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Testimony of the Department of Commerce and Consumer Affairs

Before the
House Committee on Intrastate Commerce
Tuesday, February 12, 2019
9:45 a.m.
State Capitol, Conference Room 430

On the following measure:
H.B. 1528, RELATING TO COMMERCE AND CONSUMER AFFAIRS

Chair Ohno and Members of the Committee:

My name is Catherine Awakuni Colón, and I am the Director of the Department of Commerce and Consumer Affairs (DCCA or Department). The Department strongly opposes this bill, which requires the DCCA to suspend fees relating to the licensing or registration of certain persons and entities under its jurisdiction, from the fiscal year (FY) beginning in 2021 to the FY ending in 2029. These fees provide revenues to the Business Registration Division (BREG), the Division of Financial Institutions (DFI), the Insurance Division (INS), and the Professional and Vocational Licensing Division (PVL).

Unlike other departments, the DCCA receives no general fund appropriations. Instead, the Department relies on fees paid by registrants and licensees and on fines assessed or ordered for violations. The DCCA's financial strategy is premised on ensuring that divisions have revenues to pay expenses and contribute equitably to departmental overhead costs, while maintaining sufficient reserves to address planned or unexpected contingencies. As a non-general fund department, the DCCA is subject

to the same legislative and executive budgetary controls as those for the general fund under Hawaii Revised Statutes (HRS) section 37-51, and the Department contributes to the overall cost of executive branch operations in a number of ways, including reimbursements for departmental administrative expenses (HRS section 36-30), central services assessment (HRS section 36-27), and payment to the Department of Budget and Finance to fund pro-rata pension and other post-employment benefits (OPEB).[1] The DCCA implements its financial strategy in accordance with the Hawaii Supreme Court's opinion Hawaii Insurers Council v. Lingle, et al., 120 Hawaii 51 (2008), as DCCA fees are accounted for separately by division and used for the purposes collected, with a portion of DCCA fees used for the Department's administrative overhead.

In addition to revenues received to cover operating expenses, the Department receives revenues that are held in trust and paid to aggrieved consumers who have been victimized by licensee malfeasance, such as the Mortgage Loan Recovery Fund, Contractors Recovery Fund, and Real Estate Recovery Fund, or collected and passed onto other agencies for specific purposes, such as the Drivers Education Fund, the Physician's Workforce Fund and the Center for Nursing Fee, or dedicated funds for condominium mediation and arbitration in the Condominium Education Trust Fund. Suspension of revenues for these funds will have a direct negative impact on the fund beneficiaries.

With regard to H.B. 1528, the Department opposes this bill because: (1) none of the funds that derive revenues from the fees that would be suspended have sufficient unencumbered cash balances to sustain operations for the period that is proposed in this bill; and (2) the Department has statutory mechanisms that it currently relies upon to adjust fees from time to time on an as-needed basis.

The DCCA understands this committee has concerns that the reserves in some accounts may be too large. However, the Department notes that although divisions have sufficient revenues to cover their budgets, each division's financial plan must also

[1] See State of Hawaii Department of Budget and Finance Executive Memo 18-16, p. 6: "Non-general fund programs should plan for a fringe benefit assessment rate of 60% for FY 20 and FY 21. The projected cost to fund OPEB and the statutory increases in premium contribution rates account for significant portions of this rate, which is expected to remain at around 60% for FY 22 and beyond."

include: (1) shared overhead expenses (administrative assessment) that are in excess of the division's budgeted amounts; and (2) a reserve amount to cover contingencies. When all of these expenses are included in the divisions' financial projections, it is clear that the lack of any revenue for nine years would be unsustainable.

