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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. 1071, S.D. 2, H.D. 1
RELATING TO FINANCIAL INSTITUTIONS

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. 1071, S.D. 2, H.D. 1.

This bill has two primary purposes: (1) to modernize the State's Financial Institutions law, Chapter 412, Hawaii Revised Statutes ("HRS"), in light of changes to federal banking laws and (2) to adjust fees for financial institutions 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 law, and increasing sophistication of the financial institutions industry.

Since 1993, when Hawaii's Financial Institutions law was last comprehensively reviewed, there have been many changes to banking laws particularly at the federal level. Recognizing the importance of having Hawaii's banking laws reflect these changes, the Commissioner met with the representatives of the financial services industry last summer. This bill is the outcome of those meetings as we continue to discuss the provisions.

Part I - Clarification of Existing Law

- Section 1 strengthens and clarifies the Commissioner's powers to administer and enforce the Code, and to provide adequate oversight. DFI's primary purpose is "to ensure the safety and soundness of Hawaii financial institutions and to maintain public confidence in such institutions through the process of chartering and licensing, regulatory approval, examinations and supervision¹."
- Section 2 updates the definition of "deposit" to include depository institution funds underlying nontraditional access mechanisms such as prepaid access cards and stored value cards.

¹ HRS § 412:2-100

- Section 3 adds a “remote service unit” to the list, of places to do business and it clarifies the term “branch” business.
- Section 4 amends the definition of “operating subsidiary.”
- Sections 5, 7, and 9 clarify the computation of limits on loans and extensions of credit that a bank may make to one borrower to comply with the Dodd-Frank Act. A definition of “derivative transaction” is added.
- Section 6 amends provisions regarding a bank’s transfer of real property to an operating subsidiary.
- Section 8 authorizes a financial service loan company to charge a borrower a \$10 fee to process a draft written below the minimum amount established on an open-ended loan.

Part II – New Fee Structure Effective January 1, 2014

As a result of federal laws enacted and amended over recent years², the Division must exercise heightened supervision, regulation and examination over state chartered financial institutions. A new federal regulatory partner has also been created³.

² Some of these laws include the Gramm Leach Bliley Act, Bank Secrecy Act/Anti Money Laundering, Federal Deposit Insurance Corp. Act, Equal Credit Opportunity Act, Servicemembers Civil Relief Act, Fair and Accurate Credit Transaction Act, Fair Credit Reporting Act, Electronic Funds Transfer, Real Estate Settlement Procedures Act, Truth In Lending Act, Check Clearing for the 21st Century Act, Truth In Savings Act, Secure And Fair Enforcement for Mortgage Licensing Act, and the Dodd–Frank Wall Street Reform and Consumer Protection Act.

³ Consumer Financial Protection Bureau

Therefore, Part II of the bill adjusts fees to reflect the risk based approach of supervision and the additional regulatory requirements and monitoring required for these licensees.

- Part II of the bill, Section 10, establishes a new fee structure for financial institutions, effective January 1, 2014.
 - The request to delay implementation in the fee structure has two considerations: (1) to allow the small financial institutions in particular to be able to budget for the increase in fees, and (2) as the annual fee is assessed in June, we would have already collected for the year by the time the proposed bill is passed.
 - The new structure risk based and is based on the complexity of an institution and its total assets, a term that is defined, and consists of a scaled flat fee plus a percentage of total assets. Like other states, we cap the fees so that we do not collect more than we anticipate needed.
- Section 10 specifies fees for certain applications and certifications to ensure that costs of review and issuance are covered fairly by the institutions using the Division's resources.
- Section 11 makes it mandatory for the Commissioner to charge a financial institution for travel, per diem, mileage and other reasonable expenses incurred in connection with an examination and investigation, in line with our other licensee industries.

- Sections 11-25 are conforming amendments related to the new fee structure.

Part III – Interim Fee Structure Effective on Approval

- Part III of the bill, Section 26, basically mirrors the new fee structure for applications set out in Part II, Section 10.
- We would like Part III to be effective on approval, and repealed January 1, 2014, which is the date Part II becomes effective. These dates are set out in Section 28.

Proper Staffing Levels Are Required to Maintain Accreditation

The Division was able to receive Accreditation status with the Conference of State Bank Supervisors, which recognizes that the Division meets the high regulatory standards required to provide the appropriate regulatory supervision and oversight for state chartered banks. I would point out that the Division did not meet three of the components for the accreditation standard which is the appropriate number staff, a consistent source of funding and the backlog of processing applications. Under my supervision, the Division has worked diligently and made changes in its processes to meet the other accreditation standards. However, the Division cannot sustain the high accreditation standards without adequate staffing in the Division.

