Report to the Twenty-Fourth Legislature
2008 Regular Session

Pursuant to

Act 213, Part VII, Section 196, Session Laws of Hawai'i 2007

On

How the Department of Commerce and Consumer Affairs' Expenditures will be Aligned with its Special Fund Revenue Collections

Department of Commerce and Consumer Affairs
State of Hawai'i

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I. EXECUTIVE SUMMARY

This report is required by part VII, section 196 of Act 213 (the "Act"), Session Laws of Hawai'i ("SLH") 2007 concerning the Department of Commerce and Consumer Affairs' ("DCCA" or "Department") compliance resolution fund ("CRF"). The report was first required by Act 200 (SLH 2003), and was filed with the Legislature in December 2003 ("2004 Report"). Subsequent reports were submitted in December 2004 ("2005 Report"), December 2005 ("2006 Report"), and December 2006 ("2007 Report").

Because the Department is specially funded, it has no access to general funds. Revenue is program specific, and arrives throughout the year. As a result, each program has to maintain sufficient cash reserves in order to (1) ensure operations until revenues are received, and (2) ensure against sudden downturns in revenues. The Department became fully self-funded in 1999. In the initial years, and in part due to the uncertainty related to managing a self-funded program, programs were encouraged to try to accrue reserves that amounted to two years of projected expenses (program ceiling plus internal overhead). In 2003, the Department concluded that it was unnecessary to maintain two years of reserves, and the goal was reduced to nine months.

Today, the Department continues to make progress toward its goal of a 9-month reserve. The Department has made substantial strides toward reducing and leveling its overall fund balance, reducing the cash reserve from 13.3 months at the close of FY 04 to 10.6 months at the end of FY 07. The Department anticipates closing out FY 08 with a reserve of 9.0 months.

DCCA subscribes to the principle that its customers should only pay the Department for services reasonably related to the regulation, registration, license or related service that the Department provides. Thus, the Department has worked hard to ensure that its fees are set at reasonable levels.

Toward that goal, since January 2003, the Department has implemented the following revenue reductions (Attachment B[1]):

- The Business Registration Division ("BREG") reduced the filing fee by 25% for on-line filings and payment by credit card, and by 50% for subscribers to the Hawai'i internet portal, with projected foregone combined revenue of $1,600,000 over FY 04 – FY 07;

- BREG reduced the fees charged for business document registration by 50%, exclusive of new business registration and annual report and statement fees, with projected foregone combined revenue of approximately $4,200,000 over FY 05 – FY 07;

- BREG reduced the fee charged for Certificates of Good Standing from $25 to $5, with projected foregone combined revenue of $210,000 over FY 05 – FY 07;

- BREG reduced the fee for initial and annual filings by 50%, foregoing projected combined revenue from FY 05 – FY 07 of $2,363,000;

- BREG initiated a 50% reduction for (i) securities industries Reg. D filing fees, (ii) filing fees charged for franchise fee applications, amendments and renewals, and (iii) filing fees charged for application and renewal fees for securities dealers and their salespeople, investment advisors and their representatives, and the initial notice filing and renewal fees for investment company securities, with foregone combined revenue of $7,194,986 over FY 05 – FY 07;

- The Insurance Division ("INS") reduced direct assessments on insurance companies doing business in Hawai'i from the average FY 00 – FY 03 assessment by a combined total of $15,068,580 over FY 04 – FY 07;

- INS reduced producer licensing fees by $25, with foregone combined revenue of $450,632 over FY 05 – FY 07;

[1] In prior years' reports, this attachment has contained projected revenue reductions for all fiscal years. This year, the attachment reflects actual revenue reductions for prior fiscal years except where noted.

