Credit Union Commission

Staff Report

Texas Sunset Advisory Commission

1996

TEXAS SUNSET ADVISORY COMMISSION

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In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 10-member Commission is a legislative body that reviews the policies and programs of more than 150 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency's operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them.

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EXECUTIVE SUMMARY

Executive Summary

Credit unions in Texas have become increasingly important to the state's economy and to the general public. More than 1.7 million Texans have about $7 billion worth of assets in credit unions regulated by the state. The Texas Legislature created the Texas Credit Union Commission to oversee the regulation of state-chartered credit unions. The Commission appoints a Credit Union Commissioner who employs staff to operate the Credit Union Department. The Department supervises each credit union under its jurisdiction through examinations and detailed reviews to ensure adherence to the Act as well as the rules adopted by the Commission. State regulations cover such areas as credit union fields of membership, loan practices, investment activity, and accounting and funds management.

The Sunset staff looked at credit union regulation and the Department's efforts to provide effective supervision. The review focused primarily on the Commission and its ability to function as a public policy board. Staff reviewed the Department's practices regarding public notice and participation in Commissioner decisions as well as its status as an independent agency. The following material describes the results of the review.

1. Increase the Public Perspective of the Credit Union Commission by Requiring a Public Member Majority.

The Commission, composed of six industry representatives and three public members, is dominated by the industry it regulates. This industry domination has come at the expense of public participation and is not necessary for the Commission to function effectively.

***Recommendation*:** Provide the Credit Union Commission with a majority of public members. Require the Commission to adopt rules on recusal of members, public notice of Commission activities, and credit union mergers.

2. Ensure Adequate Public Notice and Opportunity for Input Regarding Proposed New or Expanded Credit Unions.

The important role that credit unions play in providing affordable financial services to Texans makes the Department's regulation of credit unions of interest to the public. However, the Department has established procedures that prevent the public from knowing about or commenting on decisions regarding new or expanding credit unions. The Legislature's policy is for state agencies to provide for public notice and comment when conducting state business. The Department should follow such procedures.

***Recommendation*:** Require the Credit Union Commissioner to notify the public of applications for credit union charters, field of membership expansions, and mergers. Require the Commissioner to allow for public comment and opportunity to testify before deciding charters, fields of membership expansions, and mergers.

3. Continue the Credit Union Commission for four years.

The Department's function in regulating credit unions continues to be needed. While the Department performs this function effectively, the Legislature has a history of interest in consolidating the state's financial regulatory agencies. This interest has centered on the Finance Commission performing as an umbrella agency with separate Departments regulating the different financial industries. The Finance Commission currently regulates banks, thrifts, and consumer credit companies, but not credit unions. Sunset staff reviewed the question of consolidation and found a complex set of issues that demonstrated the need for a full analysis of financial regulatory consolidation, which would be an appropriate part of the Sunset review of the Finance Commission in 2001.

Recommendation: Continue the Credit Union Commission for four years. Charge the Sunset Commission with evaluating the structure of the state's financial regulatory agencies in its reviews in 2001. Require the Credit Union Commission and the Finance Commission to jointly review their laws and rules to identify areas of consistency and inconsistency.

Fiscal Impact Summary

The recommendation to continue the Commission would require its annual appropriations of approximately $1.25 million to continue. This recommendation also requires the Department to conduct a review of its rules, and the Credit Union Commission and the Finance Commission may incur some expense in conducting this study. However, the exact amount of this expense cannot be estimated. The recommendations concerning the Commission structure and public notice have no fiscal impact.

Approach and Results

Approach and Results

Approach

The Texas Credit Union Commission (Commission) exists to safeguard the public through regulation of the state's credit unions. Credit unions are non-profit associations owned by their members for the purpose of gaining access to low-cost financial services. The state has chartered credit unions since 1913 when the Legislature passed the Rural Credit Union Act. The Commission oversees the Credit Union Commissioner (Commissioner) and the Credit Union Department (Department). The Department regulates credit unions through annual on-site examinations, follow-up examinations of credit unions with deficiencies, and the use of administrative sanctions against credit unions that fail to comply with state standards.

The Sunset review focused on improving public access to the Department's decisions about credit unions.

In forming the approach to the Sunset review, staff evaluated the dual-chartering system in which both the state and federal governments offer credit union charters; the state's overall financial regulatory structure to analyze areas of similarity and contrast; and the process that the Commission uses to regulate the credit union industry.

The Sunset review focused on improving the functioning of the Commission as a public policy body representing the citizens of Texas. The issues in this report concentrate on improving public access to the Department's decisionmaking process and determining the appropriate structure of the agency.

Review Activities

In conducting the review the Sunset staff:

- Worked extensively with the Credit Union Department staff;
- Worked with staff from the Legislative Budget Board and legislative committees;

- Reviewed agency documents and reports, state statutes, legislative committee reports and previous legislation, and reports by the State Auditor's Office and Legislative Budget Board;
- Accompanied credit union staff on an on-site examination of a credit union;
- Conducted interviews with and solicited written comments from managers of Texas credit unions;
- Met with officials of the National Credit Union Administration;
- Conducted meetings and interviews with state and national advocacy and interest groups about their concerns regarding financial services regulation, including the Texas Credit Union League, Consumers Union, Texas Bankers Association, Independent Bankers Association of Texas, Credit Union National Association, National Association of State Credit Union Supervisors, and the Conference of State Bank Supervisors;
- Researched enabling statutes of agencies in other states with common functions and conducted telephone interviews with officials of those agencies;
- Researched other state agencies, met with staff of the Banking Department, and attended public hearings of the Finance Commission;
- Attended public meetings of the Credit Union Commission and reviewed past minutes and tapes of meetings; and
- Met with members of the Credit Union Commission.

Results

The Sunset review began by asking the basic question of whether Texas should continue to charter credit unions. The Texas credit union charter was created as an alternative to banks and savings and loans for the original purpose of extending financial services to rural areas. About 1.7 million Texans have deposited more than $7 billion in Texas' state-chartered credit unions. The public interest in credit union regulation is to safeguard the deposits in those institutions. Staff concluded that the Department activities in chartering and regulating credit unions were effective in safeguarding the public interest.

State government is not the only level of government that charters credit unions. Of the 830 credit unions in Texas, the federal government charters 535, Texas charters 285, and 10 are branches from other states. As all credit unions operating in Texas are insured by the federal government, state and federal regulation does overlap somewhat. In the course of this review, Sunset staff tested the value of maintaining an independent charter against the duplication that exists with the federal government. Staff concluded that maintaining the state credit union charter allows Texas to control the regulation of its credit unions and the ability to respond to future, unwanted changes on the part of the federal regulator.

Staff concluded that dual chartering gives Texas the ability to respond to future changes in federal regulation.

Once the determination was made to recommend continuing the Department's functions, the review focused on its effectiveness in carrying out its mission. Staff identified three areas of inquiry: composition of the Commission, degree of public openness, and the proper placement of the agency in the state's financial regulatory structure.

Credit Union Commission Composition **-** The Sunset staff looked for ways to increase public participation in the Commission's decisionmaking. Currently, the Commission is composed of nine members — three public members and six industry representatives. The Sunset Commission has consistently found that boards dominated by a regulated industry or profession tend to be protective of that industry. As a result, protecting the interest of the public is not always the driving force behind such a board's regulatory approach. Issue 1 addresses the Commission's composition to reinforce its functioning as a public policy body representative of Texas citizens, reduce industry-domination, and ensure active public participation.

Changes are needed in the Commission and its rules to increase the openness of the Department's activities.

Public Openness **-** In looking at the process by which the credit union industry grows, staff concentrated on the degree of public openness in decisions to grant credit union charters, field of membership expansions, and mergers. The Sunset review showed that the Commission's current notification and hearing procedures do not sufficiently allow for either public notice or input. Issue 2 provides guidance to the Commission to open its procedures to allow for public notice and comment.

