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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. 1069, S.D. 1
RELATING TO MORTGAGE LOAN ORIGINATION

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. 1069, S.D. 1.

This bill primarily focuses on amendments to Chapter 454F of the Hawaii Revised Statutes ("HRS"), the "Secure and Fair Enforcement for Mortgage Licensing Act." The bill has two major purposes. First, it clarifies licensure requirements for mortgage loan originators and mortgage loan originator companies, and for mortgage servicer companies conducting mortgage loan origination activity. Second, it adjusts

fees for the mortgage loan origination licensees, and it establishes fees for mortgage servicer companies that conduct mortgage loan origination activities. Fee adjustments were discussed with mortgage loan origination industry representatives last summer, and are needed to close the gap on the deficit that the Division of Financial Institutions ("Division" or "DFI") has been covering to meet its statutorily mandated duties to oversee and regulate its licensees.

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 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 tax¹ 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, the Division will be operating on a very thin margin, and hopes to make the payroll

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.

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 Accreditation

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 mortgage loan origination program ran substantial deficits in FY11 and FY12. To provide the minimum oversight in FY11, it cost the Division \$932,161 to operate the program, while it generated revenue for the Division of \$760,021, leaving the Division to cover the \$172,140 shortfall. In FY12, the program ran a deficit of \$94,321. The most recent results are as follows:

Mortgage Loan Origination Program	FY11	FY12
Program Cost to Division	\$932,161	\$716,791
Less Program Revenues	\$760,021	\$622,470
Program Deficit to Division	(\$172,140)	(\$94,321)

The Division anticipates that the mortgage loan origination program will bring in approximately \$10,000 of additional revenue annually, with the adjusted fee schedule. 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 fund², 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.

DFI strongly supports this administration bill, Senate Bill No. 1069, S.D. 1, 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.

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.