- The Division of Financial Institutions ("DFI") waived examination fees and related expenses for financial institutions and escrow depositories, with foregone combined revenue of $1,062,000 over FY 04 – FY 07;

- Regulated Industries Complaints Office ("RICO") initiated a 25% reduction of compliance resolution fees associated with professional and vocational license online renewals, with foregone combined revenue of $908,775 over FY 05 – FY 07, and a 10% reduction of compliance resolution fees with foregone revenue of $85,575 in FY 07;

- Cable Television Division ("CATV") directed that the cable franchisee temporarily cease collecting the Department's portion of the annual fee from subscribers, effective November 1, 2005, with foregone combined revenue of $1,850,570 in FY 06 and FY 07;

- Professional Vocational Licensing Division ("PVL") initiated a "customer appreciation credit" of 10% for biennial professional and vocational licensing online renewals between the periods of December 31, 2005 through June 30, 2007, for those licensing areas listed under section 92-28, HRS, with foregone combined revenue of $297,164 over FY 06 – FY 07;

In addition, the Department has initiated or will continue the following revenue reductions during the current fiscal year (Attachment B):

- BREG will maintain its 25% filing fee reduction for on-line filings and payment by credit card, and by 50% for subscribers to the Hawai'i internet portal, with projected foregone revenue of $400,000 in FY 08;

- BREG continues its 50% reduction in fees for business document registration exclusive of new business registration and annual report and statement fees, with projected foregone revenue of approximately $1,400,000 in FY 08;

- BREG's reduced fee for Certificates of Good Standing of $5 will remain in effect, with projected foregone revenue of $70,000 for FY 08;

- BREG will continue its 50% reduced fee for initial and annual filings, foregoing projected revenue of $945,000 in FY 08;

- BREG continued its 50% fee cut for the first quarter of FY 08 and has implemented a 25% reduction for the remainder of the fiscal year for (i) securities industries Reg. D filing fees, (ii) filing fees charged for franchise fee applications, amendments and renewals, and (iii) filing fees charged for application and renewal fees for securities dealers and their salespeople, investment advisors and their representatives, and the initial notice filing and renewal fees for investment company securities, with projected foregone combined annual revenue of $1,670,000 in FY 08;

- INS will reduce direct assessments on insurance companies doing business in Hawai'i from the average FY 00 – FY 03 assessment by $3,152,658 in FY 08;

- INS's $25 reduction in producer licensing fees will stay in effect, with projected foregone revenue of $157,575 in FY 08;

- DFI projects foregone revenue from waived examination fees and related expenses for financial institutions and escrow depositories of $150,000 in FY 08;

- RICO will continue its 10% reduction of compliance resolution fees associated with professional and vocational license online renewals, with projected foregone revenue of $156,469 in FY 08;

- CATV projects foregone revenues from the Department's portion of the annual fee from subscribers of $1,521,177 in FY 08[2];

- PVL will continue to offer the "customer appreciation credit" as described above for the biennium FY 08 - FY 09 and further has increased the discount from the prior 10%, to 25%. PVL projects foregone revenue in FY 08 of $543,909.

II. INTRODUCTION

The Act, known as the General Appropriations Act of 2007, reads in pertinent part as follows:

> "SECTION 196. Provided that the department of commerce and consumer affairs shall prepare a detailed report on *how the department's expenditures will be aligned with its special fund revenue collections*; provided further that this report shall include a discussion of plans to lower fees to appropriate levels; and provided further that the department shall submit the report to the legislature no later than twenty days prior to the convening of the 2008 and 2009 regular sessions." (Emphasis added)

Since the Department's background, its source of funds, its historical cash reserve policy and the reasonableness of its current plan to reduce fund reserves to approximately 9 months of budget ceiling were all addressed in earlier Reports, those matters are not discussed herein.

III. FY 08 PLAN DETAILS

A. DCCA Expenditures Are Becoming Aligned With Its Revenues.

[2] CATV directed that the cable franchisee resume collecting the Department's portion of the cable fee from subscribers effective December 1, 2007. However, the Department will collect only the December 2007 portion of the fee in FY 08. The remaining six months' portion of the FY 08 fee will not be collected until January 31, 2009.

