

# SB1262

**Measure Title:** RELATING TO THE SECURE AND FAIR ENFORCEMENT FOR MORTGAGE LICENSING ACT.

**Report Title:** Secure and Fair Enforcement for Mortgage Licensing; Sole Proprietorship; Mortgage Loan Originator Companies; Business Hours; Mortgage Loan Recovery Fund

**Description:** Amends the definition of "sole proprietorship". Clarifies that mortgage loan originator companies may post language specifying that members of the public may be seen by appointment during posted business hours. Raises the target balance of the mortgage loan recovery fund and requires the insurance commissioner to adjust the assessed mortgage loan recovery fund fee once the target balance is reached.

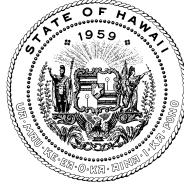
**Companion:**

**Package:** None

**Current Referral:** CPN, WAM

**Introducer(s):** BAKER, CHUN OAKLAND, KEITH-AGARAN, Espero, Ihara, Riviere, Taniguchi

| <u>Sort by Date</u> |   | <b>Status Text</b>                                                                                |
|---------------------|---|---------------------------------------------------------------------------------------------------|
| 1/29/2015           | S | Introduced.                                                                                       |
| 1/29/2015           | S | Passed First Reading.                                                                             |
| 1/29/2015           | S | Referred to CPN, WAM.                                                                             |
| 1/30/2015           | S | The committee(s) on CPN has scheduled a public hearing on 02-04-15 9:00AM in conference room 229. |



DAVID Y. IGE  
GOVERNOR  
SHAN S. TSUTSUI  
LT. GOVERNOR

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CATHERINE P. AWAKUNI COLÓN  
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TO THE  
SENATE COMMITTEE ON  
COMMERCE AND CONSUMER PROTECTION  
THE TWENTY-EIGHTH STATE LEGISLATURE  
REGULAR SESSION OF 2015

February 4, 2015  
9:00 a.m.

TESTIMONY ON S.B. NO. 1262

RELATING TO THE SECURE AND FAIR ENFORCEMENT  
FOR MORTGAGE LICENSING ACT

THE HONORABLE ROSALYN H. BAKER, CHAIR,  
AND MEMBERS OF THE COMMITTEE:

My name is Iris Ikeda, Commissioner of Financial Institutions ("Commissioner"), testifying on behalf of the Department of and Consumer Affairs ("Department") on Senate Bill No. 1262. The Department offers the following comments.

Senate Bill No. 1262 (1) amends the description of "sole proprietorship" in the Secure and Fair Enforcement for Mortgage Licensing Act (Chapter 454F, H.R.S.); (2) revises the requirements for posting business hours, and (3) revises the threshold and mechanism for replenishing the mortgage loan recovery fund.

## **Sole Proprietorship**

Section 454-1, HRS, defines “sole proprietorship”:

"Sole proprietorship" means a mortgage loan originator business that is solely and personally owned and operated by an individual mortgage loan originator, and where there is no legal distinction between the individual business owner and the business.

This definition makes it clear that the “sole proprietorship” category of mortgage loan originator (“MLO”) fees in section 454F-22(b), HRS, applies only to an MLO business that is solely and personally owned and operated by an individual mortgage loan originator, and where there is no legal distinction between the individual business owner and the business. The definition was added to Section 454F-1, HRS, by the 2014 legislature to clarify the collection of fees as DFI was able to obtain a license type called “sole proprietor” in NMLS for Hawaii.

A sole proprietor is distinguished from a one-person LLC through the assets and liabilities of the entity. A sole proprietor is a single person who receives all the income and is responsible for all the liabilities. A one-person LLC is a corporate entity where the corporation receives all the income and is responsible for all the liability; the individual is shielded from all income and can invest the income back into the business. The bill proposal would amend the definition by removing the phrase, “where there is no legal distinction between the individual business owner and the business”. However, that phrase was a purposeful part of the sole proprietorship definition to make it clear that a single owner/operator legal entity such as a corporation or LLC, is not eligible for the “sole proprietorship” category of MLO fees. Removing language from the definition as the bill proposes would cause confusion.

“Sole proprietorship” licensing application and renewals are simpler and less time consuming for DFI staff to review and process than non-sole proprietorship MLO applications and renewals. This is in part because non-sole proprietorship MLO applications involve a review of the records required of the legal entity to maintain its legal entity status, such as an LLC or corporation. Consequently, a different fee schedule was established for sole proprietorships and non-sole proprietorships.

The current definition of “sole proprietorship” is consistent with definitions used by government agencies such as the IRS and the SBA. The IRS.gov website explains: “A sole proprietor is someone who owns an unincorporated business by himself or herself. However, if you are the sole member of a domestic limited liability company (LLC), you are not a sole proprietor if you elect to treat the LLC as a corporation.” Similarly, SBA.gov provides this definition: “A sole proprietorship is the simplest and most common structure chosen to start a business. It is an unincorporated business owned and run by one individual with no distinction between the business and you, the owner. You are entitled to all profits and are responsible for all your business’s debts, losses and liabilities.”

