DIVISION OF FINANCIAL INSTITUTIONS

FY 2020-2021 OVERVIEW AND COMPOSITION

The Division of Financial Institutions (DFI) provides regulatory oversight for the State's financial service providers, which include both bank and nonbank companies. The 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, financial services loan companies (both depository and nondepository), money transmitters, mortgage loan originators and companies, mortgage servicers, escrow depositories, and credit unions.

In supervising financial institutions authorized to take deposits, the DFI works closely with the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Bank of San Francisco, Consumer Financial Protection Bureau, and National Credit Union Administration. The DFI supervises nondepository financial institutions with other state regulators through a system referred to as networked supervision. The partnerships with the federal bank regulators and networked supervision provides a comprehensive oversight over financial institutions.

During the COVID-19 pandemic, the DFI has been able to provide seamless services to applicants, licensees, and consumers. The DFI had the capability to work from home without any disruption of services because the DFI implemented electronic processing of applications, off-site examination processes, equipped all staff members with laptops and mobile wi-fi (if needed) since 2012.

The major functions of the DFI are to:

- Charter, supervise, regulate, and examine all state banks and credit unions, foreign bank branches, agencies and representative offices, and intra-Pacific branches.
- License, supervise, regulate, and examine nondepository companies, including escrow depositories, money transmitters, mortgage loan originators, mortgage loan originator companies, and mortgage loan originator branches, mortgage servicer companies and small dollar consumer lenders.
- Provide guidance to supervised financial institutions.
- Accept and investigate complaints by consumers.

The DFI is recognized by two accreditation organizations for appropriately licensing, supervising, and examining chartered and licensed companies, providing consumer protection to individuals, and providing the highest standards of training for its staff. The DFI was first accredited by the Conference of State Bank Supervisors (CSBS) in 1990 and reaccredited in 1995, 2000, 2005, 2012[1], and 2018. The CSBS accreditation program sets high standards for state banking regulators nationwide. Forty-seven out of 52 states[2] meet CSBS accreditation requirements. The DFI has

[1] Hawaii did not seek reaccreditation in 2010. A new commissioner was appointed in 2011.
[2] Includes the District of Columbia and Puerto Rico.[3] The next full accreditation review is scheduled for 2023.

been able to retain its accreditation status for banks and mortgage industry since 2018 through the annual accreditation review[3].

In 2Q FY 2015, the DFI was the eighteenth state in the nation to be accredited by the CSBS/American Association of Residential Mortgage Regulators (AARMR)[4] for mortgage supervision. The CSBS/AARMR accreditation program sets high standards for state mortgage regulators nationwide. Currently, 30 of 66 mortgage regulatory agencies meet CSBS/AARMR accreditation standards. The accreditation program includes mortgage loan originators, mortgage loan originator companies, and mortgage servicer programs.

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The **Administrative Section** coordinates and facilitates activities within the DFI, with other divisions, and with other state and federal agencies regarding regulatory and supervisory oversight issues.

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 reviewing and analyzing all applications for new financial institutions (bank and nonbank), opening, relocating, or closing branches, and adding new or unique services to determine whether consumers may be harmed by the action of any licensee. The branch reviews all license renewals for state and federal compliance before issuing an approval. The branch has two sections: one section focuses on emerging financial technology companies including money transmitters, while the other section focuses on the mortgage industry, including mortgage loan originators, mortgage loan originator companies, and mortgage servicers. This branch also oversees banks and escrow depositories and conducts investigations in all industries supervised by the DFI.

[3] The next full accreditation review is scheduled for 2023.
[4] The AARMR is a trade organization for mortgage regulators.

The **Field Examination Branch** is responsible for on-site and off-site examinations 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 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 branch is divided into two sections: one section focuses on the safety and soundness of state-chartered banks, credit unions, and money transmitters, while the other section focuses on compliance with federal and state regulatory laws and guidance for mortgage-related industries.