Placement of the Agency in the State's Regulatory Structure **-** The Sunset review examined the question of the appropriate placement of this agency in Texas' financial regulatory scheme. Although consolidating the state's financial regulatory agencies into the Finance Commission has been a trend of the Legislature, the staff found a complex set of issues that demonstrate the need to conduct a combined review of the financial regulatory system within a single Sunset review cycle. Other than the

Consolidation of the state's financial regulatory agencies should be considered in a combined review in four years.

Department, all of the state's financial regulatory agencies — the Finance Commission, Banking Department, Savings and Loan Department and Office of the Consumer Credit Commissioner — are scheduled for Sunset review in 2001. For reasons discussed in Issue 3, the staff concluded that the Department should be reviewed again in four years concurrent with these other agencies.

As a result of the Sunset review activities described above, the staff offers the following recommendations concerning the Credit Union Commission. These recommendations are discussed in detail in the issues presented in this report.

Recommendations

1. Increase the public perspective of the Credit Union Commission by requiring a public member majority.

2. Ensure adequate public notice and opportunity for input regarding proposed new or expanded credit unions.

3. Continue the Credit Union Commission for four years.

ISSUES

Issue 1

Increase the Public Perspective of the Credit Union Commission by Requiring a Public Member Majority.

Background

The regulation of credit unions in Texas and the Credit Union Department (Department) are governed by a nine-member Commission appointed by the Governor. Six members of the Credit Union Commission (Commission) are industry representatives with at least five years of experience as an executive, officer, director or committee member of a credit union. The remaining three members are public members without ties to a financial institution, who must have recognized business abilities.

The Credit Union Commission has six industry representatives and three public members.

The Commission's primary duty is to adopt rules to administer the Credit Union Act (Act) and to tailor these rules in response to changes in economic conditions. Other duties of the Commission include setting operating fees paid by credit unions, employing the Credit Union Commissioner (Commissioner), hearing appeals of the decisions and orders of the Commissioner, and appointing advisory committees, as necessary, to provide expertise to the Commission.

The Commissioner has day-to-day responsibility for the operation of the Department and broad authority to enforce the Act and Commission rules. The Commissioner is required to have a minimum of five years experience in credit union operations. Major duties of the Commissioner include approving charters, levying and collecting fees, authorizing emergency mergers and consolidations, and enforcing provisions of the Act including issuance of cease and desist, conservatorship and liquidation orders, orders removing credit union officers or employees, and imposition of restrictions of dividend payments.

The Sunset Commission has adopted an approach toward open government and public access to the decision-making process that is reflected in the Sunset Commission's across-the-board recommendations. In reviewing the Credit Union Commission, Sunset staff focused on the Commission's adherence to open government principles and whether the current structure of the Commission is necessary for effective credit union regulation.

Findings

▼ **The Credit Union Commission has failed to develop rules addressing key policymaking and administrative issues of particular interest to the public.**

- The Commission has not developed rules that provide for adequate public notice or input regarding new or expanding credit unions. While the Act requires the Commission to adopt rules concerning notice and hearings for new charters and field of membership changes, the Commission's rules effectively limit notice and comment to other credit unions and do not include the general public. The Commission's mechanism for notice is publication in the Department's newsletter. A review of the Department's newsletter mailing list showed that few citizen groups or other financial institutions are included. These problems are further discussed in Issue 2.

The Commission's rules effectively limit public notice and comment to credit unions and do not include the general public.

- Although the Act prohibits Commission members from acting on matters which directly affect the credit union of which they are an official, director, or member, the Commission has not made rules requiring Commission members to recuse themselves from these deliberations.

- Some of the discussions of certain matters affecting credit unions must take place in executive sessions due to the sensitive nature of the financial information. However, no rules are in place to ensure that an affected commission member does not participate in the private discussions.

- Sunset staff attended a meeting of the Credit Union Commission at which guidelines for mergers were considered. At that same time, one Commission member was actively pursuing a merger of the credit union he managed with another credit union. While that Commission member did not participate in the public discussion, neither did he give any clear indication of recusal at the beginning of the deliberations. In fact, a review of the Credit Union Commission minutes for the past five years shows only one instance of any Commission member abstaining from a Commission vote.

- The Act permits mergers "in accordance with rules adopted by the commission." In recent years, credit union mergers have become a major area of credit union activity. Since 1990, the Department has approved 58 mergers while approving only seven new state charters. Despite the importance of mergers, and the fact that the Commissioner has asked for guidance in this area, the Commission has not established merger rules.

▼ **An industry-dominated Commission is not necessary to effectively regulate Texas credit unions.**

- No clear need exists to maintain credit union industry control of the Commission. The duties of the Credit Union Commission and the nature of the industry are not so technical as to be outside the decision-making ability of a public member. As a result, the subject matter does not require a Commission majority experienced in credit union operations. The technical aspects of the Credit Union Department are effectively managed by the Credit Union Commissioner, as prescribed by statute.

The duties of the Credit Union Commission and the nature of the industry are not so technical as to be outside the decisionmaking ability of a public member.

- The Commission employs the Commissioner to provide the technical level of financial services and regulatory expertise. For example, the Commissioner has independent authority regarding credit unions to issue charters, approve mergers, approve expansions in fields of membership, and to take enforcement actions. The Commission is not directly involved in these regulatory activities.

- The National Credit Union Administration (NCUA), the federal agency which provides deposit insurance to all credit unions in Texas, promulgates specific technical rules and policies that are implemented and enforced by the Commissioner. Monitoring credit unions' compliance with NCUA regulations is not a part of the responsibilities of the members of the Credit Union Commission.

- An industry majority is also not required to adequately bring forward the important perspectives of credit unions in the Commission's decisionmaking process. The Commission has statutory authority to appoint advisory committees, including industry experts, if the Commission needs additional expertise in the financial services field. According to statute, such an advisory committee could be charged to evaluate industry methods or problems and present recommendations to the Commission for possible action.

- **Like credit unions themselves, the responsibilities of the Credit Union Commission may be more effectively accomplished with a public member majority.**

  - A Commission with a majority of public members would be more likely to recognize issues of particular interest to the public and develop appropriate rules and policy to address those issues, such as rules concerning public notice and recusals.

  - In keeping with the community-based, volunteer nature of the credit union industry, appointing a majority of public members to the Credit Union Commission is appropriate. Historically, credit unions have been successfully managed by members of the public who volunteer to serve their credit union. Decisions on the future of credit unions are made by volunteer board members elected by votes of the membership at annual meetings. NCUA Chairman, Norman D'Amours, states that members of the public who volunteer to participate in the management of their credit unions ensure that such credit unions are "run safely and in the best interest of the member and in the best interest of the entire system."[1]

Credit unions themselves have been successfully managed by members of the public who volunteer to serve their credit union.

  - Credit unions differ from other types of financial institutions in that credit unions are member-owned, non-profit financial cooperatives. While the daily operations of larger credit unions may be performed by paid executive staff, the leadership of all credit unions is provided by volunteer board members elected by the membership. Despite the fact that volunteer board members can be appointed to the Commission, the Commission's industry representatives have traditionally been paid presidents or managers. Currently, five of the six industry representatives on the Credit Union Commission are paid staff of their respective credit unions and are not volunteer credit union board members. A review of the composition of the Credit Union Commission over the last 10 years shows that of the 14 industry representatives appointed or reappointed to the Credit Union Commission, only one was a non-paid, volunteer credit union official.

