

HAWAII ADMINISTRATIVE RULES

TITLE 16

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

CHAPTER 27

SUPERVISORY AND ENFORCEMENT ACTION
RELATING TO HAWAII FINANCIAL INSTITUTIONS

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SUBCHAPTER 1

GENERAL PROVISIONS

§16-27-1 Objectives. The objectives of this chapter are to assure that supervisory and enforcement actions are directed to institutions whose condition warrants greater regulatory oversight, and to assure uniformity of such actions by the division of financial institutions. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100, 412:2-107, 412:2-300, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-300, 412:2-600)

§16-27-2 Definitions. As used in this chapter:

"Commissioner" means the commissioner of financial institutions of this State.

"Division" means the division of financial institutions of the department of commerce and consumer affairs of this State.

"Hawaii financial institution" or "institution" means:

(1) A corporation or credit union which holds a charter or license under chapter 412, HRS, or under prior Hawaii law, authorizing it to accept deposits, to make loans in excess of the rates permitted in chapter 478, HRS, or to engage in the business of a trust company; or

(2) A resulting bank as defined in article 12 of chapter 412, HRS, and includes a corporation, mutual savings and loan association or credit union existing and chartered as a Hawaii financial institution or licensed to transact business in this State on July 1, 1993. A Hawaii financial institution may be a bank, resulting bank as defined in article 12 of chapter 412, HRS, savings bank, savings and loan association, depository financial services loan company, nondepository financial services loan company, trust company, credit union, or intra-Pacific bank.

"Institution-affiliated party" means any of the following:

(1) Any director, officer, employee, or controlling shareholder of, or agent for, or other person that controls a financial institution;

(2) Any person who has filed or is required to file an application to become a financial institution with the commissioner or an application to acquire control of a Hawaii financial institution or financial institution holding company with the commissioner;

- (3) Any shareholder, consultant, joint venture partner, and any other person as determined by the commissioner (by rule or case-by-case) who participates in the conduct of the affairs of a financial institution; or
- (4) Any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any of the following which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the financial institution:
 - (A) Any violation of law or rule;
 - (B) Any breach of fiduciary duty; or
 - (C) Any unsafe or unsound practice.

"NRS" (Nondepository Rating System) means the rating system for nondepository financial services loan companies adopted by the division pursuant to section 16-26-8.

"UFIRS" (Uniform Financial Institutions Rating System) means the policy statement which was issued and recommended by the Federal Financial Institutions Examination Council, and adopted by the division, pursuant to section 16-26-7. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100, 412:2-107) (Imp: HRS §§412:1-109, 412:2-100)

SUBCHAPTER 2

BASIS FOR SUPERVISORY AND ENFORCEMENT ACTION

§16-27-8 Authorized actions by commissioner. (a) The commissioner has broad supervisory and enforcement powers under chapter 412, HRS. The commissioner has the power to direct a Hawaii financial institution to discontinue any violation of law or rule, or any unsafe or unsound practice, or to cease the conduct of its business in an unsafe or unsound manner. Failure or refusal to comply with the commissioner's order shall be deemed a violation of law.

(b) If an institution fails to comply with the commissioner's order, the commissioner may exercise such supervision, control, and management over the institution as the commissioner deems necessary for the public welfare, including, but not limited to, the appointment of a receiver.

(c) Supervisory or enforcement action shall be taken on institutions which have been assigned a UFIRS or NRS composite rating of "3", "4", or "5", unless circumstances do not warrant the use of such supervisory tools. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100,

412:2-107, 412:2-300, 412:2-301, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-300, 412:2-301, 412:2-400, 412:2-600)

§16-27-9 Unsafe or unsound practice. (a) The concept of an unsafe or unsound practice is one of general application which touches upon the entire field of operations of an institution.

An unsafe or unsound practice encompasses any action or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would result in abnormal risk of loss or damage to an institution, its depositors, or its shareholders. An activity not necessarily unsafe or unsound in every instance may be so in a particular instance when considered in light of all relevant facts pertaining to that situation.

(b) An unsafe or unsound practice can result from either action or inaction by management. Although the law does not define the term unsafe or unsound practice, the division has established examples of such practices, some of which are listed below.