Calculation of special fund-related administrative assessments is based on HRS section 36-30, which states generally that each special fund in the State, with some exceptions, "shall be responsible for its pro rata share of the administrative expenses incurred by the department responsible for the operations supported by the special fund concerned." HRS section 36-30 defines the pro rata share to be paid from special funds for administrative expenses of the administering department[2] as being:

> . . . [T]hat proportion of the administrative expenses of the department, including those paid from all special funds administered by the department, which the expenditures of the special fund bear to the total expenditures of the department; provided that in determining the amount to be charged to each special fund for its pro rata share:
>
> (1) Credit shall be given for any administrative expenses paid from the special fund concerned; and
>
> (2) Other adjustments shall be made as necessary to achieve an equitable apportionment.

The Department has used an administrative assessment methodology that attempts to assess each individual division or program for its share of administrative costs in proportion to the size of each division's/program's own level of appropriations in any given year. The basis for this approach has been that all divisions and programs receive a standard menu of administrative support services, and the central general administrative support operations of the Department serve the general needs of the Department and typically increase or decrease in proportion to the size of a given division or program. These services generally include those provided by the Director's Office, the Office of Administrative Services, fiscal operations, personnel operations,

[2] Under HRS section 36-30, "administrative expenses" must include salaries, building/grounds maintenance, utilities, general office expenses, and "[i]mplementation of information technology policies developed by the chief information officer and the information technology steering committee pursuant to [HRS] section 27-43."

communications and department-level outreach/consumer education, facilities operations (including facilities rental, maintenance, and utilities), information technology management and support services, and additional expenditures due to the Department of Accounting and General Services and the Department of the Attorney General.

As stated above, the Department opposes this bill not only because the suspension of revenues is fiscally unsustainable, but also because the Department already has the flexibility to adjust fees as may be necessary from time to time under HRS section 92-28. HRS 92-28 provides a mechanism to decrease nontax revenues, with the approval of the Governor, by up to 50% when it is reasonable to do so. HRS section 92-28 states, in relevant part:

> [T]he fees or other nontax revenues assessed or charged by any board, commission, or other governmental agency may be increased or decreased by the body in an amount not to exceed fifty per cent of the statutorily assessed fee or nontax revenue, to maintain a reasonable relation between the revenues derived from such fee or nontax revenue and the cost or value of services rendered, comparability among fees imposed by the State, or any other purpose which it may deem necessary and reasonable[.]

Indeed, the Department has exercised this authority under HRS section 92-28 on a number of occasions. On one occasion, fees were reduced, and the effects of that decrease were closely monitored. When it became prudent to do so, fees were reinstated and nontax revenues restored to their original amounts. The implementation of this decrease and subsequent reinstatement of fees proved to be an efficient and responsible process created by the Legislature.

As BREG, CATV, DFI, INS, and PVL receive licensing and registration fees that this bill proposes to suspend, the testimony of each division is set forth below.

Business Registration Division

This bill requires BREG to suspend its fees relating to various business, securities, and franchise filings, licenses, and registrations of persons and entities under its jurisdiction, from FY 2021 to FY 2029.

BREG is self-funded, and the fees from various filers, licensees, and registrants under BREG's jurisdiction are the source of funds for the daily operations of maintaining BREG's programs. BREG's primary functions are: (1) maintaining the State's business

registry, which includes the processing and maintenance of approximately 150,000 business registration filings per year; (2) operating Oahu and Maui offices that provide one-stop point-of-service assistance to anyone wishing to do business in Hawaii (e.g., business and employer registration; federal and state tax licensing), and providing monthly Business Resource Days in Hilo and Kona; and (3) substantive regulatory oversight over the securities industry and franchises in the State that includes conducting field examinations of broker-dealers and investment advisers in the State and investigating and prosecuting violations of the Hawaii Uniform Securities Act and state franchise laws. BREG also conducts statewide outreach through its Investor Education Program, which provides the public with free presentations and resources relating to investment fraud protection and financial literacy.

Implementation of this bill would negatively affect BREG's operations, as BREG would not be able to carry out its statutory duties without funding from these fees. These fees are critical to the day-to-day functions of BREG and would ultimately affect the public that BREG serves. Specifically, with financial fraud on the rise and financial exploitation of seniors increasing, BREG continues to develop and maintain a robust investor education and outreach program that reaches thousands of Hawaii residents annually. This investor education program relies solely on these fees for funding.

