

ACT 103

H.B. NO. 3110-76

A Bill for an Act Relating to Industrial Loan Companies.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. Findings and Purpose. The Legislature finds that Hawaii law governing industrial loan companies is not sufficient to prohibit certain practices involving loans and investments, resulting in substantial difficulties for some individual companies and creating undue risks to the depositors who invest their funds in investment certificates of these companies. These difficulties have been brought about by the following practices and circumstances:

- (1) The practice of making excessive loans to parent companies or other affiliates of the industrial loan company. Such loans are often unsecured. These transactions are sometimes motivated and controlled from the borrower's position and thus often involve more risk for the lending loan company than would occur in an arm's length transaction with a third party.
- (2) The recent explosive growth of Hawaii's industrial loan industry (\$104 million in public deposits at the end of 1969, \$412 million on June 30, 1975). This rapid influx of deposits in some institutions has resulted in a series of hasty and sometimes ill-advised decisions.

The Legislature further finds that existing law does not provide controls of sufficient strength to adequately protect depositors. Controls applicable to industrial loan companies have been historically far less strict than those applicable to banks and savings and loan associations although industrial loan companies operate in similar fashion, and many receive very substantial public deposits.

The purpose of this Act is to preserve and protect the interests of depositors in industrial loan companies by: (1) increasing the cash or security reserve; (2) placing limits on affiliate (insider) transactions; (3) placing limits on loans and investments involving a single obligor; (4) requiring collateral for certain loans; (5) placing those responsible for the management of industrial loan companies under increased responsibility to protect the interests of depositors; and (6) empowering the bank examiner to promulgate rules and regulations for the administration of Hawaii's Industrial Loan Company Act.

SECTION 2. Section 408-2, Hawaii Revised Statutes, is amended by adding three new definitions to be appropriately inserted and to read:

"Affiliate" means any corporation, partnership, venture, business trust, association, or other similar organization:

- (1) Of which the industrial loan company, directly or indirectly, owns or controls either majority of the voting shares or more than fifty per cent of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors,

- trustees, or other persons exercising similar functions; or
- (2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by shareholders of the industrial loan company who own or control either a majority of the shares of such company or more than fifty per cent of the number of shares voted for the election of directors of such company at the preceding election, or by the trustees for the benefit of the shareholders of any such company; or
 - (3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of the industrial loan company; or
 - (4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of the industrial loan company or more than fifty per cent of the number of shares voted for the election of directors of such company at the preceding election, or controls in any manner the election of a majority of the directors of such company, or for the benefit of whose shareholders all or substantially all the capital stock of such company is held by trustees.

“Person” means not only individuals but also partnerships, corporations, firms, associations and federal, state and municipal governments.

“Primary obligor” means a person legally bound to comply with a demand for satisfaction of any security. This definition shall include the maker or endorser of a note, the corporate issuer of stock and the issuer of any security or of any other evidence of indebtedness.”

SECTION 3. Section 408-14, Hawaii Revised Statutes, is amended to read:

“**Sec. 408-14 Specific powers.** Every industrial loan company, in addition to the powers exercisable by or conferred upon it under or by the general corporation law of the State, or by any other provision of this chapter, shall possess and may exercise the following powers:

- (1) To borrow money upon its own secured or unsecured notes;
- (2) To lend money upon individual credit or upon the security of comakers, personal endorsement, or the pledge or mortgage of real or personal property or choses in action, or upon any combination of such credit and security, and to contract for such interest, discount, or other consideration as is permitted by this chapter;
- (3) To discount, purchase, or otherwise acquire notes, installment contracts, warehouse receipts, or other choses in action, notwithstanding section 416-31 to the contrary;
- (4) To establish branches within the State with the prior written approval of the bank examiner;
- (5) To finance purchases for others by taking title to merchandise temporarily and only for the purpose of securing loans entered into for the purchases; and
- (6) To issue and sell certificates for the payment of money at any time, either fixed or uncertain, and to receive payments therefor in installments or otherwise, with or without allowance of interest on the

installments; provided, that nothing herein shall be construed to authorize any industrial loan company to receive deposits or to create any liability due to demand.