Beginning with revised FY 04 projections developed during the 2004 legislative session and shared with House Finance and Senate Ways and Means committees, the Department instituted an internal mid-year budgeting regimen that incorporated to-date revenue and expenditure levels.

The goal of the Department's revenue reduction plan is to reduce the Department's CRF's current fund balance to nine months or less of budget ceiling and to bring its revenues more in line with its expenses. As such, DCCA currently projects that its FY 08 expenditures will exceed its FY 08 revenues, just as Department expenditures have exceeded revenues in the prior three fiscal years (Attachment A). With reduced revenues stemming largely from permanent and temporary fee cuts and assessment waivers, and with increased expenditures stemming mainly from increased personnel costs, the Department's projected FY 08 end of year CRF cash balance is $29.7M or 9 months. FY 04, FY 05, FY 06 and FY 07 end of year cash balances were $39.0M (13.3 months), $36.2M (11.7 months), $34.7M (11.6 months), and $34.8M (10.6 months) respectively.

The Department's expenditures have increased from FY 03 to FY 07 ($25.5M to $28.0M to $29.2M to $29.8M to $32.6M), while revenues have decreased over the same period of time ($34.5M to $31.2M) (Attachment A). The Department is projecting FY 08 revenues and expenditures of $30.7M and $36.3M, respectively. As noted above, the Department is implementing new and continuing existing revenue reductions totaling approximately $10.1M in FY 08 (Attachment B). As a result, cuts and waivers implemented over the FY 04 – FY 08 period will total over $45M. *Id*.

B. DCCA Plans To Better Balance Revenues and Expenses.

The fee/assessment cuts outlined here will continue to save Hawai'i businesses and residents millions of dollars, thus strengthening Hawai'i's business and employment climate.

Program details follow.

1. Program CCA-102, Cable Television Division (CATV)

Status: CATV entered FY 08 with 9.3 months of cash reserves after having closed out FY 06 with 37.7 months of reserves. During the 2007 legislative session, the division was directed to spend $2.4M for the expansion and update of the state INET[3]. However, this one-time expenditure did not affect the division's budget or budget ceiling as the money was transferred directly from Time Warner to the University of Hawaii.

Action Plan: Effective November 1, 2005 the division temporarily stopped assessing Time Warner the Department's annual fee (approximately .64% of gross revenues), which the cable operator is allowed under federal law to pass on to cable customers. That directive reduced by two months of revenue the amount of revenue that would otherwise have been collected by the Department in FY 06, twelve months in FY 07, and eleven months in FY 08. With the division's reserves now aligned with the target of approximately 9 months, the division notified Time Warner in November 2007 to begin collecting the Department's portion of the cable fee beginning in December 2007.

Justification: Resumption of revenue collection in FY 08 is necessary for the division to cover operating expenses and maintain an adequate reserve.

Fiscal Impact: This revenue/expenditure outlook is projected to bring the division's cash reserve to 8.6 months heading into FY 09.

Reduction / (Increase)			
Description	**FY 06**	**FY 07**	**FY 08**

[3] Act 213, Part III, Section 111

DCCA's .64% annual fee	$237,275	$1,613,295	$1,521,177
Increase in INET spending		($1,500,000)	($2,400,000)

2. Program CCA-103, Division of Consumer Advocacy (DCA)

Status: DCA entered FY 07 with 11.4 months of reserve on hand, but finished the year with 10.8 months, slightly more than the 2007 Report's forecast of a 10.1 month reserve.

Action Plan: Act 183 (2007) requires the division to restructure its operations as provided for in the division's report to the legislature required pursuant to Act 143, Session Laws of Hawaii, 2006. The restructuring received final approval in December and the division anticipates hiring as many as eight of the 13 positions authorized under the restructuring during FY 08.

Justification: DCA receives its primary funding from the proceeds in the PUC Special Fund, pursuant to section 269-33, HRS. As a result, its revenues are usually fixed each year. However, with the restructuring required by Act 183, the division received an additional $198,000.

Fiscal Impact: The division expects that its reserves will be at 10.8 months at the end of the fiscal year.