In addition, BREG strives to provide efficient ways for businesses to work with the division by developing and upgrading BREG's systems to allow for more online services. BREG has commenced development of the Securities Enforcement and Compliance information technology system, which will allow securities and franchise filers to submit their filings online. The division is also working to develop a replacement Business Registration Information Management System, as BREG currently holds over one million records, to efficiently serve the public. This bill proposes to eliminate the funding source for these initiatives.

Hawaii's businesses large and small, financial institutions, and government agencies rely heavily on the services BREG provides and the information it maintains. This bill could have widespread and severe impacts to the economy and the consumers that BREG protects.

<u>Cable Television Division</u>

This bill requires the CATV to suspend all fees related to the application for issuance of a cable franchise under HRS section 440G-6 and annual fees under HRS section 440G-15, from FY 2021 to FY 2029.

A blanket nine-year suspension on the collection of fees would place the CATV in a precarious position because it lacks the flexibility required for state government to adapt and operate in a rapidly changing telecommunications landscape, and at a time when significant changes are being proposed by the Federal Communications Commission (FCC) to actively dictate and reduce telecommunications-related fees, including cable franchise fees. Because of this uncertainty, in large part created by the FCC's proposed action and its possible adverse impact on future collections of franchise fees, the CATV has determined that the most prudent course of action at this time is to defer its previous plan to reduce or temporarily suspend the collection of annual fees (i.e., fees pursuant to HRS section 440G-15) and to instead maintain current franchise fee assessments and the CATV's carryover reserves (currently approximately over three years of budgeted/estimated expenses) until the FCC and counts issue a final outcome on the proposed new rules.

The telecommunications industry now offers entertainment content by other technologies (e.g., video streaming) to which cable franchise fees do not apply; this situation continues to reduce cable television subscribership. Further, the FCC's proposed new rules would change how cable franchise fees are calculated to allow all cable-related, "in-kind" contributions (other than public, educational and governmental (PEG) capitals costs and build-out requirements) to be treated as part of the franchise fee subject to the federal 5% franchise fee cap. In-kind contributions that could be deducted from cable franchise fee payments may be interpreted to include the fair market value of other franchise requirements, such as PEG channel capacity and institutional network (INET) connections. Thus, if adopted, the FCC's proposed new rules would allow cable operators to offset the value of all contributions to the State's INET (which constitutes much of the communications infrastructure for state and local government agencies and educational institutions) and for PEG cable channels and

PEG services. This would drastically reduce future franchise fee payments to the State, INET benefits for government agencies and educational institutions, and services funding for PEG organizations.

DCCA has submitted comments to the FCC on behalf of the State objecting to the proposed new rules because of its detrimental impacts to the State. The FCC has not yet issued its decision, and judicial appeal is expected if the new proposed rules are ultimately adopted. Therefore, the CATV recommends that any changes to the collection of franchise fees be deferred while the FCC's proposed new rules are pending adoption and potential review by the courts. If the proposed new rules are not adopted or do not survive any court challenges, the CATV would then consider suspending or significantly reducing the annual fees assessed under HRS section 440G-15. Thus, the CATV urges the Committee to consider the above ramifications and to defer any action to suspend all franchise fees, given the current circumstances.

Additionally, the CATV urges this committee to not suspend all fees related to the application for issuance of a cable franchise under HRS section 440G-6. The Department strongly welcomes new entrants and increased competition in the provision of cable services in Hawaii. The CATV believes, however, that the application fees are appropriate because they offset costs directly attributable to the application process for that applicant. The application process is resource intensive and requires, during a limited application timeframe, careful investigation and evaluation of an applicant's financial, technical, and business capabilities, as well as impacts to the community. This includes, among other things, holding multiple public hearings in the applicant's proposed franchise areas and hiring consultants to conduct community assessments for the application franchise areas and to provide review for federal law compliance. The CATV strongly believes these costs should rightfully be borne by the applicant, rather than using monies that may have been collected from subscribers of other cable providers.