GOALS AND OBJECTIVES

- Maintain public confidence and trust in the financial system in a changing environment.
  - The DFI does not receive any general funds. Instead, the division receives funding from its chartered and licensed companies and individuals. DFI also receives almost half of its revenues from the franchise tax paid by the banks and other financial institutions. The DFI operates like a business, as it balances revenues and expenses to provide oversight and supervision for the benefit of Hawaii's residents.
  - The DFI keeps abreast of emerging technologies and financial products during the quickly evolving innovative products and services by fintech companies.
  - The DFI reviews and proposes changes to its laws to appropriately meet the everchanging environment in which it functions. The innovative business models and functions of licensees have changed the landscape of compliance to become complex and multifaceted. Instant fulfillment of services has become the norm for consumers, and the DFI struggles to continue maintaining proper supervision of licensees.
  - The DFI provides joint regulation, supervision, and examination of state-chartered financial institutions.
  - The DFI is the primary regulator for nondepository industries.

- Have an effective and collaborative workforce with satisfied and valued employees who see the DFI and DCCA as their employer of choice.
  - Since 2011, the DFI processes its work through electronic means and continues to expand the use of technology in processing work from applicants and licensees. Licensees apply for licenses, renewals, and any changes through a secure electronic channel. All processing of applications and requests occurs electronically. Examinations are also conducted electronically, where licensees provide examination documents through a secure channel. Examiners spend less time onsite with the licensee, saving money for the licensee and travel times by the examiners. The DFI still accepts paper inquiries and complaints from consumers, although more consumers have taken advantage of the DFI's online consumer complaint process.
  - The DFI developed a career path for employees to advance and retain employees.
  - The DFI has been successful in recruiting new employees and providing training through virtual sessions and on-the-job training.

  - The DFI leverages its resources with other state and federal agencies to provide oversight over state-chartered and licensed companies. This networked supervision involves communication skills to efficiently discuss and take appropriate action on licensees.

- Have effective and efficient operations and programs.
  - The DFI implemented a new database system and continues to work with the vendor to implement a workflow process.
  - The DFI continues to use the Nationwide Multistate Licensing System & Registry (NMLS) for licensing, supervision and examination of its nondepository licensees.

- Achieve the DFI's strategic objectives, which center on the orientation, training, and effective deployment of the division's examiners and providing best practices to licensees in a professional manner.
  - Federal training programs administered by the FDIC and the Federal Reserve System are regularly used for this purpose, as are web-based programs provided by the CSBS, AARMR, MTRA[5], NACCA[6], and Risk Management Association.
  - The DFI seeks to recruit new staff who, through on-the-job training, 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 that the DFI regulates and supervises.
  - DFI examiners aim to stay up-to-date with the latest iteration of financial products, services, and delivery methods, which have greatly expanded through technology and impact of cybersecurity.

ACCOMPLISHMENTS IN FY 2021

Impact of COVID-19 on DFI Operations

The DFI was well-prepared to continue serving the public, applicants, and licensees during the COVID-19 pandemic. There was no disruption of services with many consumers and licensees unaware we were still working from home. All team members had laptops, able to process consumer complaints via telephone or through email, able to process applications electronically, able to supervise licensees remotely, and able to conduct examinations off-site. DFI also continued to deliver training to licensees through webinars and live presentations on WebEx, Zoom, and Microsoft Teams.

The expectation by consumers was elevated during the pandemic, causing banks and our non-depository licensees to find solutions to deliver products and services in an effortless and seamless way. Consumers wanted instant responses and instant transactions for their financial activity. Consumers did not want to be "bogged down" with the security layers required by federal and state laws. Consequently, there was a constant push and pull by consumers and our financial industry

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[5] Money Transmitter Regulators Association is a national non-profit organization dedicated to the efficient and effective regulation of money transmission industry in the United States of America.