(c) Inaction by management which is deemed an unsafe or unsound practice includes, but is not limited to:

- (1) Failure to provide adequate supervision and direction over officers of the institution;
- (2) Failure to make provision for an adequate reserve for possible loan losses;
- (3) Failure to post the general ledger promptly;
- (4) Failure to keep accurate books and records;
- (5) Failure to enforce programs for repayment of loans;
- (6) Failure to obtain or maintain on the premises evidence of priority of liens on loans secured by real estate; or
- (7) Failure to account properly for transactions.

(d) Action by management which is deemed an unsafe or unsound practice includes, but is not limited to:

- (1) Operating with an inadequate level of capital for the kind and quality of assets held;
- (2) Engaging in hazardous lending or lax collection practices such as: extending credit which is inadequately secured, extending credit without first obtaining complete and current financial information, extending credit in the form of overdrafts without adequate controls, and extending credit with inadequate diversification of risk;

- (3) Operating without adequate liquidity, in light of the institution's asset and liability mix;
- (4) Operating without adequate internal controls such as: failing to maintain controls on official checks and unissued certificates of deposit, failing to segregate duties of institution personnel, and failing to reconcile differences in correspondent bank accounts;
- (5) Engaging in speculative or hazardous investment policies; or
- (6) Paying excessive dividends in relation to the institution's capital position, earnings capacity, and asset quality. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100, 412:2-107, 412:2-300, 412:2-301, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-300, 412:2-301, 412:2-302, 412:2-306, 412:2-308, 412:2-311, 412:2-314, 412:2-315, 412:2-400, 412:12-109, 412:13-224, 412:13-228, 412:13-229, 412:13-230)

§16-27-10 Unsafe or unsound condition. (a) An unsafe or unsound condition of an institution depends upon an analysis of virtually every aspect of the institution's operation. The institution's capital position, asset condition, management, earnings posture, liquidity position, and sensitivity to market risk shall be carefully evaluated. An institution's condition need not deteriorate to a point where it is on the brink of insolvency before its condition may be found to be unsafe or unsound.

(b) Although not an all-inclusive list, the following are examples of unsafe or unsound conditions:

- (1) Maintenance of unduly low net interest margins;
- (2) Excessive overhead expenses;
- (3) Excessive volume of loans subject to adverse classification;
- (4) Excessive net loan losses;
- (5) Excessive volume of overdue loans;
- (6) Excessive volume of nonearning assets; or
- (7) Excessive large liability dependence. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100, 412:2-107, 412:2-300, 412:2-301, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-300, 412:2-301, 412:2-302, 412:2-306, 412:2-308, 412:2-311, 412:2-314, 412:2-315, 412:2-400, 412:12-109, 412:13-224, 412:13-228, 412:13-229, 412:13-230)

SUBCHAPTER 3

INFORMAL SUPERVISORY AND ENFORCEMENT ACTION

§16-27-16 Memorandum of understanding. (a) Informal action by means of a memorandum of understanding shall be considered for institutions which have been assigned a UFIRS or NRS composite "3" rating. The memorandum of understanding is a means of seeking informal corrective administrative action from institutions considered to be of supervisory concern, but which have not deteriorated to the point where they warrant formal administrative action. The purpose of the memorandum is to correct an institution's weaknesses by focusing on the institution's problem areas and defining responsibility for ensuring that deficiencies are addressed within designated time periods.

(b) The memorandum of understanding shall be signed by the commissioner and the institution's board of directors. In all instances, the respective federal authority shall be invited to join in this action.

(c) The memorandum of understanding shall address the specific problems of an individual institution. Use of the memorandum, as opposed to formal supervisory and enforcement action, is appropriate where the problems discussed with management and the board of directors of the institution have been adequately detailed and the institution, in good faith, will work to eliminate the problems. An institution's failure to comply with the provisions of the memorandum, or continued deterioration in the areas addressed in the memorandum, may facilitate implementation of formal administrative action.

(d) Monitoring of an outstanding memorandum of understanding may be conducted by the division through progress reports, visitations, or examinations.

(e) Termination of a memorandum of understanding shall be considered when the institution's overall condition has improved significantly and the institution has substantially complied with the terms of the memorandum. The division shall coordinate any termination with the federal authority, if the latter is a party to the action.