▼ **The Legislature has required majority public membership on the Finance Commission and other business regulatory bodies.**

- The Finance Commission, charged with the responsibility of regulating financial service providers such as banks and savings and loans, has a public member majority. The Legislature increased the public members of the Finance Commission to a majority in 1989 to improve responsiveness to the needs of the public and to make the agency more independent of the industries it regulates.[2] The Finance Commission consists of two banking executives, two savings and loan executives, and five public members with recognized business ability. Interviews with representatives of consumer groups and financial services industries indicate that the lack of a bank or savings institution majority on the Finance Commission has not led to problems with its regulation of either industry.

- Other examples of business regulatory bodies that have a majority of public members include the Alcoholic Beverage Commission, Funeral Services Commission, and Public Utility Commission. The members of these commissions regulate industries that require public diligence to maintain fairness and safety.

Having a Commission dominated by members of the credit union industry is not necessary for it to accomplish its duties.

Conclusion

Although the Sunset review did not find any glaring conflict-of-interest instances at the Commission that would demand a change in its composition, the Commission is dominated by the industry it regulates and has not ensured active public participation. The Sunset Commission has consistently found that boards dominated by a regulated industry or profession tend to be protective of that industry. As a result, protecting the interest of the public is not always the driving force behind such a board's regulatory approach.

In the case of the Credit Union Commission, having a policy body composed of and dominated by representatives of credit unions is simply not necessary to accomplish the duties of the Commission. The primary duty of the Commission, to develop rules regarding credit union operations, is not so technical as to be beyond the capability of public members. In fact, the Finance Commission, with a public member majority, effectively regulates banks, savings and loans, and consumer credit companies.

The important perspective of credit unions can be maintained without having a majority voice on the Commission. The Commission obtains needed technical expertise from the Commissioner and can appoint a statutorily-authorized advisory committee when necessary.

Recommendation

Changes in Statute

- **Increase public membership on the Credit Union Commission from three to five public members.**
- **Require the Credit Union Commission to adopt rules governing recusal of Commission members, providing public notice of Commission activities, and outlining the credit union merger process.**

This recommendation ensures that members of the public, and not the industry itself is the driver of the state's financial regulatory structure. The effectiveness of a regulatory body's ability to protect the public can be linked to the number of public members in relation to the number of industry representatives. Strong pressure within a board for a more consumer-oriented approach encourages public-minded decisions, but such pressure is less effective when only a minority of members are representative of the public.

This recommendation would increase public membership on the Credit Union Commission from three to five members. The Commission would have four members with at least five years of experience as an executive, officer, director or committee member of a credit union. This composition of the Credit Union Commission would maintain a workable level of industry expertise among its members, while increasing the public perspective on regulatory issues.

Requiring the Commission to adopt specific rules governing public notice and recusal would heighten fairness and objectivity and decrease potential perceptions of conflicts-of-interest regarding Commission decisions. Such rules would increase the Commission's focus on protecting consumers while maintaining the soundness of the credit union industry.

Requiring the Commission to adopt rules governing the process for mergers of credit unions would ensure that the Commission sets the policy and procedure for evaluating mergers. Placing these policies in the Department's rules would afford the public with adequate notice of how the agency approves proposed mergers.

Fiscal Impact

This recommendation would not have a direct fiscal impact to the state.

[1] National Credit Union Administration Chairman Norman D'Amours, *Speech at the CUNA Governmental Affairs Conference*, March 11, 1996.

[2] House Research Organization, SB 607 Bill Analysis, May 20, 1989.

Issue 2

Ensure Adequate Public Notice and Opportunity for Input Regarding Proposed New or Expanding Credit Unions.

Background

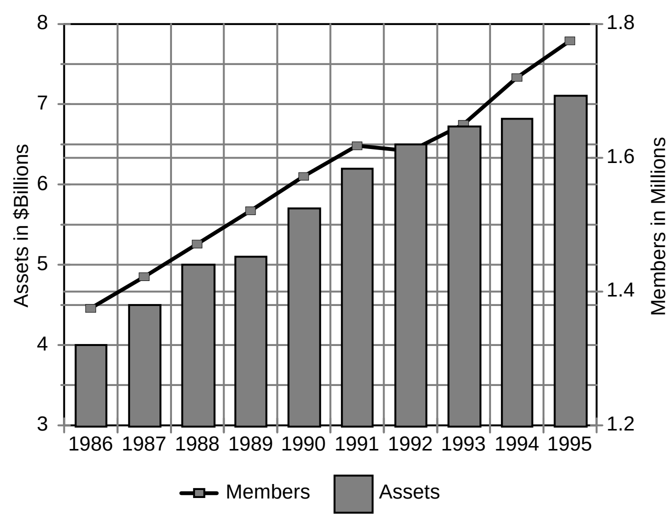
When Texas first began regulating credit unions, these member-owned cooperatives served only select groups of people that either worked for the same company, belonged to the same church or civic organization, or lived in the same limited geographic region. Today, the nature of credit unions has changed significantly. Rapidly changing economic and social conditions in which the population grew and the likelihood of knowing each other decreased, have prompted federal and state regulators to expand the scope of credit union membership requirements.[1]

Credit unions hold a greater share of the public's money than ever before.

With the increasing demand for affordable financial services and less restrictive membership requirements, credit unions now affect more people and hold a greater share of the public's money than ever before. The chart, *Credit Union Assets and Membership Growth*, shows increasing assets and membership growth for Texas state credit unions.

The state regulates credit union growth through its oversight of chartering, field of membership changes, and mergers. Credit unions must obtain a charter to do business in Texas. The Credit Union Act (Act) sets charter requirements and directs the Commissioner to review charter applications. The Commissioner examines detailed information on a proposed credit union to assess whether it can operate in a financially safe and sound manner and may either approve or deny the charter application. The Act also requires the Commissioner to review and approve or deny credit union field of membership expansions. A field of membership is the

Credit Union Assets and Membership Growth
Calendar Years 1986 - 1995



potential group of individuals that meet the credit union's membership qualifications. The Act requires a field of membership to be based upon a definable community of interest such as occupation, association, or residence.

Credit union mergers are another common method through which credit unions expand. The Act requires merging credit unions to submit a plan, approved by their boards and members, to the Commissioner. In emergency situations, the Commissioner may waive the requirement that the plan be approved by the members of either credit union. If the Commissioner is satisfied that all requirements have been met, then the merger is approved.

The Sunset review focused on the degree of public openness in decisions to grant credit union charters, field of membership expansions, and mergers, and whether the public and all affected parties are notified and given an opportunity to be heard.

Findings

Proposed credit union charters and expansions are listed only in the Department's newsletter.

▼ **Current notification procedures used by the Department do not provide adequate public notice of proposed credit union expansion activities.**

- The current notification procedures do not effectively notify anyone other than credit unions. The statute requires notice of only charter applications and does not speak to field of membership expansions or mergers. Rules developed by the Commission limit notice of charter applications to publication in the Department's newsletter. Although not required, the Commission has adopted the same notice requirement for field of membership expansions. Proposed mergers are not addressed by the rule's notice requirements.

- A review of the Department's newsletter mailing list showed that few citizen groups or other financial institutions were included on the list. The Department makes no further effort to reach people outside of the credit union industry.

- **The public is not provided an opportunity to offer testimony or input on new charter applications, field of membership expansions, or mergers.**

  - The Department does not provide an opportunity for public comment on credit union proposals. As discussed above, Commission rules do require that new charter applications and field of membership expansions be posted in the Department's newsletter. As a result, affected credit unions are allowed an opportunity to comment on the impact of the new or expanded credit union. However, the public and other interested parties, such as other financial services providers, are generally not included unless they happen to be on the Department's mailing list.

  - The Commission does not provide for a public hearing regarding credit union proposals. The Act provides a general requirement for the Commission to adopt rules relating to conditions under which a hearing may be available. However, the nature of the hearing is not addressed by the statute. The Commission's rules limit hearings on charters so that only *credit unions* have standing to comment on applications and to appeal the Commissioner's decision. Thus, the hearings do not serve as an opportunity to collect information on a credit union proposal and do not allow the public to be heard.