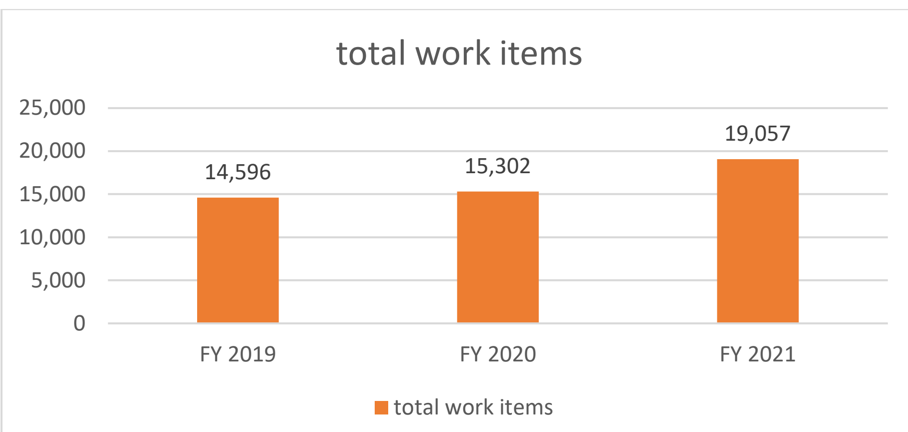
[6] National Association of Consumer Credit Administrators was formed to improve the supervision of consumer finance companies and to facilitate the administration of laws governing these companies.

to service consumers. This translated into using more financial technology ("fintech") by all financial institutions. Fintech companies exploded into the financial products and services arena, creating experiential and experimental pathways to traditional banking, mortgage, and money transmission activities (non-depository financial institutions). The DFI pivoted and started supervision and examining non-depository financial institutions for cybersecurity. This shift expanded the scope of the supervision and examination for the DFI, allowing DFI to review the cybersecurity protocols, policies, and procedures of the non-depository financial institutions.

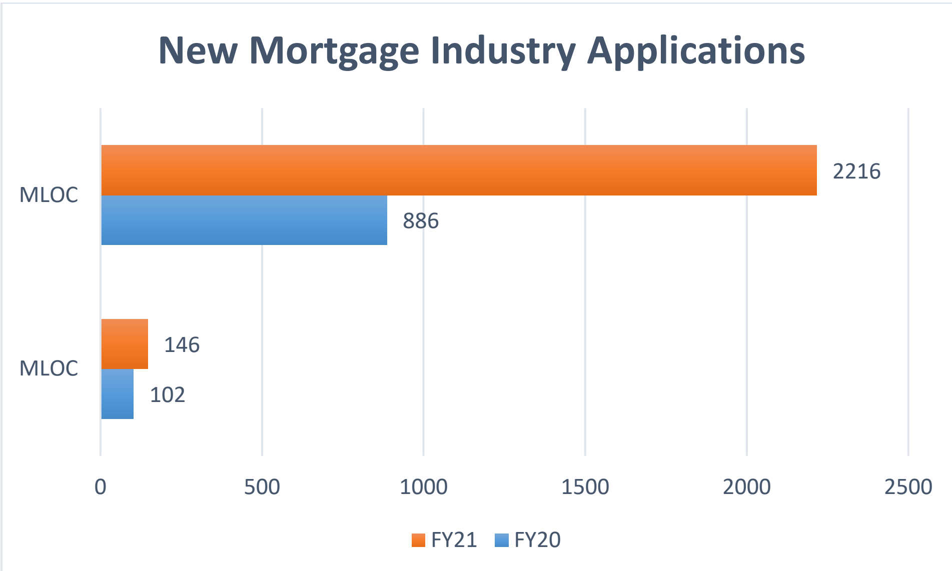
The DFI examination team, through the recently passed networked supervision provisions of Act 108 (SLH 2021), expanded its participation in multi-state examinations for money transmitters, mortgage loan originator companies, and mortgage servicer companies. In FY22, the DFI will participate in the first "One Company One Exam" on the largest mortgage loan originator company in the nation with 36 other states.

Through DFI's ongoing independent examination of licensees for compliance with laws, rules, and regulations, DFI examiners identified instances where consumers were harmed, resulting in DFI ordering licensees to return approximately $5.6 million to 716 consumers in CY2020. Consumers did not expect the restitution, and fearing a scam, the DFI also contacted the affected consumers to validate that the restitution checks were legitimate.

The DFI's licensing staff was overwhelmed by the number of work items submitted. These work items included amendments to the application for change in control by key individuals, name changes to the company, change of employers, and surrender of licenses. The DFI believes these changes were largely due to the pandemic circumstances with working from home and the type of employment available.

