DIVISION OF FINANCIAL INSTITUTIONS (DFI)

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), 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 (FRB), Consumer Financial Protection Bureau, and National Credit Union Administration.

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 and mortgage servicer companies.
- 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[10], and 2018. The CSBS accreditation program sets high standards for state banking regulators nationwide. Forty-seven out of 52 states[11] meet CSBS accreditation requirements.

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)[12] for mortgage supervision. The CSBS/AARMR accreditation program sets high standards for state mortgage regulators nationwide. Currently, 26 of 66 mortgage regulatory agencies meet CSBS/AARMR accreditation standards. The accreditation program includes the mortgage loan originators, mortgage loan originator companies, and mortgage servicer programs. Hawaii was also recognized for its robust regulatory scheme and oversight, as well as for its mature examination program.[13]

[10] Hawaii did not seek reaccreditation in 2010. A new commissioner was appointed in 2011.
[11] Includes the District of Columbia and Puerto Rico.
[12] The AARMR is a trade organization for mortgage regulators.
[13] In 2009, the Hawaii Secure and Fair Enforcement for Mortgage Licensing, or SAFE, Act was passed, giving the DFI authority to supervise, regulate, and examine mortgage loan originators and mortgage loan originator companies.

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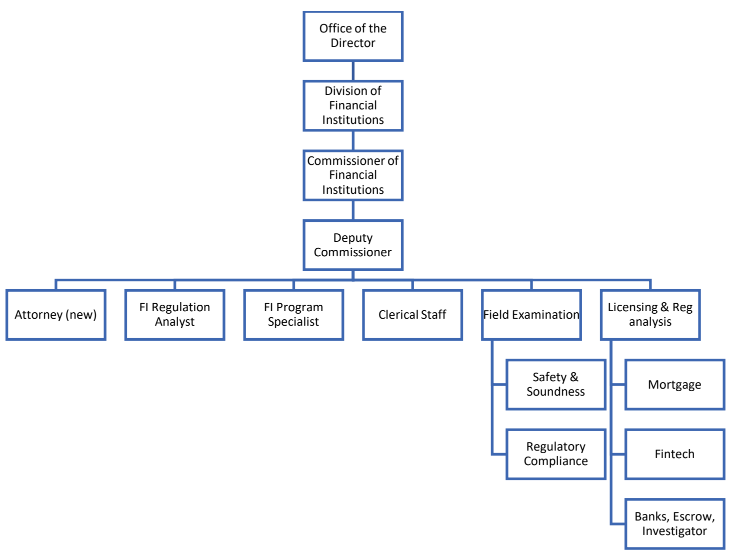
The DFI is led by the Commissioner of Financial Institutions, who is assisted by the **Administrative Section**, which has a deputy commissioner, a staff attorney, a specialist, a regulation analyst, and secretarial staff supervised by the secretary of the division. This section coordinates and facilitates 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 composed of financial institution examiners and supervised by a branch manager. The 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 (fintech) 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 includes an investigator who conducts investigations in all industries supervised by the DFI.

The **Field Examination Branch** is composed of financial institution examiners and supervised by a branch manager. The 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. 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 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 has been developing a career path for employees to advance and retain employees. The DFI has been successful in recruiting new employees and retaining employees once trained.
    - The DFI leverages its resources with other state and federal agencies to provide oversight over state-chartered and licensed companies. This coordination involves communication skills to efficiently discuss and take appropriate action on licensees.

- Have effective and efficient operations and programs.
    - The DFI continues to work with a vendor to implement a workflow process that would include a searchable database.
    - The DFI continues to use the Nationwide Multistate Licensing System (NMLS) for licensing and supervision of its nondepository licensees.

- Achieve the DFI's strategic objectives.
    - The DFI's goals and objectives center on the orientation, training, and effective deployment of its 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, Risk Management Association, and Hawaii Bankers Association. On-the-job training is also a valuable component of the training plan. The DFI's goals also focus on recruiting 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 the DFI. Delivery methods have also expanded through use of the internet, cellular phones, and other mobile devices, as well as their impact upon cybersecurity. Consequently, it is challenging for examiners to stay up-to-date with the latest iteration of products, services, and delivery methods.

ACCOMPLISHMENTS IN FY 2019

During FY 2019, the DFI strengthened its relationship with other sister state agencies, its federal partners, and the CSBS, AARMR, Money Transmitter Regulators Association, National Association of Consumer Credit Administrators, and the National Test Maintenance Committee.