  - In the case of merging credit unions, no opportunity for any input to the Commissioner exists. Neither interested credit unions, the public, nor other financial services providers are notified or allowed an official opportunity to comment on proposed credit union mergers.

By rule, only credit unions have standing to comment on or appeal decisions on proposals.

- **Public input is necessary for assessing the availability of financial services.**

  - A 1990 State Auditor's report identified a need for financial regulatory bodies, such as the Credit Union Department, to address the availability of adequate financial services.[2] The current process used by the Department for gathering information does not adequately meet this goal. Most of the input used by the Commissioner is limited only to credit unions. Input from the public, community representatives, and other financial institutions would provide the Commissioner broad-based information to consider when making decisions.

- Public input would also allow other affected financial institutions an opportunity to comment on the impact of credit union services on their communities and business. Credit union expansion may affect the operations of other financial institutions such as banks, savings and loans, and other credit unions located within the community.

- Concerned parties have shown interest in providing input regarding changes in the credit union industry. During the review, Sunset staff received letters from several credit unions and banking associations that requested an opportunity to comment on credit union expansion activity before approval by the Commissioner.

General state policy requires agencies to publish major actions and proposed rules in the Texas Register.

▼ **The state has general procedures in place and other agencies have established processes that provide for public participation in the state's business.**

- State policy requires agencies to publish major agency actions and proposed rules in the Texas Register. This well accepted approach keeps the public informed on government activities and allows an opportunity to provide input to state government decision makers.

- Most state agencies have adopted policies that provide for public notice of proposals and allow comment. In the area of financial regulation, the Banking Department and Savings and Loan Department post notice of charter applications in newspapers where a financial institution is to be located. Each agency also allows for public comment before granting a charter.

- The Sunset Commission has developed a standard recommendation, applied to agencies under Sunset review, that requires the opportunity for public comment at all meetings of an agency's policymaking body. This ensures that those affected by a state agency can be heard.

Conclusion

Credit unions play a vital role in providing financial services to communities. As the demand for affordable financial services increases, public input is necessary in helping the Commissioner determine how credit unions are structured to fulfill this demand. Current notification and hearing procedures used by the Department do not sufficiently allow for broad-based input. The state has established procedures that provide for public notice and input in the decisions of state agencies. The Credit Union Department should follow such procedures.

Recommendation

Changes in Statute

- **Require the Credit Union Commissioner to provide for public notice, comment, and an opportunity for a public hearing before making decisions regarding approval or denial of charter applications, field of membership expansions, and mergers.**
- **Require the Credit Union Commissioner to publish notice of proposed expansion activities in the Texas Register.**

This recommendation would require the Credit Union Commissioner to follow the state's policy to adequately inform and seek input from the public and other interested parties before making important decisions about new or expanding credit unions. Publishing credit union expansion information in the Texas Register would ensure that all interested parties, even those not listed on the Department's mailing list, are informed of proposed credit unions, expanding fields of membership, or mergers.

Allowing for public input and opportunity for public hearings would provide the Credit Union Commissioner with the broad-based information necessary to assess the availability and adequacy of financial services and the impact of these decisions on local communities. A public hearing would be required when requested by any interested party, including members of the general public. Public hearings would be conducted to obtain public input by the Commissioner and would not rise to the level of full administrative review hearings under the Administrative Procedures Act.

In addition to this recommendation, the Sunset staff has recommended, on page 31, that the Sunset Commission across-the-board recommendation on public input be applied to this agency. This will provide continued opportunity for public testimony at each meeting of the Credit Union Commission. This ensures another place for those interested in the Department's business to offer input and address concerns about the way credit union regulation is carried out in the state.

Fiscal Impact

Strengthening public notice and input requirements will not result in a fiscal impact to the state.

[1] Albert Burger and Tina Dacin, *Field of Membership: An Evolving Concept*, University of Wisconsin-Madison, Filene Research Institute, February 1992, p.27.

[2] State Auditor's Office Report, *Financial Services in the 90s: Need for a Comprehensive Regulatory View*, October 1990, pp.12-13.

Issue 3

Continue the Credit Union Commission for Four Years.

Background

The Texas Legislature first authorized credit unions in 1913. Credit unions are distinguished from other financial services providers, such as banks and savings and loans, in that credit unions are member-owned, non-profit cooperatives. Until 1969, when the Legislature created the Texas Credit Union Department (Department), the Banking Commission performed credit union regulation.

Credit unions are member-owned, non-profit cooperatives.

The Legislature's stated purpose in creating the Department was to:

- safeguard the public interest;
- maintain sound credit union growth;
- promote public confidence in credit unions; and
- provide effective supervision and regulation.

The Department's policy body is the Credit Union Commission, composed of nine governor-appointed members. The primary role of the Commission is to adopt rules to administer the Credit Union Act (Act) and to tailor these rules in response to changes in economic conditions. Major areas of the Commission's rulemaking authority include the setting of standards for:

- types of permitted loans and investments;
- mergers;
- field of membership expansions; and
- deposit insurance.

Other duties of the Commission include employing the Credit Union Commissioner, hearing appeals of the decisions and orders of the Commissioner, and setting the credit union fees used to cover the operating expenses of the Department.

All credit unions operating in Texas must obtain a charter from either the state, federal government, or regulatory bodies of other states or countries. The Department has supervisory authority over credit unions chartered in Texas and in other states and other countries, but no authority over federally-chartered credit unions.

Commission rules require state-chartered credit unions to carry deposit insurance from the National Credit Union Administration (NCUA). NCUA is the federal agency that charters federal credit unions and administers the National Credit Union Share Insurance Fund (the Fund). Because NCUA is responsible for protecting the Fund from losses caused by failed credit unions, NCUA sets minimum financial standards for credit unions insured through the Fund. Although requiring state-chartered credit unions to maintain federal insurance has resulted in some degree of dual oversight by the state and the federal government, the Department is responsible for the day-to-day regulation of these institutions.

Credit unions are an important part of how the state makes financial services available to its citizens.

While the Department stands as an independent agency, the state's other financial services industries are regulated by the Finance Commission of Texas. This nine-member policymaking body oversees three independent Departments — the Banking Department which regulates banks, trust companies and prepaid funeral service contract providers; the Savings and Loan Department which regulates thrifts (savings and loans and savings banks); and the Office of the Consumer Credit Commissioner, which regulates pawn shops and commercial credit lenders. The Finance Commission hires each of the Commissioners and has rulemaking authority for each Department.

In recent years, the trend by the Legislature has been to consolidate the state's financial regulatory agencies under the umbrella of the Finance Commission. In 1989, the Legislature restructured the Finance Commission by requiring a majority of public members and eliminating the separate industry sections to allow the whole Commission to act on matters affecting each industry. At this time, the only major financial industry that is regulated separately from the Finance Commission is the credit union industry.

