFI implements a cease and desist order and the small business escrow operation is shut down for even a couple of days, that escrow depository will very likely be out of business permanently. We have also serious issues with the language in the cease and desist sections. For instance, it states that the DFI Commissioner may issue a cease and desist order to an escrow depository 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; . . ." There is no detailed procedure or definition set forth in the bill to afford *Due Process* to the escrow depositories.

In addition, some of the proposed language can further impact our business. If we, pursuant to the proposed language for §449-7.5, had to give 15-day advance notice of a branch manager's potential termination to the DFI, then the escrow depositories would be placed 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. A suggestion may be a requirement to give notice to the DFI within 15 days after termination. But these are just examples of issues that the Association strongly believes that 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.

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