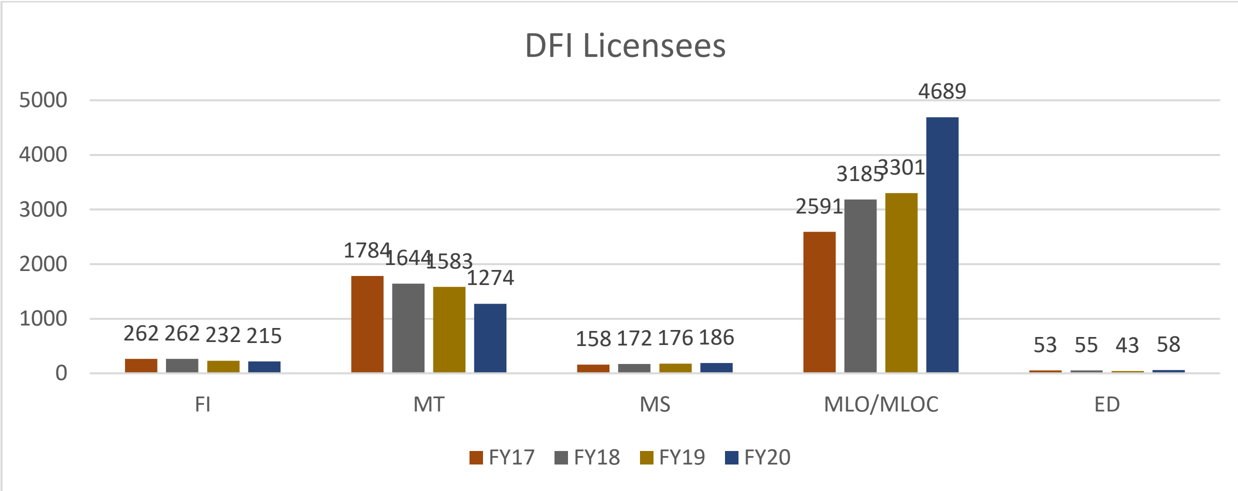


The most impactful activity for the DFI was the unprecedented number of applications by the mortgage industry. Around the country, as employees were either laid off or unable to work from home because of the pandemic, the mortgage industry appeared attractive. Mortgage loan originators were able to work from home and deliver loan documents electronically to consumers, and communicate through video conference calls or telephone calls. The DFI licensing staff, like staffs across the nation saw an explosion of applications throughout the year partially fueled by the low mortgage interest rates and low housing inventory. Processing times dramatically increased from an average of 10 days to 180 days.



The DFI team licensing money transmitters saw an increase in the number of applications from 14 in FY20 to 22 in FY21. The applications became increasingly complex as money transmitters used creative fintech applications and platforms to either request an exemption from the law or have such complex business structures, to make it difficult to determine how the flow of money occurred during the transactions. Additionally, many money transmitters became increasingly global, and had directors and key individuals (control persons of the company) outside the jurisdiction of the United States. This factor is one that the DFI continues to discuss with states about how discipline can be conducted for companies operated outside the jurisdiction of the United States.

Added to the number of applications, mortgage loan originator companies and money transmitter companies were making changes to their business models layering subsidiaries, affiliates, and related companies to facilitate the transactions. The DFI licensing team reviewed thousands of pages of business models, explanations, additional policies, and flow of funds to determine if consumers would continue to be protected by state and federal laws. These subsidiaries, affiliates and related company key individuals also had to be vetted to determine whether they met the regulatory criteria which proved to be difficult in some cases because of the global nature of the individuals.