Division of Financial Institutions

From FY 2021 to FY 2029, this bill requires the DFI to suspend the following fees collected pursuant to the following statutory sections:

HRS section	Description	FY 2019 (anticipated)	FY 2018
412:2-105.2	State bank assessments and application fees	$615,000	$655,852
412:12-108	Interstate bank cooperative agreements; assessments; exam fees; multi-state enforcement fees	$0	$0
412:13-206	Foreign/international bank application fees	$0	$0
449-14	Escrow licensing fees and renewal fees	$19,400	$20,700
454F-10.7	Mortgage loan originator company change-in-control fees	$35,000	$55,000
454F-22	Mortgage loan originator and mortgage loan originator company licensing fees and renewal fees	$1,285,805	$1,678,510
454F-41	Mortgage Recovery Fund	$90,000	$176,900
454M-4	Mortgage servicer licensing fees and renewal fees	$98,750	$180,561
489D-10	Money transmitter licensing fees	$110,000	$80,000
Total		**$2,253,955**	**$2,798,023**

The revenue generated by the DFI is collected from the fees assessed to its state-chartered financial institutions, escrow depositories, mortgage loan originators, mortgage loan originator companies, mortgage loan originator branches, mortgage servicer fees and money transmitter fees. The DFI does not generate enough revenue

to sustain itself for the nine-year period and, as shown below, would deplete its revenues and reserves by FY 2021 if suspension were to take place immediately.

HB 1528	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
Revenues	$5,678,123	$4,787,705	$4,656,000	$4,658,000	$4,656,000
Expenditures	$4,231,480	$4,514,147	$5,096,803	$5,096,803	$5,096,803
Overhead	$643,137	$688,703	$688,703	$688,703	$688,703
Net (if no revenue)	$803,505	-$415,145	-$1,129,506	-$1,127,506	-$1,129,506
Ending balance from reserves	**$11,209,350**	**$8,006,500**	**$4,220,994**	**$435,488**	**-$3,350,018**
		added Franchise tax revenue	added Franchise tax revenue	added Franchise tax revenue	added Franchise tax revenue

The financial services industry runs on a cyclical cycle with the economy. When the economy is strong, the number of financial institution branches and licensed entities and individuals increases. In contrast, when the economy is showing signs of weakness, the numbers drop. Currently, the cycle is on a downward projection. As shown in the DFI's total anticipated revenues in FY 2019, the DFI expects a $544,068 decline in its revenues. The most dramatic decrease in revenues pertains to the mortgage loan originator industry and mortgage servicer industries, wherein most of the revenue has been realized by December 31 of each calendar year. For the mortgage industry, which includes the mortgage loan originator industry and mortgage servicer industry, there was a 25% and 55% decline in renewals year after year. If Hawaii follows this national trend, the decline is anticipated for the next three years.

Consistent source of revenue is a factor in bank and mortgage accreditation standards, which the DFI must meet. The DFI was recently reaccredited in 2018 by the Conference of State Bank Supervisors (CSBS) for both bank and mortgage industries, after showing that the division met the high standards in supervising, regulating, and examining the two industries. The DFI must meet these standards each year to maintain its accreditation with the CSBS. If the DFI fails to meet these standards, consumer protection will suffer. The DFI has been recognized by the accreditation

teams as having a superior supervision and examination team. This means the DFI team is able to provide ongoing supervision over banks and the mortgage industry for applications (i.e., new individuals or companies, change in control, mergers, acquisitions, surrenders) and examinations. The DFI conducts regular examinations and typically finds regulatory and statutory violations during examinations. In these cases, the DFI will order the companies or individuals to comply with the laws and regulations, pay restitution to consumers, and possibly pay administrative fines.

To teach the licensees supervised by the DFI, the Commissioner of Financial Institutions conducts an educational session annually to inform licensees about the laws, especially new laws that may affect them, examination findings, and any “hot topics” for which they should be aware. Last year’s hot topic was cybersecurity and how to be safe.