3. Program CCA-104, Division of Financial Institutions (DFI)

Status: DFI entered FY 07 with reserves of 16.4 months and finished the year with 16.6 months. DFI's reserve appears higher than that of other divisions because the division receives approximately 80% of its funding at the end of each fiscal year by means of a transfer from the Department of Taxation. Thus, immediately prior to June 30 of FY 07, DFI's reserves stood at 4.6 months – a more accurate reflection of the division's reserve status.

Action Plan: In FY 04, FY 05, FY 06, and FY 07 DFI waived examination fees and related expenses for its examination of regulated financial institutions and escrow depositories pursuant to sections 412:2-105 and 449:14, HRS, foregoing revenue of $1,062,000. This waiver was temporary and subject to regular review by the program's Commissioner. DFI has announced its intention to end this waiver beginning January 1, 2008. FY 08 revenue for the division is expected to increase by $150,400 with resumption of examination fees and expenses.

Justification: DFI has the ability to charge its regulated businesses examination fees and related expenses pursuant to Chapter 412, Code of Financial Institutions and Chapter 449, Code of Escrow Depositories. The waiver of these fees has resulted in savings of over $1 million for Hawaii financial institutions. At this time, it is prudent to reinstate these fees as the division is actively recruiting to fill four permanent positions (3 examiners and one clerk typist) resulting in additional division expenses.

Fiscal Impact: The division's reserve level at close of FY 08 is anticipated at 15.5 months.

Revenue Reduction					
Description	**FY 04**	**FY 05**	**FY 06**	**FY 07**	**FY 08**
Exam fees and related costs	$171,000	$292,000	$331,000	$268,000	$150,000

4. Program CCA-105, Professional and Vocational Licensing Division (PVL)

Status: The Department's 2007 proposal to expand the list of professions/vocations covered by the administrative fee reduction process in section 92-28, HRS by 30 additional professions and vocations was passed by the Legislature and signed into law by the Governor. Act 155 (2007). As PVL has utilized section 92-28 HRS to offer a "customer appreciation credit" for online licensing renewals, this Act increased the number of professions and vocations eligible for the division's "customer appreciation credit".

Action Plan: PVL has increased its existing "customer appreciation credit" from 10% to 25% for professional and vocational licensing online renewals between the period of December

31, 2007 through June 30, 2009 and through its efforts to pass Act 155, now is able to offer the discount to more professions and vocations.

Justification: Because of the State's strong economy, PVL's revenue has increased over the last four years. PVL increased its customer appreciation credit in order to encourage more of its customers to utilize on-line services. Increasing the credit combined with expanding the number of professions and vocations eligible for the credit will result in a total projected FY 08 savings to licensees (and reduction in revenue to the division) of $543,909. A further reduction in revenue is also projected for FY 09.

Fiscal Impact: The division expects to end FY 08 with a reserve level of 10.5 months, down from 13.5 months at the beginning of the fiscal year.

Revenue Reduction			
Description	**FY 06**	**FY 07**	**FY 08**
Online renewal fee reductions (per §92-28, HRS)	$188,140	$109,024	$543,909

5. Program CCA-106, Insurance Division (INS)

Status: The Insurance Commissioner is given the authority to determine the amount and timing of the assessment to defray the operating costs incurred by the division and the supporting divisions pursuant to sections 431:2-215(d) and 431:2-216, HRS. This authority was granted to the Insurance Commissioner since revenue from insurance fees is insufficient to cover all program expenditures. The assessment provides INS with a mechanism for annually adjusting total revenues to estimated expenditures, thereby allowing the division to maintain its fund balance at the Department's policy level.

Action Plan: INS reduced its FY 04 direct assessment on insurers, mutual benefit societies and health maintenance organizations from $5,616,310 in FY 03 to $1,942,052 in FY 04. Assessments were reduced to zero in both FY 05 and FY 06. Assessments were reduced in

FY 07 by $2,752,658. INS will reduce assessments on the industry by a total of $3,152,658 for FY 08.[4] Additionally, from FY 05 – FY 07, INS reduced licensing fees for resident producers by $25 for a 3-year revenue reduction of $450,633. INS will maintain its reduced resident producer licensing fee in FY 08 resulting in additional projected foregone revenue of $157,575.