DFI respectfully submits that amending the definition of “sole proprietorship” as this bill proposes, will cause unnecessary ambiguity and confusion in the interpretation of Chapter 454F, HRS. DFI submits concerns about the bill proposal’s amendment to the definition of “sole proprietorship”.

### **Office Hours by Appointment**

The public would be disserved by relaxing the MLOC office hour requirements of Section 454F-10.5, to require only that an MLOC be available “by appointment”, during posted business hours that are during regular business hours.

A mortgage loan is of paramount importance to a borrower. It is typically a 30-year commitment to pay hundreds of thousands of dollars, and the basis for a family's financial future. The home that secures the loan is often a family's largest investment. By appointment only may work for industries where potential consumer risks and licensee responsibilities are magnitudes lower. But by appointment only does not serve a stressed mortgage customer trying to understand important loan disclosures, terms, and last minute underwriting requirements, especially when loss of substantial escrow deposits, penalties and lawsuits are looming for failure to close on time. The current law requires very little of MLOCs in terms of office hours, and in view of the risk to consumers who cannot contact their MLO, it should not be changed.

DFI has made a genuine effort to work with the industry to provide flexibility to smaller MLO businesses. However, the record does not support the change proposed by the bill. DFI received 33 complaints in 2013 related to consumers being unable to reach their MLO. DFI found 14 of these complaints were of MLOs working from virtual offices with no physical business location open to the public, or MLOs who listed an address for NMLS but had no rental or lease agreement at the specified location.

In response, the 2014 Legislature amended Chapter 454F to require an MLOC location to be open for business to the public during posted business hours, which must be during regular business hours (the latter is defined as Monday through Friday,

between 8 a.m. and 4:30 p.m., excluding State holidays). Even after passage of the 2014 amendments to Chapter 454F, DFI received 22 complaints related to consumers being unable to reach their MLO. DFI investigations found that in eight of the complaints, the MLO was working from a virtual office and had no physical location. While DFI understands that appointments make sense for busy MLOs, DFI does not support an amendment that would allow an MLOC to be open for business to the public by appointment only, during posted business hours which are during regular business hours.

#### **Mortgage Loan Recovery Fund**

DFI has concerns about the bill proposal's amendment to the Mortgage Loan Recovery Fund ("MLRF"). Section 454F-41(d), HRS, authorizes the Commissioner to adjust or cease collection of fees generated by renewals, by rule, when the MLRF reaches \$750,000. The Department of the Attorney General is reviewing a rule drafted by the Department to enable the Commissioner to exercise this authority. The rule adoption process of Chapter 91, HRS, will follow as contemplated by Section 454F-41. The rule would allow that the Commissioner can suspend or adjust the amount collected at renewal for the next licensing cycle if the balance is more than \$750,000. The Commissioner must make a finding that the collection of the entire fee in the next licensing cycle is not reasonably needed in order for the MLRF to pay its obligations as they become due.

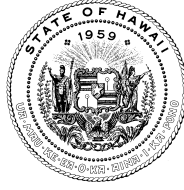
The bill proposal basically sets a \$750,000 floor and \$1 million ceiling on the MLRF balance. This does not provide flexibility in the likely event that the circuit court

orders payouts from the MLRF. DFI therefore submits concerns about the bill proposal's amendment to the MLRF in view of our rule proposal.

Finally, DFI notes that page 3, line 2 of the bill proposal refers to the "insurance commissioner" in connection with the MLRF. The Commissioner of Financial Institutions oversees the MLRF pursuant to Section 454F-41, HRS.

DFI has concerns about this bill, Senate Bill No. 1262, and the unintended consequences that may ensue.

Thank you for the opportunity to testify. I would be pleased to respond to any questions you may have.



DAVID Y. IGE  
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TO THE SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION  
THE TWENTY-EIGHTH LEGISLATURE  
REGULAR SESSION OF 2015

Date: Wednesday, February 4, 2015  
Time: 9:00 a.m.  
Conference Room: 229

**TESTIMONY ON SENATE BILL NO. 1262**  
**RELATING TO SECURE AND FAIR ENFORCEMENT FOR MORTGAGE LICENSING**  
**ACT**

TO THE HONORABLE ROSALYN H. BAKER, CHAIR, AND MEMBERS OF THE COMMITTEE:

Thank you for the opportunity to testify. My name is Tung Chan, Commissioner of Securities and head of the Business Registration Division of the Department of Commerce and Consumer Affairs. We offer comments regarding the bill's impact to business registration law and take no position beyond our area of expertise.

First, there appears to be a minor misstatement in the preamble which refers to a "limited liability corporation." The term "limited liability corporation" is not a recognized business entity. The word "corporation" should be changed to "company" if the intent was to refer to limited liability companies ("LLCs").

Second, we strongly do not recommend the proposed amendment to the definition of "Sole proprietorship" that deletes the phrase "there is no legal distinction between the individual business owner and the business". "Sole proprietorship" is a



very well-established legal term of art and its primary key feature is that “there is no legal distinction between the individual business owner and the business,” as compared to other entities like for example, an LLC which is expressly defined as “a legal entity distinct from its members.” HRS §428-201.

