2016 Annual
Compliance Resolution Fund Report
to the Legislature

DEPARTMENT OF COMMERCE
AND CONSUMER AFFAIRS

STATE OF HAWAII

DIVISION OF FINANCIAL INSTITUTIONS (DFI)

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OVERVIEW

The Division of Financial Institutions (DFI) addresses the safety and soundness of state-chartered and state-licensed financial institutions, and ensures regulatory compliance by state-licensed financial institutions, escrow depositories, money transmitters, mortgage servicers, mortgage loan originators and mortgage loan originator companies, by fairly administering applicable statutes and rules, in order to protect the rights and funds of depositors, borrowers, consumers and other members of the public. In order to effectively regulate a growing and diverse group of industries and implement state and federal regulatory requirements, the DFI made changes to its licensing and examination programs to focus its resources on risk-based supervision.

DFI provides regulatory oversight for our State's financial service providers which includes both bank and nonbank industries. DFI provides supervision, regulation and examination of all Hawaii state-chartered and state-licensed financial institutions, including banks, foreign banking agencies and representative offices, savings banks, trust companies, and financial services loan companies (both depository and non-depository), and credit unions. In supervising financial institutions authorized to take deposits, DFI works closely with the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Bank of San Francisco (FRB), the Consumer Financial Protection Bureau (CFPB), and the National Credit Union Administration (NCUA).

DFI licenses and regulates, supervises and examines escrow depositories, money transmitters, mortgage servicers, mortgage loan originators and mortgage loan originator companies. DFI partners with other states and federal agencies to provide supervisory oversight on companies who operate and conduct business across the United States and outside the country. DFI also conducts examinations with the other states to pool resources and experience.

DFI was first accredited by the Conference of State Bank Supervisors (CSBS) in 1990 and re-accredited in 1995, 2000, 2005 and 2012[6]. The CSBS accreditation program sets high standards for state banking regulators nationwide. DFI will seek accreditation in 2018 for both banking and mortgage.

In 2Q FY2015, DFI was the eighteenth state in the nation to be accredited by the CSBS/AARMR[7] for mortgage supervision. The CSBS/AARMR accreditation program sets high standards for state mortgage regulators nationwide. The accreditation program includes the mortgage loan originator, mortgage loan

[6] Hawaii did not seek reaccreditation in 2010. With the new commissioner appointed in 2011, updates made to the banking supervision, regulation and examination, DFI received accreditation in 2012.

[7] American Association of Residential Mortgage Regulators is a trade organization for mortgage regulators.

originator companies, and mortgage servicer programs. Hawaii was also recognized in having a robust regulatory scheme and oversight, as well as a mature examination program.[8]

DFI is located at 335 Merchant Street, Room 221, Honolulu, Hawaii 96813. The public may call DFI at (808) 586-2820 or send e-mail to dfi@dcca.hawaii.gov or dfi-nmls@dcca.hawaii.gov (mortgage program).

Composition:

DFI is led by the Commissioner of Financial Institutions. The Commissioner is assisted by an *Administrative Section* consisting of the Deputy Commissioner, a specialist, a regulation analyst, and a secretarial staff supervised by the Secretary of the Division. This section coordinates and facilitates activities within DFI, with other divisions, and with other state and federal agencies regarding regulatory and supervisory oversight issues.

Within DFI, there are two branches: (1) the Field Examination Branch and (2) the Licensing and Regulatory Analysis Branch, each composed of financial institution examiners and supervised by its own Branch Manager. The *Field Examination Branch* is responsible for the on-site examination of all state-chartered and state-licensed financial institutions. Examinations, unlike accounting audits, are forward-looking and risk-based reviews of factors underlying the safety and soundness of the financial institutions. For example, examiners not only evaluate existing and projected financial information, but also assess the effectiveness of management, its policies, and implementation of those policies in administering the institution's risk management programs and practices. The field branch is divided into two sections, one to focus on the safety and soundness of our state-chartered banks and credit unions, the other section focuses on the compliance with federal and state regulatory laws and guidance for all industries.