The certificates shall not be issued by any such company without receiving the prior written approval of the bank examiner, and shall bear upon the face of the instrument the words, "THIS IS NOT A CERTIFICATE OF DEPOSIT."

No industrial loan company shall have outstanding at any time its certificates and/or its debentures registered under chapter 485 in an aggregate sum in excess of ten times the aggregate amount of its paid-up capital and surplus; provided, that the bank examiner shall have the authority to limit the ratio of certificates and/or debentures to capital and surplus which may be issued by any industrial loan company if he determines that such lower ratio is necessary in the public interest. In determining the ratio to be permitted, the bank examiner shall consider all relevant circumstances, including, without limitation, the following factors:

- (1) The length of time the company has been in operation.
- (2) Ratio of losses to volume of loans made and contracts purchased.
- (3) The creation and maintenance of adequate reserve for losses.
- (4) Charge-off of uncollectable accounts.
- (5) The amount or growth of undivided profits and/or earned surplus.
- (6) Diversification of character and source of loans made and contracts purchased.
- (7) Creation and maintenance of adequate internal controls.
- (8) Sound and efficient management.

Every industrial loan company shall, as of January 1, 1977, maintain and have on hand at all times a reserve composed of cash and other securities in an amount equal to the sum of five per cent of its liabilities on outstanding certificates and debentures with an original term not exceeding one year and five per cent of its liabilities on outstanding certificates and debentures with an original term of one year or more, and after January 1, 1978, maintain and have on hand at all times the above-mentioned reserve in an amount equal to the sum of seven per cent of its liabilities on outstanding certificates and debentures with an original term not exceeding one year and five per cent of its liabilities on outstanding certificates and debentures with an original term of one year or more. Said reserve shall not be pledged.

This reserve shall be determined as of a particular date and shall be based upon the daily average of all outstanding certificates and debentures of the immediate preceding seven calendar days. During a succeeding seven calendar day period, the average daily balance of said reserve shall equal or exceed such reserve amount. At the end of the seven calendar day period, a new reserve amount shall be determined based upon the daily average of the immediate preceding seven calendar days and for the next succeeding seven calendar day period, the average daily balance of said reserve shall equal or exceed such new amount. Determination of reserve requirements shall be made on form approved by the bank examiner and shall be computed within two working days after date of determination. Upon any failure to maintain the reserve requirement for the required seven calendar day period, the industrial loan company shall promptly

take action to correct the reserve deficiencies, shall cease making any loans or other advances or extensions of credit until the reserve deficiency is corrected, and shall notify the bank examiner within two working days after the close of the period. The bank examiner may in writing direct specific directors and officers of any industrial loan company in violation of this section to take actions reasonably necessary to increase its reserve so as to comply with this section.

Cash reserves shall be limited to cash in banks and on hand, bank or savings and loan certificates of deposit, direct United States, state or county government securities, and passbook deposits in banks or savings and loans; and such cash reserve shall at all times equal no less than fifty per cent of the aforementioned reserve that is required by this section.

Other securities shall be limited to direct obligations of the United States government, state, or county, bankers acceptances approved by the bank examiner, irrevocable lines of credit in a form acceptable to the bank examiner, and securities listed on the New York stock exchange or the American stock exchange and no more than twenty-five per cent of the total reserve of cash and other security shall be held in securities listed on the New York stock exchange or the American stock exchange."

SECTION 4. Chapter 408, Hawaii Revised Statutes, is amended by adding thereto a new section to be appropriately designated and to read:

"Sec. 408- Transactions involving affiliates, officers, directors and certain shareholders; limitations. (a) No industrial loan company that issues certificates as provided for in section 408-14, or has outstanding any debentures registered under chapter 485 shall:

- (1) Invest any of its funds in the capital stock, bonds, debentures, or obligations, other than for secured loans as provided for in paragraphs (3) and (4) of this section, in any of its affiliates if thereby the aggregate amount of all such investments in all affiliates will exceed the following percentages of its paid-up capital and surplus during the calendar years hereafter indicated: ninety-five per cent from July 1, 1977 through December 31, 1977; ninety per cent from January 1, 1978 through December 31, 1978; eighty per cent from January 1, 1979 through December 31, 1979; seventy per cent from January 1, 1980 through December 31, 1980; sixty per cent from January 1, 1981 through December 31, 1981; and fifty per cent from January 1, 1982 through December 31, 1982 and thereafter.
- (2) After the effective date of this section invest any of its funds in any affiliate unless it shall have obtained the prior written approval of the bank examiner. The bank examiner may withhold or refuse any such approval if he finds that the activity engaged in by the affiliate company is substantially unrelated to those activities authorized by section 408-14.
- (3) Make any unsecured or partially secured loan, advance, or extension of credit to any of its affiliates if thereby the aggregate amount of all unsecured or partially secured loans, advances, or extensions to all of its affiliates will exceed five per cent of the paid-up capital and surplus

of the industrial loan company.

- (4) Make any secured loan, advance, or extension of credit, as described in section 408- , to any of its affiliates if thereby the aggregate amount of all such secured loans, advances, or extensions of credit to all affiliates will exceed the following percentages of its paid-up capital and surplus during the calendar years hereafter indicated: ninety-five per cent from July 1, 1977 through December 31, 1977; ninety per cent from January 1, 1978 through December 31, 1978; eighty per cent from January 1, 1979 through December 31, 1979; seventy per cent from January 1, 1980 through December 31, 1980; sixty per cent from January 1, 1981 through December 31, 1981; and fifty per cent from January 1, 1982 through December 31, 1982 and thereafter.
- (5) Accept as collateral the capital stock of itself or of any of its affiliates.
- (6) Without the prior written approval of its board of directors, directly or indirectly, make any loan, advance or extension of credit to, or purchase a contract or chose in action from:
 - (A) A person who is an officer, director, or beneficial owner of ten per cent or more of the shares of the industrial loan company or of any of its affiliates.
 - (B) A person who directly or indirectly acquires such contract through intervening assignments from a person described in (A) hereof, provided, however, that no such prior approval shall be required on any loan made to such persons in (A) and (B) herein which is secured by investment certificates or debentures issued to such persons by the industrial loan company.

(b) All industrial loan companies that issue certificates as provided for in section 408-14, or have outstanding any debenture registered under chapter 485, shall submit to the bank examiner, at his request, an annual financial report, prepared by an independent certified public accountant, for any affiliate to which they have loaned or invested their funds."

SECTION 5. Chapter 408, Hawaii Revised Statutes, is amended by adding thereto a new section to be appropriately designated and to read:

"Sec. 408- Loans and investments; limitation on to a single primary obligor. (a) No industrial loan company shall make any unsecured or partially secured loan, advance or extension of credit to any single primary obligor other than to its affiliates as provided in section 408- , if thereby the aggregate amount of the industrial loan company's unsecured or partially secured loans, advances or extensions to such primary obligor will exceed the greater of either \$25,000 or five per cent of the paid-up capital and surplus of the industrial loan company.

(b) No industrial loan company shall make any secured loan, advance or extension of credit as described in section 408- , to any single primary obligor, other than to its affiliates as provided in section 408- , if thereby the aggregate amount of all of the industrial loan company's loans, advances or extensions to such primary obligor including loans, advances or extensions provided for in (a), will exceed fifty per cent of the paid-up capital and surplus of the industrial loan company; provided, however, that such aggregate amount may be increased to

not exceed one hundred per cent of the paid-up capital and surplus of the industrial loan company if all loans made to any such single primary obligor in excess of fifty per cent of the paid-up capital and surplus of the company other than to its affiliates, are secured by mortgages on real property other than unimproved raw land.

(c) No industrial loan company shall in any manner invest in excess of twenty-five per cent of its paid-up capital and surplus in the capital stock, bonds or other obligations of any single primary obligor other than industrial loan company affiliates.”

SECTION 6. Chapter 408, Hawaii Revised Statutes, is amended by adding thereto a new section to be appropriately designated and to read:

“**Sec. 408- Loans; collateral required.** (a) No industrial loan company shall either directly or indirectly make any loan, advance or extension of credit which will exceed the greater of \$25,000 or five per cent of the paid-up capital and surplus of the industrial loan company unless such loan, advance or extension is secured by collateral so that the loan, when added together with the outstanding balances of any prior liens, will not exceed ninety-five per cent of the fair market value of the collateral; provided, however, that secured loans, advances or extensions of credit to affiliates shall be secured by collateral so that the loan, when added together with the outstanding balances of any prior liens, will not exceed eighty per cent of the fair market value of the collateral.