To modify the key feature of a sole proprietorship, especially when it creates ambiguity between it and other well-established business entities like LLCs, seems ill-advised since it may undermine the settled legal, business and tax distinctions that have accrued to sole proprietorships in the law and through the courts. In fact, the Hawaii Intermediate Court of Appeals noted the importance of this particular feature of sole proprietorships in Credit Associates of Maui, Ltd. v. Carlborn, 98 Haw. 462, 465-66, 50 P.3d 431, 434-35 (Ct. App. 2002) where it wrote, “a sole proprietorship has no legal identity apart from its owner.” The court then took efforts to re-emphasize this critical point. To delete this fundamental feature of a sole proprietorship creates a high probability of unintended consequences in any future court interpretations.

For these reasons, we do not recommend the proposed change to this fundamental understanding of a sole proprietorship and we recommend great caution. If the bill's main goal is not to alter this very well-established term of art, we respectfully ask the Committee to explore an alternate drafting solution and we offer our services to assist. Thank you for the opportunity to testify. I would be happy to answer any questions the Committee may have.



February 4, 2015

TO: COMMITTEE ON COMMERCE AND CONSUMER PROTECTION  
Senator Rosalyn Baker, Chair  
Senator Brian Taniguchi, Vice Chair

FR: Cathy Lee, President  
Hawaii Association of Mortgage Brokers

RE: S.B. 1262 Relating to the Secure and Fair Enforcement for Mortgage Licensing Act.  
**Position: Support**

Dear Chair Roslyn Baker, Vice Chair Brian Taniguchi and members,

Thank you for this opportunity to testify in support of SB 1262, a bill relating to the Secure and Fair Enforcement for Mortgage Licensing Act. I am here to provide testimony on behalf of the Hawaii Association of Mortgage Brokers, a non-profit organization of mortgage professionals dedicated to promoting high standards of professionalism in the mortgage industry through education and representation.

HAMB supports this bill which seeks to update provisions of Hawaii's mortgage loan origination laws to conform to the industry's current operations. The bill's purpose clause clearly expresses the reasons for these changes. First, the definition of sole proprietor is being amended to include Mortgage Loan Origination Companies (MLOC) owned and operated by a single loan originator. This change allows these small MLOCs to take advantage of lower registration and renewal fees. There are currently about 35 MLOCs that will be affected by this change.

The next proposed change allows MLOCs the flexibility to operate their businesses to best meet the needs of their clients. Mortgage loan originators are often asked to meet outside of their office at a location convenient for the client. In addition, the originators are frequently required to attend real estate deal closings at the offices of other professionals involved in the transaction. The current version of the law requiring the originators to be present at their office during set hours, does not provide enough flexibility to accommodate these activities.

The final proposed change would provide abatement of mortgage loan recovery fund fee collection when the fund totals more than \$1,000,000. We support the collection and accumulation of fees to provide funds to help compensate individuals harmed by unscrupulous mortgage loan originators. When this fund was established a few years ago, it was intended to

be collected to build up a pool of \$750,000 to pay claims. However, the most recent report to the legislature shows the fund at more than \$1,100,000, far above the original target. Although the current law provides the Commissioner of the Division of Financial Institutions the discretion to suspend mortgage loan recovery fund fee collections, that discretion has not been exercised. This bill would provide for the automatic abatement of the collection of renewal fees unless and until the fund is reduced to less than \$750,000. At that point, the fee collection would be reinstated. This change will save each renewing licensee at least \$300 next year.

We would also recommend a change to page 3, line 2 which incorrectly refers to the insurance commissioner. The correct reference would be to the Commissioner of the Division of Financial Institutions.

We respectfully request that you approve SB 1262 and refer it to the Committee on Ways and Means for further consideration. I am available to answer any questions you may have.



KAILUA MORTGAGE

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**Testimony on SB 1262**

Hearing date: February 4, 2015 9:00 am

**IN SUPPORT**

Chair Roslyn Baker and Vice Chair Brian Taniguchi

Thank you for the opportunity to present testimony on this bill related to the SAFE Act dealing with mortgage loan originations

There are three issues warranting modification of the current statute

1. Definition of Sole Proprietor in relation to fees collected

As originally understood by the industry, Chap 454F was modified to provide a fee reduction for “one person shops”, meaning a single owner who is the only Mortgage Loan Originator licensed. The definition was seriously restricted in 2014 to eliminate the majority of single person operations should they avail themselves of LLC, Sub S or C Corp status. SB 1262 sets the definition as the Hawaii industry understood it to be when it originally supported the reduction

2. Use of “by appointment” as a legitimate public notice form

A literal interpretation of the existing statute anchors mortgage personnel to their physical location for fixed hours which is not the normal flexible operating mode

3. Modify the funding triggers for the Mortgage Loan Recover Fund

The proposal raises the funding target levels in exchange for clarity on the fund collection process once trigger targets are reached.

**Claude Phillips** - NMLS 338964

Mortgage Loan Originator