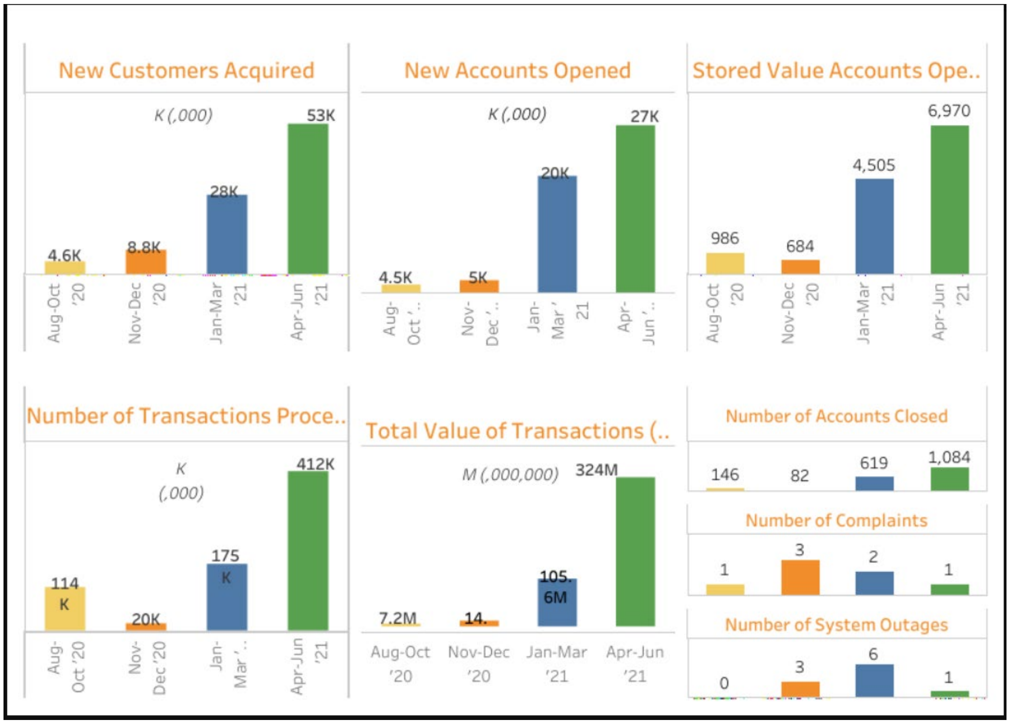


Digital Currency Innovation Lab

The Digital Currency Innovation Lab (DCIL) completed its first full year of participation with fifteen companies. The DCIL started operations in August 2020 with twelve companies[7]. In June 2021, another four companies were allowed to participate in the DCIL. The DCIL as of 06.30.21, had over 53,000 consumers taking part with the participating companies.

The DCIL was created to study whether the money transmitter law was the appropriate licensing scheme, and to determine whether digital currency companies should be licensed for consumer protection. The DFI will submit its interim report in late 2021 about what was learned so far, to report on various findings and high points with respect to ongoing supervision of the DCIL participant companies, and finally the recommendation for a new regulatory framework and licensing scheme to replace DCIL and enable consumer protection supervision of the digital currency industry.

[7] One company failed to comply with DCIL requirements and its membership was terminated.



Successful Pilot Testing

The DFI was one of six states (and the District of Columbia) piloting a complaints portal of a multi-state examination system with the CSBS. The State Examination System is used to conduct off-site examinations of nondepository licensees. This System is being used by the network of states which conduct examinations of nondepository companies.

Continued Accreditation status for Banking and Mortgage

The DFI was able to continue its accreditation status for banking and mortgage through the pandemic. The DFI team members were able to continue training, processing applications, providing on-going supervision, and conducting examinations off-site. The DFI team members worked with the FDIC, FRB, CFPB to coordinate on-going supervision and conduct examinations on our banks with all of the agencies working from home.

The network of states learned to work together to license companies and conduct examinations. The networked supervision allows states to use subject-matter experts to share expertise in the area of regulatory compliance, information security, cybersecurity, and financial analysis.

Although the DFI's partnership with other agencies and training is ongoing, every effort the DFI undertook sought to ensure the safety and soundness of the financial system, protect consumers, and encourage economic growth — all while promoting innovative and responsive supervision.
Lastly, through the efforts of state banking agencies, including the DFI, state regulators were represented through the State Liaison Committee on the Federal Financial Institutions Examination Council, which: issued updated Bank Secrecy Act examination procedures; issued new customer due diligence and beneficial ownership examination procedures; and identified areas of the supervisory process that could be modernized to reduce burden and improve efficiency.

CRF FINANCIAL SUMMARY FOR FY 2021

Personnel Expenses	Operating Expenses	Total Expenses	Revenues Received
$4,098,678	$736,090	$4,834,768	$54,779,655