The DFI spends at least two percent of its budget on training. It typically takes five years to train an examiner before the examiner is fully independent and can conduct examinations and license reviews independently. In the last five years, the DFI has hired 15 new examiners, who are still undergoing rigorous training to become independent. It costs about $250,000 over the five-year period to train these examiners. As the DFI’s budget for training is only $150,000, the division cannot train examiners more expeditiously while adequately licensing and examining the number of chartered and licensed entities under the DFI’s supervision.

HRS section 454F-41 established the Mortgage Loan Recovery Fund to compensate consumers who are harmed by an act, representation, transaction, or conduct of a licensee involving fraud, misrepresentation, or deceit. The Commissioner of Financial Institutions must be ordered by the circuit court or district court of the county where the violation occurred to pay out an amount not more than $25,000 per transaction. The DFI is aware of claims totaling at least $200,000 from consumers who are still going through the circuit court process.

Since 2014, the Commissioner of Financial Institutions has used the authority in HRS section 454F-41(d) to determine the fund is sufficient to cover known claims and has ceased collecting fees from existing mortgage loan originators and mortgage loan

originator companies and branches. The Commissioner continues to collect fees for this fund for new mortgage loan originators and mortgage loan originator companies and branches. The Commissioner believes that all licensees should initially fund the Mortgage Loan Recovery Fund, since any of the licensees could commit fraud, misrepresentation, or deceit. Further, it would not be fair for a bad licensee to get a "free ride" and have other licensees pay for the bad acts.

For these reasons, the DFI strongly opposes having the statutory fees suspended for nine years.

Insurance Division

The blanket suspension of fees for a nine-year period would severely curtail the INS' ability to continue existing obligations while planning and executing long-range plans servicing licensees and Hawaii's consumers. Moreover, with increasing occurrences of natural disasters affecting the State, an underfunded division, if this blanket suspension occurs, would not be able to implement timely and much-needed services to impacted citizens in their time of need. Hawaii's citizens greatly rely on insurance coverages they have purchased, and the inability of an underfunded INS to provide policyholders with timely assistance and aid during the aftermath of these catastrophes would compound their suffering.

This bill identifies the following sections in HRS title 24 that the suspension of DCCA fees would affect:

- HRS section 431:7-101, Fees;
- HRS section 431:10C-115, Drivers Education Fund Underwriters Fee (for motor vehicle insurance);
- HRS section 431:10G-107, Drivers Education Fund Underwriters Fee; Motorcycle and Motor Scooter Operators Education Fund;
- HRS section 431:19-102, Certificate of Authority (for captive insurance companies);
- HRS section 431:31-107, Application for License and Fees (for portable electronics insurance);

- HRS section 431P-5, Powers, Duties, and Functions (for the Hawaii Hurricane Relief Fund (HHRF));
- HRS section 431P-16, Establishment of Trust Funds (for the HHRF); and
- HRS section 432D-17, Fees (for health maintenance organizations).

Both HRS sections 431:10C-115, Drivers Education Fund Underwriters Fee, and 431:10G-107, Drivers Education Fund Underwriters Fee; Motorcycle and Motor Scooter Operators Education Fund, are "pass-through" funds, whereby money is collected by the Insurance Commissioner and forwarded to driver and motorcycle/motor scooter training and education programs to various state agencies for their operations. The curtailing of a funding source for nine years would decimate these programs and invariably cause detriment to the public.

This bill also affects HRS sections 431P-5, Powers, Duties, and Functions, and 431P-16, Establishment of Trust Funds. Although the HHRF is currently dormant, the ability of the HHRF to immediately become a viable entity after a hurricane, or whenever it is called upon to do so, would be severely hampered if its existing trust fund is affected in any way.

Professional and Vocational Licensing Division

The bill requires the PVL to suspend all fees relating to the licensing or registration of persons under its jurisdiction, from FY 2020 to FY 2029.