For a number of years, the Legislature and legislative agencies have studied possible consolidation of credit union regulation with that of the Finance Commission. The 1983 Sunset Commission staff report on the Credit Union Commission outlined three alternatives that each included transfer credit union regulation to the Finance Commission. In 1988, the Legislature's Special Committee on Organization of State Agencies recommended restructuring the Finance Commission, but deferred the issue of consolidating the Department for further consideration.[1] In 1990, the State Auditor concluded that the Legislature should consider placing the oversight of the financial services industry under a single regulatory agency.[2]

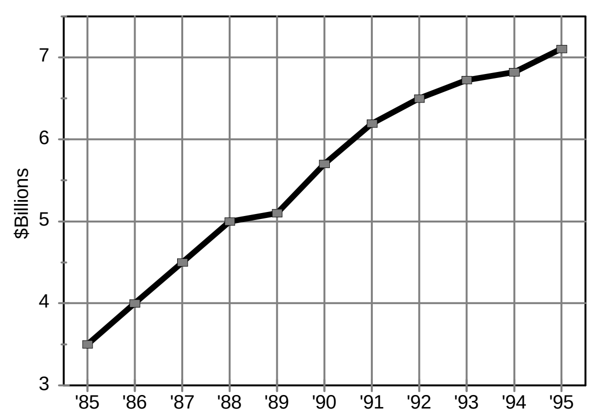
In a Sunset review, continuation of an agency and its functions depends on certain conditions being met, as required by the Sunset Act. First, a current and continuing need should exist for the state to provide the functions or services. In addition, the functions should not duplicate those currently provided by any other agency. Finally, the potential benefits of maintaining a separate agency must outweigh any advantages of transferring the agency's functions or services to another agency. The evaluation of the need to continue the Credit Union Department and its functions led to the findings discussed in the following material.

Findings

▼ **The importance of credit unions in Texas' economy requires the state to play a continuing role in protecting the public interest.**

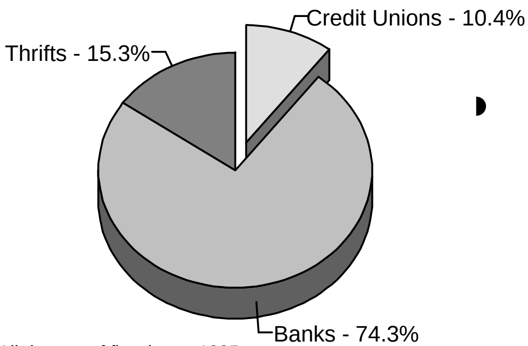
- Financial services, such as those provided by banks, credit unions, and other depository institutions, are important to the continued development of Texas' economy. In fact, economists point out that economic development depends upon the availability of financial services.[3] Credit unions are an important part of how the state makes a wide range of financial services available to its citizens. As one observer noted, "credit unions, and [the] Texas Credit Union Department, play an important role in assuring financial services are available at reasonable prices and under fair terms to more Texans."[4] The fact that Texas' 285 state-chartered credit unions hold deposits of more than $7 billion and serve more than 1.7 million members highlights the important economic role served by credit unions. The chart, *State-Chartered Credit Union Assets*, shows the steady increase in credit union

State-Chartered Credit Union Assets



Source: Texas Credit Union Department, May 1995.

Comparison of State-Chartered Financial Institutions by Asset Size



Notes: All data as of fiscal year 1995. Thrifts include savings and loans and savings banks.

deposits. The chart, *Comparison of State-Chartered Financial Institutions by Asset Size*, shows how the $7 billion in credit union assets compare to the $10.3 billion in thrifts, and the $50 billion in banks.

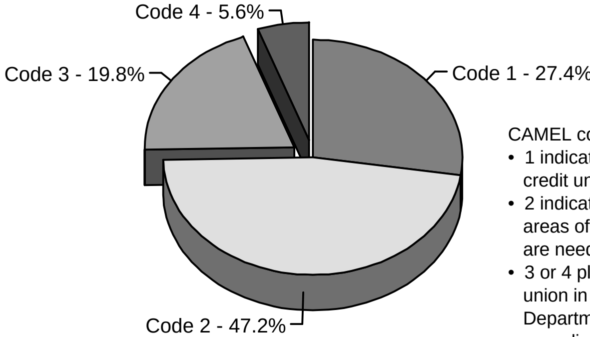
- The interest of the public in regulating credit unions is to maintain their solvency, thereby safeguarding the assets of depositors. As detailed above, the large number of Texans who are members of credit unions and the high dollar value of their deposits highlights the continuing need to protect the soundness of these deposits through regulation.

▼ **The Credit Union Department has effectively supervised credit unions by identifying and assisting credit unions with deficiencies.**

- Oversight of credit unions by the Department is designed to assure that credit unions remain financially healthy and that potential problems are identified and dealt with before the soundness of the institution is threatened. The Department conducts annual on-site examinations, uses remedial examinations to address specific problems, and takes enforcement action against credit unions that fail to comply with state standards. In fiscal year 1995, the Department examined 280 of the 289 credit unions operating at that time.

- In its examinations, the Department uses an evaluation and rating scale called a CAMEL code. The term, CAMEL, is an acronym based on the components: capital, assets, management, earnings, and liquidity. The chart, *Ratings of State-Chartered Credit Unions*, shows the relative distribution of Texas' credit union examination scores in December 1995. The Department places all credit unions with CAMEL code scores of 3, 4, or 5 in its remedial monitoring program. One quarter of the state's 285 state-chartered credit unions in December 1995 had serious enough financial problems to warrant including the credit union in the remedial monitoring program. These problem credit unions have a combined asset base of $511 million.

Ratings of State-Chartered Credit Unions



CAMEL codes:
- 1 indicates a well-run credit union
- 2 indicates that some areas of improvement are needed
- 3 or 4 places a credit union in the Department's remedial monitoring program
- 5 indicates an insolvent credit union

Notes: Data from Texas Credit Union Department for December 1995. No credit union had a CAMEL Code of 5.

- Common deficiencies among problem credit unions include an excessive percentage of delinquent loans, weak earnings, inadequate collection efforts, inadequate reserves held against potential losses, poor record-keeping, and poor management. Written responses to the examination reports are required for all credit unions given composite CAMEL code ratings of 3, 4, or 5. The Department also requires problem credit unions to submit frequent updates on how these problems are being addressed, provides technical assistance to help resolve the deficiencies, and re-examines the credit unions monthly, quarterly or semi-annually. In addition to the 280 annual examinations mentioned above, the Department also conducted 101 remedial examinations in fiscal year 1995. Through the Department's efforts, 20 credit unions improved their financial condition sufficiently to be removed from the remedial monitoring program in fiscal year 1995.

- If a credit union does not correct its financial deficiencies through the remedial monitoring program, the Department may use a range of administrative sanctions to gain compliance. These actions begin with informal agreements called letters of understanding and agreement. When necessary, the Department may escalate its action to include issuing cease and desist orders, removing directors or employees from office, ordering conservatorship, and liquidating the credit union. The chart, *Enforcement Actions Initiated — Fiscal Years 1986-1995*, details the number of actions taken by the Department in the past 10 years.

Enforcement Actions Initiated
Fiscal Years 1986 - 1995

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	Total
Letters of Understanding and Agreement	0	0	1	2	4	0	3	0	8	8	26
Cease and Desist Orders	0	0	2	1	0	0	2	1	1	0	7
Orders of Removal	0	0	0	0	0	0	0	0	0	0	0
Conservatorships	6	12	11	9	11	20	14	0	0	0	83
Involuntary Liquidations	4	6	9	8	6	7	10	15	0	0	65

Credit Union Opposition to Consolidation

Credit Union Non-Profit Status

Opponents of consolidation argue that regulation of non-profit and for-profit institutions is so different that a single agency cannot adequately regulate both types. Credit unions are owned by their members and operate on a non-profit basis. The institutions currently regulated by the Finance Commission — banks, thrifts, consumer credit corporations, pre-need funeral service providers, pawn shops, and others — all operate for the profit of their owners or shareholders. Any effort to consolidate the state's financial regulatory agencies must take these factors into consideration.

Competition with Banks

Credit unions feel their institutions would be harmed by competitive pressures from the other financial industries. Opponents of consolidation predict that credit unions would switch their charters to the federal government, because as one Credit Union official wrote to Sunset staff, "most state-chartered credit unions would feel that they were being regulated by their competitors."[8]

Inadequate Attention From Supervisor

A third argument against consolidation is that credit union regulation would not get enough attention from the main decision-maker. The Department noted this argument in its Self-Evaluation Report to the Sunset Commission, "if the Credit Union Act were administered by any other state agency, the supervision of credit unions could suffer because of the fragmented attention of an umbrella agency head."