- The Commissioner is a board member of the CSBS Board of Directors, the chairperson of the CSBS legislative committee, and a member of the CSBS District V region (Western states). The Commissioner provided training at the Money Transmitter Regulators Association school and conference.

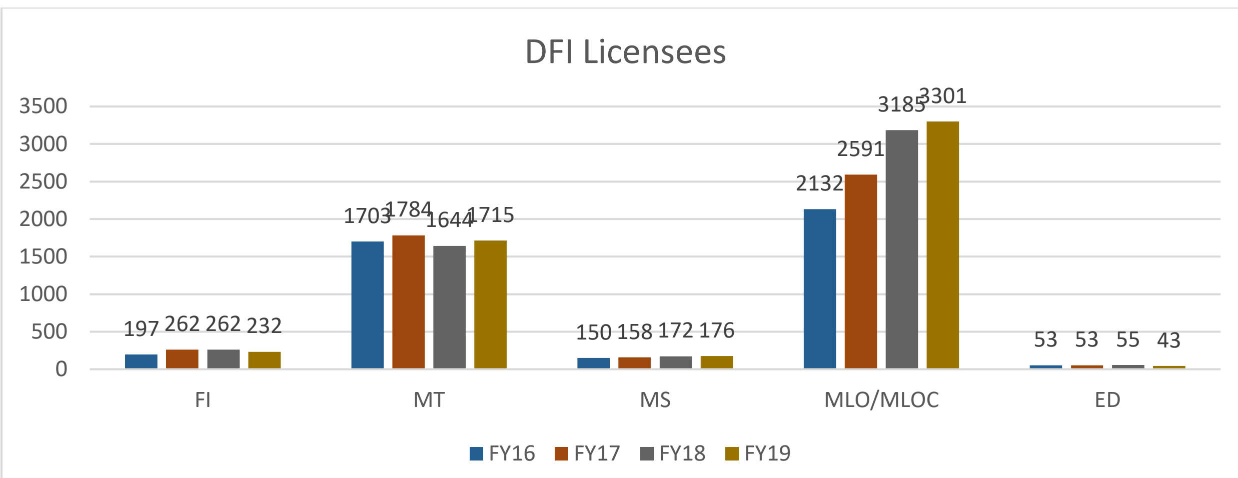
- The Deputy Commissioner is a member of the CSBS Performance Appraisal Committee. This committee reviews policies and best practices for bank, mortgage, and money transmitter accreditation.
- The Mortgage Supervisor is a member of the National Test Maintenance Committee, which is comprised of regulators, mortgage experts, and the mortgage industry.

The DFI continued to foster effective and efficient state regulation through training, educational programs, and examiner tools. Various examiners taught other state examiners about regulatory oversight, regulatory supervision, safety and soundness supervision, and money transmitter laws and examination procedures. Many DFI examiners and staff attended cybersecurity training to support consumer protections.

The DFI used the NMLS to license and register nonbank financial service providers (mortgage industry, money transmitters, and escrow companies). See below chart for the number of institutions the DFI regulated and supervised in FY 2016 through FY 2019.

Chart 1: Number of Institutions Regulated and Supervised

(FI = financial institutions; MT = money transmitters; MS = mortgage servicers; MLO = mortgage loan originators; MLOC = mortgage loan originator companies; ED = escrow depositories)



In addition, the DFI implemented two fintech solutions to assist in managing the supervision of DFI licensees. The DFI implemented the first fintech solution, which was a new database system and workflow system to replace the outdated legacy DFI database system. The second fintech solution was a nationwide solution through the NMLS. The NMLS system will allow the states to conduct multi-state examinations more efficiently and to share the examination reports. Hawaii is a member of the pilot program.

Although the DFI's partnership with other agencies and training is ongoing, every effort the division 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 2019

Personnel Expenses	Operating Expenses	Total Expenses	Revenues Received
$3,946,910	$813,251	$4,760,161	$5,503,582

As a special-funded division, the DFI receives approximately half its revenue in the second quarter of the FY from the renewal fees of nondepository licensees, and approximately half its revenue in the following FY from the franchise tax. The DFI targets to maintain a reserve of approximately 18 months to continue operations and have sufficient funding to replace its outdated database and records management system. With this target in mind, effective July 1, 2019, the DFI reduced by 50% the mandated renewal fees by licensed companies and individuals and annual assessments paid by state-chartered financial institutions. This reduction of renewal fees and assessments is for one year. In addition, the DFI ceased collection of fees for the mortgage loan recovery fund until the fund reaches the statutory level. However, the high cost customers incur to receive renumeration from the fund makes this recovery untenable for consumers.