- (1) Loans secured by unimproved raw land shall not exceed, when added together with outstanding balances of any prior liens, seventy per cent of the appraised value.
- (2) All real property used as collateral for loans in excess of \$25,000 made under this section shall be appraised by a qualified appraiser before making the loan.

(b) The provisions of this section shall not prevent any industrial loan company from taking additional liens on existing or new collateral of any kind to secure the repayment of debt previously contracted for in good faith when the subsequent liens are necessary to further secure the payment of any debt and to save the company from loss.”

SECTION 7. Chapter 408, Hawaii Revised Statutes, is amended by adding thereto a new section to be appropriately designated and to read:

“**Sec. 408- Liability of officers, directors, shareholders; power of removal in bank examiner.** Any officer, director or beneficial owner of more than ten per cent of the outstanding voting stock of an industrial loan company who wilfully makes or participates in making any transaction in violation of this chapter or who knowingly and wilfully approves any such transaction shall be subject to removal from office by the bank examiner after a hearing conducted pursuant to chapter 91. The bank examiner may in addition to or in lieu of removal fine any such officer, director or owner a sum not to exceed \$1,000 for each such transaction.”

SECTION 8. Chapter 408, Hawaii Revised Statutes, is amended by adding thereto a new section to be appropriately designated and to read:

“Sec. 408- Issuance of certificates to minors. Certificates of industrial loan companies may be issued in the name of a minor in the same manner as to an adult person. The investment represented by the certificate and made by or in the name of any minor shall be held for the exclusive right and benefit of the minor and free from the control or lien of all persons, and shall be paid, together with the interest, if any, thereon, to the minor. The receipt or acquittance of the minor shall be a valid and sufficient release and discharge for the investment or any part thereof, to the company; provided that in case any guardian or trustee is appointed for the minor, any court having jurisdiction may order the investment to be placed under the control of the guardian or trustee. The company shall, upon receipt of a certified copy of the order, pay over or credit to the guardian or trustee all funds held by the minor under the certificate including all interest pertaining thereto. The receipt or acquittance of the guardian or trustee shall be a valid and sufficient release and discharge for the investment, or any part thereof, to the company.”

SECTION 9. Chapter 408, Hawaii Revised Statutes, is amended by adding thereto a new section to be appropriately designated and to read:

“Sec. 408- Rules and regulations. Subject to chapter 91, the bank examiner may adopt such rules and regulations as he deems necessary for the effective administration and enforcement of this chapter.”

SECTION 10. Section 408-20, Hawaii Revised Statutes, is amended to read:

“Sec. 408-20 Other restrictions on business. No industrial loan company shall engage in the banking or trust company or building and loan association business. A licensee shall not charge, contract for, collect, or receive interest, discounts, fees, fines, commissions, charges, or other considerations in excess of the interest or discount, charges, recording and satisfaction fees, or premiums for insurance authorized by this chapter and shall not split or divide any contract so as to obtain charges in excess of those authorized by this chapter. A licensee shall not sell any loan to another person or company doing business in this State whenever such loan provides by contract for a rate of interest greater than would be permissible under section 478-3 unless such person or company has the right to charge, contract for, receive, collect in advance or recover interest, discount and other charges at the same rates and in the same amounts as permitted by law in the case of loans made by industrial loan companies licensed under chapter 408 and such loans are sold without recourse.”

SECTION 11. Any industrial loan company which on the effective date of this Act is not in compliance with any of the provisions or requirements set forth herein shall within no more than 180 days so inform the bank examiner and file with him a financial plan for achieving full compliance with this Act. The bank examiner shall review and consider the circumstances of the company and shall by order establish a date by which full compliance shall be achieved, provided that such date shall not in any event be later than December 31, 1978, except as otherwise provided herein.

SECTION 12. Statutory material to be repealed is bracketed. New

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material is underscored. In printing this Act, the revisor of statutes need not include the brackets, the bracketed material, or the underscoring.*

SECTION 13. This Act shall take effect upon its approval.

(Approved May 13, 1976.)

*Edited accordingly.