Justification: Act 1 (2005 Special Session) restricts the division's ability to assess the insurance industry (the principal method by which the division is funded) and to maintain a cash reserve. The ending cash balance from FY 05 and the revenue received in FY 06 were sufficient to fund the division's operations in FY 06. A projected deficit in FY 07 resulted in an assessment being made in that fiscal year. In addition, unanticipated revenue received in FY 07 from a higher than expected rate of increase in non-resident producer licensing fees provided INS with sufficient cash to fund operations from July 1, 2007 to present. If the assessment was not made and the unanticipated revenue not received in FY 07, the division would not have had sufficient cash to operate during the first three months of FY 08.

Fiscal Impact: Despite assessing the industry in FY 07 and FY 08, the division's expenses are projected to exceed its revenue by over $2 million. INS entered FY 08 with a cash reserve level of 4 months, and by the close of the year expects to be at 1.6 months, a particularly precarious position for this division.[5]

Revenue Reduction					
Description	**FY 04**	**FY 05**	**FY 06**	**FY 07**	**FY 08**
Direct assessment	$2,810,606	$4,752,658	$4,752,658	$2,752,658	$3,152,658
Resident producers fee reduction		$152,049	$145,989	$152,595	$157,575
TOTAL	$2,810,606	$4,922,658	$4,922,658	$2,922,658	$3,310,233

[4] Direct assessment reduction amounts are based on the FY 00 – FY 03 average assessment.
[5] The Department expects to propose legislation in the 2008 Session to allow INS to maintain a 3-month carryover into a new fiscal year.

6. Program CCA-110, Office of Consumer Protection (OCP)

Action Plan: The administrative overhead assessment on DCCA's net revenue generating programs provides the principle funding source for OCP and is the mechanism by which the program will annually adjust its beginning fund balance. The Department will adjust the administrative overhead assessment for each year to reflect any beginning cash balance in the recipient programs' accounts over and beyond that prescribed by the Department's fund balance reserve policy.

Justification: OCP's operating costs are covered primarily by the administrative overhead assessment on DCCA's net revenue generating programs. Therefore, any beginning cash balance in excess of that necessary to ensure the continuation of program services into the new fiscal year, should be credited back to the revenue generating source programs.

Fiscal Impact: The program expects to reduce its fund balance from 4.1 months going into FY 08 to 3 months at the close of the fiscal year.

7. Program CCA-111, Business Registration Division (BREG)

Action Plan: By executive order of the Governor, BREG online filing fees were reduced effective March 4, 2003 by 25% for online filings and payment by credit card and by 50% for subscribers to the Hawai'i internet portal that file documents regularly and these fee cuts remain in effect. The estimated foregone revenue is $400,000 annually. Pursuant to legislation passed in 2005, the bulk of the program's document registration fees (exclusive of new business registration and annual report and statement fees) were reduced by 50%. The estimated annual foregone revenue is $1,400,000. In addition, although DCCA recommended that Certificates of Good Standing be provided at no cost, the Legislature required that there be a $5 charge. The fee reduction has been implemented, and the estimated annual foregone revenue associated with issuing these certificates is $70,000.

In FY07, BREG implemented additional reductions of 25% for (i) securities industries Reg. D filing fees, (ii) filing fees charged for franchise fee applications, amendments and renewals, and (iii) filing fees charged for application and renewal fees for securities dealers and their salespeople, investment advisors and their representatives, and the initial notice filing and renewal fees for investment company securities.

Justification: Fee reductions will stabilize the program's fund balance, should positively affect Hawai'i's business climate, and are based on the principle that, to the extent a healthy economy increases filings and allows the program to reduce fees while still receiving adequate funding, it should adjust its fees accordingly.