(f) General use of a memorandum of understanding for a UFIRS or NRS composite "3" rated institution does not preclude recourse to formal supervisory and enforcement action when it is believed that management is unwilling to take necessary corrective action.

(g) The memorandum of understanding may be used in a situation where other than a UFIRS or NRS composite "3" rating is assigned, depending on the circumstances. [Eff 8/13/87; am and comp 1/27/01] (Auth:

HRS §§412:2-100, 412:2-107, 412:2-300, 412:2-301, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-300, 412:2-301, 412:12-109, 412:13-224)

SUBCHAPTER 4

FORMAL SUPERVISORY AND ENFORCEMENT ACTION

§16-27-22 Institutions rated "4" or "5". (a) Institutions with UFIRS or NRS composite ratings of "4" or "5" by definition will have problems of sufficient severity to warrant formal supervisory and enforcement action. Formal action may be taken against institutions rated "4" or "5", where evidence of an unsafe or unsound practice or condition is present. The formal action may consist of a cease and desist order, or order to suspend or remove an institution-affiliated party.

(b) The commissioner may consider not taking formal action when the condition of the institution reflects significant improvement resulting from an effective corrective program or where individual circumstances strongly mitigate the appropriateness of the action. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100, 412:2-107, 412:2-300, 412:2-301, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-300, 412:2-301, 412:2-302, 412:2-306, 412:2-308, 412:2-311, 412:2-314, 412:2-315, 412:2-400, 412:2-401, 412:2-402, 412:2-500, 412:2-501, 412:2-600, 412:2-601, 412:12-109, 412:13-224, 412:13-228, 412:13-229, 412:13-230)

§16-27-23 Compliance with cease and desist order. (a) When a cease and desist order is issued under part III of article 2 of chapter 412, HRS, the periods for compliance with the various provisions of the cease and desist order are determined based on the circumstances and may include different periods ranging from thirty days to twelve months or more, from the effective date of the order. A cease and desist order may specify intervals setting forth the form and manner of compliance with the substantive requirements of the order.

(b) A visitation may be made as a cross-check on the accuracy of the institution's progress reports and its degree of compliance with the cease and desist order. Examinations of the institution may also be conducted to determine compliance with the order and may be scheduled to coincide with one of the specific corrective periods stated in the order. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-100, 412:2-107, 412:2-300, 412:2-301, 412:12-109, 412:13-224) (Imp: HRS §§412:2-100, 412:2-301, 412:2-302, 412:2-303, 412:2-304, 412:2-305, 412:12-109, 412:13-224)

§16-27-24

§16-27-24 Repealed. [R 1/27/01]

§16-27-25 Repealed. [R 1/27/01]

§16-27-26 Repealed. [R 1/27/01]

§16-27-27 Repealed. [R 1/27/01]

§16-27-28 Repealed. [R 1/27/01]

Amendments to and compilation of chapter 16-27, Hawaii Administrative Rules, on the Summary Page dated December 11, 2000, were adopted on December 11, 2000, following a public hearing held on the same date, after public notice was given in the Hawaii State and County Public Notices for the City and County of Honolulu, County of Kauai, County of Maui and the County of Hawaii on November 6, 2000.

These amendments shall take effect ten days after filing with the Office of the Lieutenant Governor.

/s/ Lynn Y. Wakatsuki
LYNN Y. WAKATSUKI
Commissioner of Financial Institutions

APPROVED AS TO FORM: Date 1/04/01

/s/ James C. Paige
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APPROVED: Date 1/04/01

/s/ Kathryn S. Matayoshi
KATHRYN S. MATAYOSHI, Director
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APPROVED: Date 1/11/01

/s/ Benjamin J. Cayetano
BENJAMIN J. CAYETANO
Governor
State of Hawaii

January 17, 2001
Filed

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Amendment and Compilation of Chapter 16-27
Hawaii Administrative Rules

December 11, 2000

SUMMARY

1. §§16-27-1 and 16-27-2 are amended.
2. §§16-27-8 through 16-27-10 are amended.
3. §16-27-16 is amended.
4. §§16-27-22 and 16-27-23 are amended.
5. §§16-27-24 through 16-27-28 are repealed.
6. Chapter 27 is compiled.

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Effective 1/27/01