Self-Funding Requirement Necessitates Requested Fee Changes

The chart below shows that the financial institutions program ran substantial deficits in FY11 and FY12.

FINANCIAL INSTUTIONS PROGRAM	FY11	FY12
Total Program Cost to Division	\$1,446,353	\$1,502,562
Less Program Revenues	\$341,165	\$332,213
Surplus/(Deficit)	(\$1,105,188)	(\$1,170,349)

The Division anticipates that the financial institutions program will bring in approximately \$272,590 of additional revenue annually, with the adjusted fee schedule. Although the amount of the anticipated revenue will not cover the cost of supervision, it will help us become more fully staffed permanently.

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	4,007,975	4,005,429	4,012,290	4,012,290

Expenditures				
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 tax⁴ 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.

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

⁴ 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.

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 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 fund⁵; it is currently headed toward a fiscal cliff absent an increase in revenues. It cannot expect to receive funding

⁵ 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").

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.⁶

DFI strongly supports this administration bill, Senate Bill No. 1071, S.D. 2, H.D. 1, and respectfully asks that the measure be passed with the amendments requested above.

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

⁶ See HIC v. Lingle, 201 P.2d at 580.

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March 27, 2013

Rep. Sylvia Luke, Chair
and members of the House Committee on Finance
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **Senate Bill 1071, SD 2, HD 1 (Financial Institutions)**
Hearing Date/Time: Wednesday, March 27, 2013, 4:45 p.m.

I am Marvin Dang, the attorney for the **Hawaii Financial Services Association** ("HFSA"). The HFSA is a trade association for Hawaii's consumer credit industry. Its members include Hawaii financial services loan companies (which make mortgage loans and other loans, and which are regulated by the Hawaii Commissioner of Financial Institutions), mortgage lenders, and financial institutions.

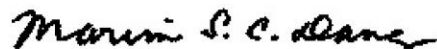
The HFSA supports Sections 8 and 9 of this Bill, but takes no position on the other sections.

The purposes of this Bill are to: (1) modernize the State's financial institutions law, codified as Chapter 412, Hawaii Revised Statutes, (2) replace individual fees for Hawaii banks and nondepositories for specific regulatory items with one assessment, (3) increase and clarify bank powers, and to (4) clarify the authority of the Commissioner of Financial Institutions.

We support Sections 8 and 9 of this Administration Bill. Section 8 gives financial services loan companies the power to charge a \$10 fee to process a draft written below the minimum amount established on an open end loan. Section 9 clarifies the credit exposure of depository financial services loan companies for derivatives.

We do not take a position on the other Sections of this Bill.

Thank you for considering our testimony.



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Presentation To
House Committee on Finance
March 27, 2013 at 4:45 pm
State Capitol Conference Room 308

Testimony in SUPPORT of Bill S. B. 1071, SD2, HD1

TO: The Honorable Sylvia Luke, Chair
The Honorable Scott Y. Nishimoto, Vice Chair
The Honorable Aaron Ling Johanson, Vice Chair
Members of Committee

My name is Neal Okabayashi and I am testifying on behalf of the Hawaii Bankers Association (HBA), a trade association of local banks, savings banks and a financial services loan company whose deposits are insured by the Federal Deposit Insurance Corporation.

Our present Code of Financial Institutions was enacted in 1993 and since that time, many new banking developments have come to pass, including the Gramm-Leach-Bliley Act and more recently, the Dodd-Frank Act. In addition, innovative technology has led to electronic banking, stored value cards and concern for the unbanked and underbanked who can be well-served by stored value cards. Thus, an effort to modernize our Code to be up-to-date with current federal law and FDIC regulations was spearheaded by our commissioner of financial institutions, and HBA lauds her for her efforts.

These changes will enable state chartered banks to keep pace with our brethren who are chartered by the federal government (such as American Savings and Hawaii National Bank) who operate under federal laws, which have kept pace with modern banking.

Thus, in the interest of a level playing field and a more current banking law, HBA supports sections 1 through 6 of SB1071, SD2, HB1.

Neal Okabayashi
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FINTestimony

From: mailinglist@capitol.hawaii.gov
Sent: Monday, March 25, 2013 5:40 PM
To: FINTestimony
Cc: tabraham08@gmail.com
Subject: Submitted testimony for SB1071 on Mar 27, 2013 16:45PM

SB1071

Submitted on: 3/25/2013

Testimony for FIN on Mar 27, 2013 16:45PM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
Troy Abraham	Individual	Support	No

Comments: i support passage of Hawaii banking system reform

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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