▼ **Despite some overlap of state and federal regulation, Texas should continue to provide state charters for credit unions.**

- Maintaining the state charter for credit unions allows Texas to continue to control the regulation of its financial institutions. Although state and federal regulation of credit unions appear duplicative, this dual regulatory system allows the state to decide the policies and procedures that are appropriate for the credit unions it charters. For example, federal credit unions are restricted to purchasing only federally-backed investments, while state credit unions have other options.[5] In addition, federal regulators have expressed a desire to relax regulation to allow credit unions to supervise themselves with federal regulation limited to serving in a backup capacity.[6] The state charter allows Texas to decide the best way to regulate its credit unions without being subject to the changes in approach by the federal government.

- NCUA shows clear support for state regulation. In evaluating the Department's effectiveness, NCUA indicated to Sunset staff that, "NCUA benefits from the work performed by [the Department]; thus, eliminating the function of [the Department] would have a detrimental impact on NCUA and Texas credit unions."[7]

▼ **An assessment of the question of consolidating the Department within the Finance Commission revealed a complex set of issues that demonstrate the need to conduct a combined review with the state's other financial regulatory agencies.**

- Although benefits could result from consolidating the Department under the Finance Commission's umbrella, possible disadvantages exist as well. These potential disadvantages have spawned strong opposition to the consolidation and highlight the need to carefully examine both sides of the issue. To date, Sunset staff has received 45 letters from both state and federal credit unions opposing consolidation. This opposition to consolidation usually hinges on three points: the differences between banks, savings and loans, and credit unions; fear of competitive pressures of the industries represented on the Finance Commission; and fear of inadequate attention from a regulator responsible of other parts of the financial industry. The textbox, *Credit Union Opposition to Consolidation*, summarizes credit union opposition to this issue.

- Despite strong opposition to consolidation, potential advantages to combining the state's financial regulatory agencies also merit exploration. Consolidation could ensure the state's financial industries are regulated consistently, that financial regulatory agencies act to address problems in a coordinated fashion, and administrative savings could result from the increased efficiencies of a combined agency. The textbox, *Potential Advantages to Consolidation*, summarizes these points.

- The complexity of issues concerning the possible consolidation requires that this question not be studied in isolation. The state's financial institutions represent a system of which credit unions are a part. Despite the importance of a system-wide approach, the Department is the only component part that is under Sunset review at this time. The state's other financial regulatory agencies — the Finance Commission, Banking Department, Savings and Loan Department, and Office of Consumer Credit Commissioner — are scheduled for simultaneous Sunset review in 2001.

  A decision on the proper organization of the state financial regulatory agencies must include a comprehensive review of the entire system. While the Sunset Commission could include the other agencies under its review for this purpose, the staff chose not to extend the review of the Credit Union Department to that degree. The reasons for this decision involve questions that relate directly to the Finance Commission and as a consequence would be better addressed as part of its Sunset review. These issues include determining the proper balance of representation on a combined agency board, lack of unification of the Finance Commission, and the timing of the change, and are detailed on the following page in the textbox, *Consolidation Issues Relating to the Finance Commission*.

Potential Advantages to Consolidation

Consistency of Regulation

The state's financial industries are regulated in similar ways: chartering, examination and supervision. These regulatory actions should be applied to all financial institutions in the same way. Differences between the Commission and the Finance Commission in the areas of public openness, powers of the commissioners to make decisions without public notice or input, and public participation in board processes could be resolved in a consolidated financial regulatory agency to ensure consistency in the state's regulation of all financial institutions.

Coordination of Regulatory Effort

Consolidation could also ensure that agencies act to address problems in the provision of financial services in a coordinated fashion. For example, the Legislature, in 1995, directed the Finance Commission to study the availability, quality, and prices of financial services in Texas and, in 1993, it directed a similar charge to the Department. A complete study of equity in the provision of financial services needs to take a system-wide approach — encompassing the institutions regulated by both the Finance Commission and the Department.

Administrative Savings

Operating efficiencies could result from consolidating the Department's staff within the Finance Commission, particularly in the area of administration. Eliminating administrative overlap by combining support functions such as accounting, payroll, personnel, and computer support could result in savings. Joint training and possible co-location of field staff could also lower costs. However, a preliminary review suggests that the resulting savings alone would not be sufficient to warrant consolidation.

Consolidation Issues Relating to the Finance Commission

Board Composition

The Finance Commission is composed of two banking representatives, two thrift representatives, and five public members. The public majority was the result of a compromise between industry and consumer advocates. To place credit union regulation under the Finance Commission, without representation on the board, could cause harm to credit unions. However, to reorganize the board to include credit union representation without reviewing the composition of the Finance Commission could upset the board's balance.

Degree of Finance Commission Consolidation

The Finance Commission is not a unified agency. Each Department of the Finance Commission submits separate strategic plans and legislative appropriations requests, and receives separate appropriations. The Finance Commission is not budgeted for a staff of its own and the Banking Commissioner acts as its executive director. The proper organization of the Finance Commission should be part of a review of the financial industry regulatory system.

Timing of Consolidation

The Finance Commission is undergoing changes as a result of the financial industry crisis of the 1980s, the rewrite of the Banking Act, and the fact that the Legislature is due, in 1999, to reconsider its decision to opt out of the Interstate Banking and Branching Act.

The financial industry crisis of the 1980s — during which 351 Texas banks and 115 savings and loans failed — caused repercussions that are still felt at the Finance Commission. One example is the creation of the savings bank charter. Although the Savings and Loan Department currently supervises only 23 institutions, the new savings bank charter is expected to gain many charters in the near future.[9] Other fallout from the financial industry crisis concerns questions about parity between the two federal deposit insurance funds created in the effort to resolve the crisis and federal regulatory agency restructuring proposals. The pending resolution of these federal issues continues to add uncertainty to the industries supervised by the Finance Commission.

The rewrite of the Banking Act also greatly expanded the work of the Finance Commission for the near future. This new act granted the Finance Commission expanded rulemaking authority regarding state bank regulation.[10] The Finance Commission is currently undertaking a two-year process to revise the banking rules in response to the legislation.[11]

A third concern with the timing of a possible consolidation of financial regulatory agencies is the fact the 76th Legislature in 1999 will reconsider the issue of interstate banking. This hotly contested issue was resolved in 1995 by the decision to opt out of interstate banking under the terms of the federal Riegle-Neal Interstate Banking and Branching Efficiency Act. However, the decision to opt out expires in 1999 and will need to be addressed again by the Legislature.

These changes being experienced by the Finance Commission and the decision on interstate banking should be settled in time for the Sunset review in 2001.

▼ **The Sunset review in 2001 would be enhanced if the affected agencies conduct a consistency review of all state financial services regulations.**

- The regulation of financial institutions is similar in both subject matter and regulation by the Departments within the Finance Commission and the Credit Union Department. However, major differences exist between the statutory powers of the Credit Union Commissioner and the Banking, Savings and Loan, and Consumer Credit Commissioners and in the rules that the respective commissions have passed. If the Legislature chose to standardize the provision of financial services through combination of the Credit Union Department with the Finance Commission, an important first step would be to conduct a comprehensive review of all rules and regulations affecting financial institutions. This review could be conducted by the affected agencies before a combined Sunset review in 2001.

Conclusion

Credit unions play an important part in the state's economy. As long as the state charters credit unions, the Credit Union Department's primary function — to protect the public from potential losses of member deposits — will continue to be needed. Sunset staff concluded that the Department performs as an effective regulator of credit unions. Sunset staff studied the question of whether Texas should independently charter and regulate credit unions in light of the fact that the federal government also performs this function. While some duplication was noted, the review concluded that the state benefits from maintaining control over its financial institutions and that it should continue to charter credit unions.