Fiscal Impact: Since FY 04, BREG has provided its registration services with approximately $14,678,000 in fee reductions. FY 08's projected fee reduction total of $4,485,000 will bring the division's 5-year total savings to Hawaii's business and professional community to $19,163,000.

These initiatives have brought the program's revenues in better alignment with expenditures. As a result, the program's fund balance is expected to remain essentially static, with an end of fiscal year balance of 10.4 months.

Estimated Revenue Reduction				
Description	**FY 05**	**FY 06**	**FY 07**	**FY 08**
25-50% reduction for online filers	$400,000	$400,000	$400,000	$400,000
50% reduction for doc registration fee and reduced COGS fee	$1,470,000	$1,470,000	$1,470,000	$1,470,000
50% reduction initial filings	$177,500	$330,000	$330,000	$330,000
50% reduction online annual filings	$295,500	$615,000	$615,000	$615,000
50% reduction for (i) securities industries Reg. D filing fees, (ii) filing fees charged for franchise fee applications, amendments and	$1,405,000	$2,526,345	$3,263,641	$1,670,000

renewals, and (iii) filing fees charged for application and renewal fees for securities dealers and their salespeople, investment advisors and their representatives, and the initial notice filing and renewal fees for investment company securities				
TOTAL	$3,748,000	$5,341,345	$6,078,641	$4,485,000

8. Program CCA 112, Regulated Industries Complaints Office (RICO)

Action Plan: RICO lowered its appropriation in the FY 05 supplemental budget by approximately $237,000. The bulk of this amount ($150,000) represented a pure budget ceiling reduction, with the remainder amounting to a transfer to the office of consumer protection. RICO followed by implementing a 25% reduction in online CRF fees, resulting in revenue reductions of $94,920, $467,850 and $346,635 in FY 05, FY 06 and FY 07, respectively. RICO instituted a 10% reduction in online CRF fees resulting in a revenue reduction of an additional $85,575 in FY 07.

Justification: Just as PVL's revenue has risen with the State's strong economy, so, too, has RICO's. Negotiated salary increases and filling additional positions are projected to substantially reduce RICO's reserve level from the 13.7 months the division had entering this fiscal year.

Fiscal Impact: The program expects to close the FY 08 fiscal year with reserves of 10.9 months.

Revenue Reduction				
Description	**FY 05**	**FY 06**	**FY 07**	**FY 08**
Reduction in CRF fees for online filers	$94,920	$467,850	$432,210	$156,469

9. Program CCA-191, Administration/Office of Administrative Hearings (ADMN)

Action Plan: The administrative overhead assessment on DCCA's net revenue generating programs provides the principle funding for ADMN and is the mechanism by which the program will annually adjust its beginning fund balance. The Department will adjust the administrative overhead assessment for a fiscal year for any beginning cash balance in the recipient programs' accounts over and beyond that prescribed by the Department's fund balance reserve policy. Overhead will increase in FY 07 due to increases in electricity costs, and increased maintenance costs to the Department by both DAGS (15%) and the company contracted for outside maintenance (2.5%).

Justification: ADMN's operating costs are covered primarily by the administrative overhead assessment on DCCA's net revenue generating programs. Therefore, any beginning cash balance in excess of that necessary to ensure the continuation of program services into the new fiscal year, should be credited back to the revenue generating programs from where the funding was sourced.

Fiscal Impact: The program expects to reduce its fund balance in the current biennium from 3 to 2.8 months. This appears to be a reasonable reserve level for ADMN.

IV. CONCLUSION

DCCA has demonstrated an ongoing commitment to reducing its overall fund balances, and keeping its revenues aligned with its expenses. The plan has already borne significant fruit in the form of significant assessment reductions, exam fee waivers and fee cuts.

The Department will continue to strive to improve its services to customers by reducing fees where possible, making use of innovations in technology, keeping up to date with national management and services trends, and ensuring that its personnel receive the training necessary to fulfill its core mission of protecting consumers and providing a well-regulated business climate.