The *Licensing and Regulatory Analysis Branch* is responsible for licensing activities and other regulatory approvals, the quarterly off-site monitoring program, responding to complaints and inquiries from consumers and licensees, and investigating alleged violations of state and federal laws. Licensing activities include review and analysis for all applications for new financial institutions (bank and nonbank), closure of any branches, opening or relocation of branches, addition of new or unique services to determine whether consumer may be harmed by the action of any licensee. The Licensing and Regulatory Analysis Branch Manager also assists the Deputy Commissioner in administrative matters such as legislation, training, and budgetary items. This branch has two sections, one focuses on banks, money transmitters and escrow depository matters and one focuses on the mortgage industry, including mortgage loan originators, mortgage loan originator companies, and mortgage servicers.

[8] In 2009, the Hawaii Safe and Fair Enforcement for Mortgage Licensing or SAFE Act was passed giving authority to DFI to supervise, regulate and examine mortgage loan originators and mortgage loan originator companies. In late 2010/early 2011, DFI began its supervision. In 2011-2012, DFI provided training to the industry. In 2013, DFI began its examination program.

GOALS and OBJECTIVES

Division Goals:

DFI's mission reflects the increased focus of the division's role in not only protecting consumers, but in educating them to protect themselves. Recent legislation in the financial services area reflects the need to educate consumers about the risks they take in using financial products. Regulation and appropriate enforcement, hand in hand with consumer education and awareness are the best defenses in protecting consumers. DFI faces a number of challenges in the next few years including the increasing risk of cybersecurity fueled by the innovative uses of technology, the impact of the economy on financial service providers and consumers; dealing with increased complexity in our financial institution companies and their products which can lead to increased opportunity for fraudulent activity; and dealing with the threat of federal preemption of our regulatory authority at a time when our services are needed the most.

Over the last five years, DFI's staffing has undergone a tremendous change, with 20 new staff members who work with technology to meet DFI's goals and objectives. In FY2016, DFI added seven new examiners. DFI's goals and objectives center on the orientation, training, and effective deployment of its Examiners and providing best practices to our licensees in a professional manner. Federal programs administered by the FDIC and the Federal Reserve System are regularly used for this purpose, as are web-based programs provided by CSBS, the Risk Management Association, and the Hawaii Bankers Association. On-the-job training is also a valuable component of the training plan. DFI's goals also focus on the recruitment of new staff who will be able to adjust to the rapidly changing landscape of the financial services industry. New financial service products continue to be created, modified, and initiated by licensees regulated and supervised by DFI. The delivery methods have also expanded with the use of the internet and mobile cellular telephones or other mobile devices and its concurrent impact of cybersecurity. Consequently, the orientation and training for examiners continues to be challenging to keep up to date with the latest iteration of products, services and delivery methods.

Objectives and Policies:

As a part of the CSBS accreditation process, DFI established a strategic plan and developed policies and operating guidelines to achieve plan objectives. DFI updates the plan annually. DFI's strategic plan is to:

- Stay relevant in a changing environment;
- Provide value for the services the division offers;
- Expand employees' respective skill sets;
- Embrace the new regulatory and compliance environment;
- Deliver effective and timely services; and
- Communicate in a respectful, timely and meaningful manner.

DFI's objectives are defined by its strategic plan and the policies to accomplish those objectives are imbedded within its policy and operating manuals.

Action Plan:

DFI's action plan is built around its strategic plan. The timetable calls for reaching its goals in a three to five year time frame as it must provide additional training for staff and provide new training to meet the regulatory needs required by the federal regulations and expected by consumers who use our financial institutions. DFI continues to explore various technology to improve its efficiency, databases, and outreach to consumers and licensees. In addition, DFI has joined other states in the supervisory oversight and examination of non-depository companies who conduct business in the United States and outside our country.

Performance Measurement:

DFI currently measures performance in two ways. The first is empirical – that is, absolute measurements based on the fiscal health and regulatory compliance of the State's DFI-regulated financial institutions using both regular financial- and examination-based measurements. The second is the measurement of DFI's internal throughput – that is, how many complaints have been answered, how many applications processed, etc. The first measurement is critical, especially in the current climate of global turmoil in the financial services industry, and demonstrates performance in DFI's key area of responsibility – to ensure the safety and soundness of Hawaii-chartered and licensed financial institutions. The second measurement is difficult to quantify since the complexity of the majority of the inquiries makes the review of both applications and complaints time and resource intensive. It takes many hours of research before a sound analysis of Hawaii's laws can be made to provide appropriate responses to inquiries. Likewise, consumer complaints or investigations are time consuming to work with the licensee about past practices, policies and procedures and determine whether the licensee acted appropriately with the consumer before DFI can determine whether the consumer was harmed. This second measurement provides DFI with insight related to innovations or original solutions taken by companies to address financial services. DFI is mindful that these measures alone do not necessarily provide complete indicators of the division's efforts or the activity happening at the various levels of regulation (state, federal).