As a result of this fee reduction, it is anticipated that in FY 2020, the DFI will exhaust the majority of its reserve, leaving it with an 18-month reserve, which is exactly what DFI the requires to continue operations and provide consumers protection. In FY 2021, the DFI will not have a sufficient reserve amount to continue operations at its current level. In FY 2022, unless fees are adjusted, the DFI will lack sufficient reserves to continue operations at its current level. During FY 2021, the DFI anticipates it will need to adjust fees for all industries to provide appropriate consumer protection and continue its operations.

	FY 2019	**FY 2020**	**FY 2021**	**FY 2022**
Estimated carryover beginning balance	$11,209,350	$10,794,204	$8,853,325	$8,371,967
Estimated ending balance	$10,794,204	$8,853,325	$8,371,967	$7,826,544
Estimated ending balance (number of months)	22.4	18.1	17.1	16.0

The DFI's reduction in revenue will impact its ability to regulate certain disruptors of the financial services industry, including:

- The proliferation of nonbank companies, including mortgage, money transmission, and escrow industries. Nonbank companies have entered nearly every sector of the financial services industry, due to the concentration of banking services in a few of the biggest mainland banks and the increase of unbanked and underbanked populations.
- Nonbank fintech companies, which deliver services through different channels and often in a more cost-effective manner. Fintech companies are largely unregulated, and there are issues surrounding compliance with consumer protection laws.
- Innovators from outside the banking industry that target unbanked and underbanked populations. These customers are generally financially insecure as a result of declining wages, increased income volatility, and eroding public and private safety nets. Their mistrust of banks seems to stem in part from the changes in the regulatory environment since the 2008 foreclosure financial crisis. The unbanked and underbanked populations also take note of the cultural difference between banks and nonbanks, with the latter embracing a more entrepreneurial nature and therefore providing more perceived personalized or customized services.

In addition, the DFI's reduction in revenue will hinder its ability to properly train its staff to regulate this rapidly evolving financial services landscape. The DFI is working with the CSBS to brainstorm ways to train examiners through multistate online training and through blogging to notify and receive just-in-time comments and advice from multistate examiners. However, these training options are costly, as most of the classroom training with the CSBS, FDIC, FRB, and trade organizations occurs out-of-state. Training and travel expenses will likely decrease or cease entirely in FY 2022, as the DFI will lack sufficient revenue to meet its operational needs. This, in turn, could cause the division to lose its accreditation, lose its skilled workforce, and most importantly, lose its ability to effectively supervise banks and nondepository licensees and to stop consumer harm by bad actors.

CONCLUSION

As the State's banking regulator, the DFI must retain its ability to protect Hawaii consumers while, at the same time, fostering an environment conducive to commerce. Nonbank companies are playing a larger and more integral role in the financial services industry, and they are increasingly interacting with consumers through their use of technology. State regulators, like the DFI, are at the forefront of nonbank company supervision. Consequently, the DFI has substantial experience in balancing consumer protections with concerns for developing efficient markets.

With respect to supervising financial institutions authorized to take deposits, the DFI, in conjunction with the FDIC and FRB, continues to maintain its dual responsibility of ensuring that business is conducted in a safe and sound manner and that consumers are protected. The DFI will continue to focus on three fundamentals of supervision: financial condition, compliance, and consumer protection. The division will monitor financial condition, test for compliance with laws and regulations, investigate situations of consumer harm, seek remediation or restitution, and impose enforcement orders in appropriate circumstances.

The DFI and its federal partners have provided Hawaii's state-chartered banks and financial institutions with the supervision necessary to operate in a safe and sound manner, and with adequate capital and capable management. During FY 2019, the DFI strove to overcome its resource challenges while it continued its regulatory, supervisory, and licensing programs and implemented its new mortgage servicer and mortgage loan originator examination programs. Previous legislative appropriations to increase DFI staffing should improve the division's ability to appropriately supervise, regulate, and examine licensees to protect consumers. In addition, the DFI continues to use technology and social media to inform and educate licensees and consumers, process applications from applicants and licensees, and conduct examinations on licensees.

Overall, the DFI has met its mission and goals through its service to applicants, state-chartered institutions, state-licensed companies and individuals, and Hawaii's residents. As nonbank companies and innovators from outside the banking industry increasingly disrupt the financial services landscape, the DFI will endeavor to keep pace with these rapid changes through appropriate training and licensee oversight.