For the Committee's information, effective July 1, 1994, Act 322, Session Laws of Hawaii (SLH) 1993 established the CRF. The fees collected by the PVL and other divisions are deposited into the CRF and are used to defray administrative costs, including personnel costs associated with the PVL and costs incurred by supporting offices and divisions. Since the establishment of the CRF, the Department and its divisions are no longer supported by general funds. The Department must be self-sufficient and fiscally prudent.

In FY 2018, the PVL maintained its funding from 14,000 newly issued licenses and 70,000 renewed licenses. This funding comes from initial application, certificate, license, permit, and renewal fees. These fees also assist in defraying costs for other non-revenue generating divisions within the Department.

The suspension of all fees relating to the licensing or registration of persons under the DCCA's jurisdiction would be a detriment to the State and its consuming public. The suspension of fees for nine years would halt all services to the public that the Department provides and would prevent the PVL from issuing and renewing licenses, thereby leaving consumers without services provided by professionals such as doctors, mental health professionals, and accountants. Without these fees, the Department would have to seek general funding to operate and carry out its statutorily mandated duties.

For the foregoing reasons, the Department strongly opposes this bill and requests that it be held.

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Presentation To The
Committee on Intrastate Commerce
February 12, 2018 at 9:45 A.M.
State Capitol Conference Room 430

Testimony in Opposition to House Bill 1528

TO: The Honorable Takashi Ohno, Chair on Committee on Intrastate Commerce
The Honorable Dale T. Kobayashi, Vice Chair on Committee on Intrastate Commerce
Members of the Committee

My name is Neal K. Okabayashi, the Executive Director of the Hawaii Bankers Association (HBA). HBA is the trade association representing eight Hawaii banks and three banks from the continent with branches in Hawaii.

The Hawaii Bankers Association opposes House Bill 1528 because the consequences of this measure will be harmful to the local banks regulated by the Division of Financial Institutions (DFI), not to mention the impact on the community. Six Hawaii banks are regulated by DFI and the others are regulated by either a federal regulator or a federal regulator and a state regulator.

Banks acknowledge the importance of a sound bank regulatory body with a capable staff able not only to regulate the financial institutions under its purview but also to provide advice and support in certain instances. We think it is important to realize that DFI does more than regulate banks but it provides a meaningful community service in regulating non-banks who are not regulated by a federal agency.

In the dual banking system, the state-chartered banks are regulated by a federal agency (usually the FDIC) as well as DFI. This created a robust regulatory system for banks but for non-banks, DFI is often the sole regulatory authority that supervises the actions or omissions of non-banks. We recognize the importance of a prudent regulatory system to provide stability to the community.

The dual banking system depends on sound examination by both federal and state banking regulators. If the finances of DFI were to diminish, it is likely that the pay for state examiners will diminish and hamper sound examination review by DFI.

For banks, we prepare an annual budget which includes paying a regulatory fee. The current system of paying a set fee enables banks to ascertain their regulatory costs in advance in the preparation of their annual budget rather than another system where charges depend on the examination of the banks and other factors and thus the timing of expenditures can be erratic.

If DFI were not able to receive fees for eight years, DFI would suffer from deficits and may have to reduce expenditures as a result. The end result may be the inability to hire competent staff and other necessities.

The other problem caused by the effects of this bill is that a huge fee would have to be charged for the fiscal year beginning in 2029, which would have a detrimental effect on banks, especially on the smaller banks.

A lesson can be gleaned from the financing of Association of Apartment Owners (AOAO). Previously, the AOAOs did not budget for expensive maintenance items which occurred periodically such as the roof or painting. As a result, the unit owners at the time of the expenditure were hit with a large special assessment while others that may have benefitted and had sold their unit did not contribute to the maintenance cost. The legislature resolved this issue by requiring the AOAOs to include in their maintenance fees amounts to balance out the costs of maintenance. While this example is not identical, it points out the importance of not reducing assessments for a temporary gain.

Thank you for the opportunity to submit this testimony and please let us know if we can provide further information.

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