ACCOMPLISHMENTS

1. Effective supervision – There are six Hawaii state-chartered banks in Hawaii, two out-of-state-chartered banks (CA and WA), two national banks, and one foreign bank. DFI directly supervises the six Hawaii state-chartered banks, oversees with its sister states the two out-of-state chartered banks, and oversees the one foreign bank. All state-chartered banks are operating in a safe and sound manner and complying with regulatory laws and guidance. As of 2Q FY2016, all state-chartered banks have reported increased earnings due in part to increased loan growth.
2. Use of technology for education – DFI used the technology of social media to provide free education to its licensees and consumers. DFI developed and maintains its website. DFI frequently updates its website with regulatory guidance or training videos and will "e-blast" the industry affected. DFI uses YouTube videos to provide education to licensees about regulatory compliance issues. Every year, DFI uploads a training session as a reminder to licensees about the renewal requirements, which has increased compliance and a quicker processing time to license renewal. Twitter has been used to quickly alert followers to new developments or information about fraud, elder financial abuse, cybersecurity, disaster planning, updates to our website, and upcoming training opportunities.

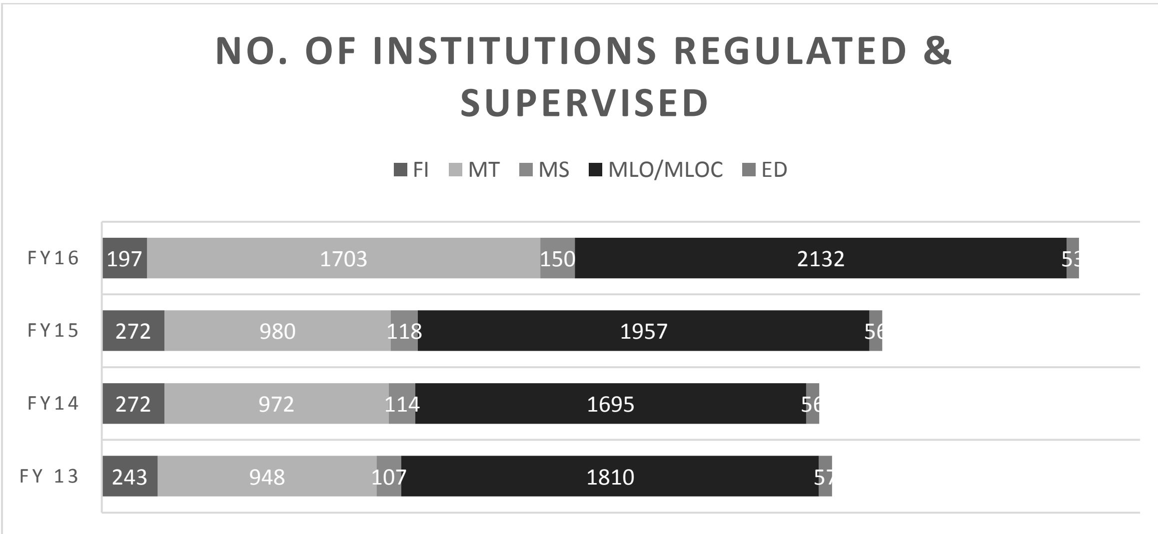
3. Use of technology for applications – DFI is using NMLS to process applications for mortgage loan originators, mortgage loan originator companies, mortgage servicers and money transmitters. In FY2016, DFI added escrow depository companies to NMLS, and worked with the State Legislature to ensure that the State's laws assist DFI with the use of NMLS for this purpose. This technology requires licensees and applicants to provide a response to each question before submitting an application to DFI for review. DFI communicates with applicants through a secure email channel.
4. Use of technology for examination requests – DFI is using a secured email system to both send and receive examination request information from licensees. Use of this technology has eased the communication between the examiner and licensee and lessened the number of days DFI spends on-site at any location.
5. Licensing branch – In FY2016, the licensing branch is current in its processing of requests from licensees, applicants, and consumers. This improvement, from the historic 120-180-day backlog, is due to the use of technology and the hiring of an examiner.
6. Field branch – DFI continues to take the lead as the regulatory agency for at least one bank examination and one visitation with the FDIC. DFI conducts multi-state examinations with other states for non-depository companies who conduct business in the United States and abroad.
7. Business Continuity/Disaster Planning – The Commissioner continues to participate with the financial institutions (all banks and credit unions) to improve communication and disaster planning.
8. CSBS District V – The Commissioner serves as the Chairperson for the CSBS District V, consisting of the commissioners for banking departments in the Western states of the United States. As Chair, the Commissioner coordinates semi-annual meetings of the District V (Western) states and territories to discuss emerging issues in supervision, regulation and examination with emphasis on issues affecting Alaska, Arizona, California, Guam, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, and Washington. The meetings also include representatives of the FDIC, FRB, CFPB, and the Office of the Comptroller of the Currency. The Commissioner also serves on several CSBS committees including the regulatory compliance, supervision, technology, and legislation with other Commissioners.

