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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. 1071, S.D. 1
RELATING TO FINANCIAL INSTITUTIONS**

**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. 1071, S.D. 1.

This bill has two primary purposes. First, it modernizes the State's Financial Institutions law, Chapter 412, Hawaii Revised Statutes ("HRS"), in light of changes to federal banking laws including the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Second, it adjusts fees for financial institutions to reflect 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.

The last comprehensive review of financial institutions laws was in 1993. In the summer of 2012, the Commissioner conducted meetings with representatives of the financial institutions industry for the purpose of reviewing and modernizing the State's banking laws to reflect changes in federal law. This bill is the result of those meetings.

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

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 fully staffing the Division.

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 financial institutions program ran a deficit in FY11 and FY12:

Financial Institutions 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. 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

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.

running, and will help the Division carry out the responsibilities pertaining to financial institutions that it has been given.

Requested Amendment

The Division requests one technical amendment for clarity. Section 10, lines 12-14 (p. 32) sets out the top tier caps on annual fees for financial institutions. In S.D. 1, the numbering of the two tier fee descriptions was dropped. The Commissioner recommends that for clarity, the numbering should be restored so that the provision reads as it did in S.B. 1067 (Section 10, lines 18-22, p. 33), as follows:

provided however that the yearly fee assessed for financial institutions with total assets of:

- (1) At least \$2,000,000,000 but less than \$10,000,000,000, shall be no more than \$100,000; and
- (2) At least \$10,000,000,000, shall be no more than \$150,000.

DFI strongly supports this administration bill, Senate Bill No. 1071, S.D. 1, and respectfully asks that the measure be passed with the technical amendment cited above.

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

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February 22, 2013

Senator David Y. Ige, Chair
and members of the Senate Committee on Ways and Means
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **Senate Bill 1071, SD 1 (Financial Institutions)**
Hearing Date/Time: Friday, February 22, 2013, 9:00 a.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) replace individual fees (for specific regulatory items) with one assessment for Hawaii banks and nondepositories, (2) increase and clarify bank powers, and (3) clarify the authority of the Commissioner of Financial Institutions.

We support Sections 8 and 9 of this Bill. Those Sections affect financial services loan companies by giving them the power to charge a \$10 fee to process a draft written below the minimum amount established on an open end loan (Section 8) and by clarifying the credit exposure for derivatives (Section 9).

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

Thank you for considering our testimony.

MARVIN S.C. DANG
Attorney for Hawaii Financial Services Association

(MSCD/hfsa)

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