A complete analysis of placing the Credit Union Department within the Finance Commission should occur during the Sunset review of all financial regulatory agencies in four years.

The Sunset review noted the Legislature's long history of interest in creating a unified regulatory structure for the state's financial regulatory agencies. This interest has centered on the Finance Commission performing as an umbrella agency with separate Departments that regulate the different industries. The review concluded that a complete analysis of placing the Credit Union Department within this structure would be more appropriate as part of the Sunset review of all financial regulatory agencies in 2001.

Recommendation

Changes in Statute

- **Continue the Credit Union Commission for four years.**
- **Charge the Sunset Commission, in its reviews in 2001, with evaluating the structure of the state's financial regulatory agencies.**
- **Require the Credit Union Commission to coordinate with the Finance Commission of Texas to jointly review financial institution regulatory laws and rules to identify areas of consistency and inconsistency and report to the Sunset Commission, by September 1, 1999, on the results of the review.**

This recommendation would continue the Department for four years — a period that would place its Sunset date in line with that of the Finance Commission, Banking Department, Savings and Loan Department, and Office of the Consumer Credit Commissioner. Reviewing the Credit Union Department simultaneously with the state's other financial institution regulatory agencies would allow the Legislature, at a more appropriate time, to fully consider the organizational structure of financial regulation. The Sunset Commission would conduct this review with the specific charge to study the effects of consolidating the Credit Union Department with the Finance Commission. This recommendation also requires a comprehensive look at the state's financial regulatory laws and rules. The results of this study would help the Sunset Commission in its review of the regulation of the industry as a whole.

Fiscal Impact

If the Legislature continues the current functions of the Credit Union Department, using the existing organizational structure, the Department's annual appropriation of about $1.25 million in fiscal year 1996 would continue to be required for the operation of the agency. The Department may incur some expense in conducting the required review of the rules. However, the exact amount of this expense cannot be estimated.

[1] Special Committee on Organization of State Agencies, *Report to the Governor and Members of the 71st Texas Legislature*, December 1988.

[2] Office of the State Auditor, *Financial Services in the 90s: Need for a Comprehensive Regulatory View*, October 1990, p. 21.

[3] Strategic Economic Policy Commission, *A Strategic Economic Plan for Texas*, January 1989.

[4] Rob Schneider, Senior Staff Attorney, Consumers Union, *Letter to Joey Longley*, April 1, 1996.

[5] Investment policy information from an interview with Gary Vopat, NCUA Associate Regional Administrator on March 21, 1996, and a review of the national and Texas statutes by Sunset staff. Other information from Credit Union National Association and National Association of State Credit Union Supervisors, *1994 Profile of State Credit Union Supervisory Agencies*, pp. 180, 203.

[6] NCUA Press Release, *Chief Regulator Says NCUA Should be Secondary Supervisor of Credit Unions,* March 11, 1996.

[7] John S. Ruffin, Regional Director National Credit Union Administration, *Letter to Joey Longley,* April 2, 1996.

[8] Robert S. Hayes, Public Service Employees Credit Union President, *Letter to Steve Hopson*, June 14, 1996.

[9] Texas Savings and Loan Department, *Agency Strategic Plan*, June, 1996, p. 6.

[10] Everette D. Jobe, General Counsel, Texas Department of Banking, "Expanded Rule-making Authority Will Benefit Texas Banks," *Banking Law: A Texas Lawyer Supplement*, January 15, 1996, p. 5.

[11] Texas Department of Banking, *Agency Strategic Plan*, June 1996, p. 20.

ACROSS-THE-BOARD RECOMMENDATIONS

Credit Union Commission	
Recommendations	**Across-the-Board Provisions**
	A. GENERAL
Update	1. Require at least one-third public membership on state agency policymaking bodies.
Update	2. Require specific provisions relating to conflicts of interest.
Update	3. Require that appointment to the policymaking body be made without regard to the appointee's race, color, disability, sex, religion, age, or national origin.
Apply	4. Provide for the Governor to designate the presiding officer of a state agency's policymaking body.
Update	5. Specify grounds for removal of a member of the policymaking body.
Apply	6. Require that information on standards of conduct be provided to members of policymaking bodies and agency employees.
Apply	7. Require training for members of policymaking bodies.
Apply	8. Require the agency's policymaking body to develop and implement policies that clearly separate the functions of the policymaking body and the agency staff.
Apply	9. Provide for public testimony at meetings of the policymaking body.
Update	10. Provide for notification and information to the public concerning agency activities.
Update	11. Require the agency to comply with the state's open meetings law and administrative procedures law.
Apply	12. Require development of an accessibility plan and compliance with state and federal accessibility laws.
Update	13. Require that all agency funds be placed in the treasury to ensure legislative review of agency expenditures through the appropriations process.
Update	14. Require information to be maintained on complaints.
Update	15. Require agencies to prepare an annual financial report that meets the reporting requirements in the appropriations act.
Apply	16. Require development of an equal employment opportunity policy.
Update	17. Require the agency to establish career ladders.
Update	18. Require a system of merit pay based on documented employee performance.

Credit Union Commission		
Recommendations	**Across-the-Board Provisions**	
	B. LICENSING	
Not Applicable	1.	Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2.	Provide for timely notice to a person taking an examination of the results of the examination and an analysis, on request, to individuals failing the examination.
Already in Statute	3.	Authorize agencies to establish a procedure for licensing applicants who hold a license issued by another state.
Not Applicable	4.	Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Not Applicable	5.	Authorize the staggered renewal of licenses.
Already in Statute	6.	Authorize agencies to use a full range of penalties.
Apply	7.	Specify disciplinary hearing requirements.
Modify	8.	Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Not Applicable	9.	Require the policymaking body to adopt a system of continuing education.

BACKGROUND

Background

Agency History

In 1913, Texas became one of the first states in the nation to provide for regulation of the emerging credit union industry when the Legislature passed the Rural Credit Union Act. This statute authorized the formation of cooperative associations for the purpose of promoting thrift and reducing the cost of living among tenant farmers. In 1929, the statute was amended to include all areas of the state, not just rural areas. By 1934, when the federal government began regulating federal credit unions, Texas had been joined by 37 other states in permitting the operation of state credit unions.

For the first 56 years of state chartering, Texas regulated credit unions through the State Banking Board and the Bank Commissioner. In 1969, the Legislature separated the regulation of credit unions and banks by creating the Texas Credit Union Department. Today the Department and the Texas Credit Union Commission, the Department's governing body, supervise 285 state-chartered credit unions with combined assets of $7 billion. The text box, *History of Credit Union Regulation in Texas*, provides a timeline of major credit union statutes.

