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**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. 1071, S.D. 2**  
**RELATING TO FINANCIAL INSTITUTIONS**

**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. 1071, S.D. 2.

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.

### **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. The Commissioner oversees all the regulation and supervision of all licensees in DFI, and 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 supervision<sup>1</sup>."
- 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.
- Section 3 amends the list of places where a financial institution may conduct business by adding a "remote service unit" to the list, and it clarifies the term "branch" business.
- Section 4 amends the definition of "operating subsidiary." The bill changes the threshold to more than 50 per cent of the voting securities, which may be held

directly or indirectly by the bank. Also, the bill clarifies that this includes activities under Section 412:5-305, HRS (relating to permitted investments by a bank), and title 12 Code of Federal Regulations part 362 (Activities of Insured State Banks and Insured Savings Associations).

- Sections 5, 7, and 9 clarify the computation of limits on loans and extensions of credit that a bank may make to one borrower, specifying how credit exposure arising out of derivative transactions affects the computation as required by the Dodd-Frank Wall Street and Consumer Protection Act (2010). A definition of “derivative transaction” is added.
- Section 6 amends provisions regarding real property interests owned by a bank. It clarifies that a bank may transfer real property to an operating subsidiary of the bank if the bank’s investment in the subsidiary is no more than 15 percent of the bank’s tier one capital.
- 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 years<sup>2</sup>, the Division must exercise heightened supervision, regulation and examination over state chartered

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<sup>1</sup> HRS § 412:2-100

<sup>2</sup> 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

financial institutions. A new federal regulatory partner has also been created<sup>3</sup>.

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.

- Section 10 establishes a new fee structure for financial institutions, effective January 1, 2014. The request to delay implementation in the fee structure is twofold: (1) to allow the small financial institutions in particular to be able to budget for the increase in fees and (2) the annual fee are assessed in June, thus, 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 the company and the institution's 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 also specifies fees for certain applications and certifications. This is to ensure that initial costs to the Division of reviewing these applications and the cost of certifications 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

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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 21<sup>st</sup> 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.

<sup>3</sup> Consumer Financial Protection Bureau

in connection with an examination and investigation, in line with our other licensee industries.

- Sections 11-25 have conforming amendments to delete references to specific fees.

### **Part III – Interim Fee Structure Effective on Approval**

- 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.
- Section 28 outlines the effective date of Part II and Part III. Part III is needed so that the change in application fees will be effective on the bill's approval, rather than waiting until January 1, 2014 when the new fee structure of Part II comes into effect.

### **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:

<b>DFI CASH FLOW PROJECTION</b>
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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<sup>4</sup> 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 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.

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<sup>4</sup> 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 below shows that the financial institutions program ran substantial deficits in FY11 and FY12.

<b>FINANCIAL INSTITUTIONS PROGRAM</b>	<b>FY11</b>	<b>FY12</b>
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 retire the debt, it will help us become more fully staffed permanently.

The Division would like to have a reasonable reserve fund<sup>5</sup>; 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.<sup>6</sup>

### **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

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<sup>5</sup> 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").



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.

### **Requested Amendments**

The Division requests the following amendments.

- A technical amendment is requested for clarity. Section 10, (p. 32, lines 14-16) sets out the top tier caps on annual fees for financial institutions. In S.D. 2, 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. 1071 (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.
- It is requested that globally throughout the bill, the term “national banks” be changed to “federal financial institutions,” for the reason that the latter is the term used in Chapter 412. This change would be made to S.B. 1071, S.D. 2 as

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<sup>6</sup> See HIC v. Lingle, 201 P.2d at 580.

follows: p. 12, lines 10, 12, 19 and 22; p. 22, line 22; p. 23, lines 2-3, 9-10, and 13; p. 29, line 21; p. 30, lines 1, 9, 12; and p. 35, line 3.

- It is requested that the Act take effect “upon its approval,” rather than on July 1, 2050, as currently set out in Section 28.

**DFI strongly supports this administration bill, Senate Bill No. 1071, S.D. 2, 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.

Presentation To  
Committee on Consumer Protection and Commerce  
March 11, 2013 at 2:00 pm  
State Capitol Conference Room 325

**Testimony in Support of Bill S. B. 1071, S. D. 2**

TO: The Honorable Angus L. K. McKelvey, Chair  
The Honorable Derek S. K. Kawakami, Vice Chair  
Members of CPC

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 HB 840.

Neal Okabayashi  
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March 11, 2013

Rep. Angus McKelvey, Chair

and members of the House Committee on Consumer Protection and Commerce

Hawaii State Capitol

Honolulu, Hawaii 96813

Re: **Senate Bill 1071, SD 2 (Financial Institutions)**  
**Hearing Date/Time: Monday, March 11, 2013, 2:00 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) 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)

**kawakami2 - Rise**

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**From:** mailinglist@capitol.hawaii.gov  
**Sent:** Saturday, March 09, 2013 10:38 AM  
**To:** CPCtestimony  
**Cc:** TABRAHAM08@GMAIL.COM  
**Subject:** Submitted testimony for SB1071 on Mar 11, 2013 14:00PM

**SB1071**

Submitted on: 3/9/2013

Testimony for CPC on Mar 11, 2013 14:00PM in Conference Room 325

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
TROY ABRAHAM	Individual	Support	No

Comments: i support urgent banking and financial reform

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