Efficiency:

The division continued its successful efforts to automate the initial application and renewal process for mortgage loan originators, mortgage loan originator companies, mortgage servicers, money transmitters and escrow depository companies. The automation effort includes the filing of additional documentation through the NMLS system. All states can share regulatory information with one another to assist in ongoing supervision, licensing and enforcement of multi-state licensees.

Workload:

DFI's workload has increased dramatically, both in the type and number of institutions regulated (see chart below) and in the scope and complexity of the work.



The complexity and security and privacy of the money transmitter industry has increased exponentially. Money transmitter companies use the newest technologies and are innovative in the way they transmit funds from person-to-person (P2P), business-to-business (B2B) and person-to-business (P2B). Following trends in other states, money transmitter companies are no longer "mom and pop" stores, but money transfers via virtual wallets and mobile devices, expanding use of internet money transfers and prepaid cards, the rise of virtual currencies, and rapidly developing technology. DFI is working to address these issues as they impact cybersecurity, consumer security and privacy, potential money laundering and fraud, and others.

DFI has implemented its examination program for mortgage loan originator companies and mortgage servicers. With over 370 licensed companies that need to be examined at least once every five years, DFI added additional examiners to properly examine these companies. Currently DFI has four field examiners conducting the examinations. To improve efficiencies, DFI has teamed with other states to conduct multi-state examinations on the larger mortgage loan originator companies and mortgage servicers. In addition, DFI has teamed with CFPB in examining very large mortgage loan originator companies and mortgage servicers (licensed in 35 states or more).

CRF Financial Summary

The CRF financial summary relating to DFI for FY2016 is as follows:

Personnel Expenses	Operating Expenses	Total Expenses	Revenues Received
$2,511,836	$422,794	$2,934,630	$5,115,594

CONCLUSION

During FY2016, while DFI maintained its established regulatory, supervisory, and licensing programs, and devoted considerable resources to implementing the newer mortgage servicer and mortgage loan originator examination programs, the division continues to work to find solutions to overcome its resource challenges. DFI believes that recent appropriations by the Legislature to increase its staffing will help improve DFI's ability to provide appropriate ongoing supervision, regulation and examination of licensees for the protection of consumers. DFI continues to use technology to inform and educate licensees and consumers, process applications from applicants and licensees, and conduct examinations on our licensees.

The long-term impact of the "global financial crisis" of the last decade, with its disruption to the normal pattern of financial services product delivery, has had an equally long-lasting impact on both the local economy and all financial institutions operating in the State (depository and non-depository). Increased supervisory oversight continues to be mandated by new federal laws and expected by consumers.

DFI continues to aggressively respond to these rapidly changing global and local economic conditions and pursues the active regulation and supervision of Hawaii-chartered and Hawaii-licensed financial institutions to preserve their safety and soundness and protect the rights of depositors, borrowers, consumers and other members of the community.