Credit unions differ from other types of financial services institutions. Credit unions are member-owned, non-profit cooperatives designed to serve a select field of membership. A field of membership is a group of people who share a definable common bond such as employment by the same company, residence in the same geographic area, or membership in the same civic or religious organization. In contrast, banks and savings and loans operate for the profit of their shareholder-owners and make services available to all members of the public. The text box, *Comparison of Major Elements of Credit Unions and Banks*, shows the

History of Credit Union Regulation in Texas

<u>Time Line:</u>

1800s	-	Credit societies and cooperatives emerge in Europe.
1909	-	First credit union in the United States opens in New Hampshire. First law regulating credit unions passes in Massachusetts. Texas State Banking Board created.
1913	-	The Texas Legislature passes the Rural Credit Union Act permitting the chartering of credit unions in Texas.
1929	-	Texas Legislature amends the Rural Credit Union Act to make credit unions more accessible by lowering the initial deposit requirement from $25 to $5 and by including all parts of the state - not just rural areas.
1934	-	Congress passes the Federal Credit Union Act, permitting credit unions to organize anywhere in the United States and incorporate under state or federal law.
1969	-	The Texas Legislature passes the Texas Credit Union Act (ACT), creating the Credit Union Department as a separate entity apart from the Banking Department.
1973	-	Legislature amends the Act to require credit unions to provide deposit insurance.
1975	-	Texas Share Guaranty Credit Union (TSGCU) receives charter from the Department. TSGCU formed to provide deposit insurance to other credit unions.
1991	-	Credit Union Commission adopts rule requiring all credit unions to obtain federal deposit insurance from the National Credit Union Administration. This requirement eliminated the private insurance provided by TSGCU.

significant differences between credit unions and other financial institutions. Also important to note is the fact that credit unions may be chartered either by the state or the federal government. However, the

Comparison of Major Elements of Credit Unions and Banks		
	Credit Union	**Banks**
Purpose	not-for-profit	for-profit
Type of Organization	member-owned	corporation
Types of Loans	personal	personal
	auto	auto
		commercial
Sources of Assets	member deposits return on investments interest from loans	shareholder investments return on investments interest from loans
Distribution of Income	dividends to members	dividends to stockholders/ investors
Members/Customers	select field of membership	mass-marketed
Board of Directors	volunteers from membership	stockholders

Department only has jurisdiction over state charters. The chart, *Comparison of State and Federally Chartered Credit Unions in Texas*, shows the relative number of credit unions and their assets chartered by both levels of government.

Comparison of State and Federally Chartered Credit Unions in Texas		
State	285	$7,031,617,000
Federal	535	$15,442,928,000
Total	820	$22,474,545,000

Source: National Credit Union Administration, *1995 Midyear Statistics for Federally Insured Credit Unions.*

The mission of the Credit Union Department is to supervise, regulate, and examine state-chartered credit unions to safeguard the public interest, protect the financial interests of credit union members, and promote public confidence in the credit union industry.

Policymaking Structure

The Credit Union Commission is composed of nine members, appointed by the Governor and confirmed by the Senate. Members of the Credit Union Commission serve six-year, staggered terms. Six members must have at least five years experience as an executive, officer, director, or committee member of a credit union. Three members are public members who must have recognized business abilities. Public members may not be engaged in the management of or have an interest in a financial institution other than as a customer or member. The Commission elects its chair and vice chair and met four times in fiscal year 1995.

The primary role of the Commission is to hire, supervise, consult with, and advise the Credit Union Commissioner; adopt rules to administer the Act; and update these rules in response to changes in economic conditions. Major areas of the Commission's rulemaking authority include:

- determining the types of loans and investments that credit unions can make, and the amount of reserves that credit unions must hold;
- setting guidelines for credit union charters, mergers and changes in fields of membership; and
- mandating insurance of credit union members' deposits.

Other duties of the Commission include setting operating fees paid by credit unions, hearing appeals of the decisions and orders of the Commissioner, and appointing advisory committees, as necessary, to provide expertise to the Commission.

The Commissioner has independent authority to approve charter applications, changes in membership, and credit union mergers.

The Credit Union Commissioner has day-to-day responsibility for the operation of the Department and broad authority to enforce the Act and Commission rules. The Commissioner exercises authority over credit unions independent of the Commission by approving charter applications, changes in fields of membership, and mergers of credit unions. The Commissioner may also compel the production of books and records necessary for the examinations of credit unions, and levy and collect operating fees.

Funding and Organization

FUNDING

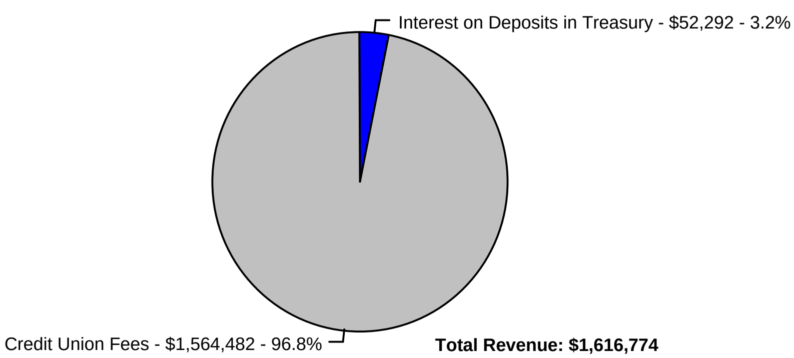
The Credit Union Department receives its funding from fees collected from credit unions. The primary fee is the credit union operating fee, which is assessed according to a credit union's assets with smaller credit unions paying less than larger ones. This fee schedule is set in rule and the Commissioner has the authority to raise or reduce the fee by 10 percent as circumstances warrant with the approval of the Commission. The current fee schedule is displayed in the chart, *Credit Union Operating Fee Schedule*.

Credit Union Operating Fee Schedule

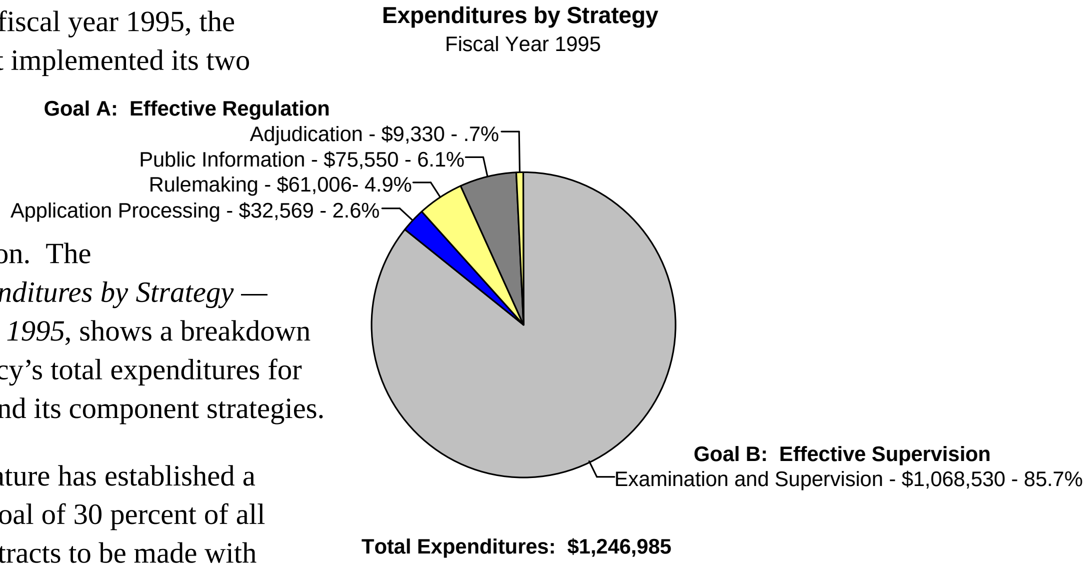
Credit Unions with Total Assets of:	The Operating Fee is:
Less than $200,000	$0
$200,000 - $500,000	$490 + $2.45/$1,000 of the amount over $200,000
$500,000 - $1 million	$1,225 + $.93/$1,000 of the amount over $500,000
$1 million - $5 million	$1,690 + $.38/$1,000 of the amount over $1 million
$5 million - $10 million	$3,210 + $.33/$1,000 of the amount over $5 million
$10 million - $25 million	$4,860 + $.13/$1,000 of the amount over $10 million
$25 million - $50 million	$6,810 + $.16/$1,000 of the amount over $25 million
$50 million - $100 million	$10,810 + $.17/$1,000 of the amount over $50 million
$100 million and over	$19,310 + $.07/$1,000 of the amount over $100 million

The Department's budget is also supported by two other fees—the out-of-state credit union fee and the special examination fee paid by credit unions requiring additional supervision and assistance. The assessment of the special examination fee was waived by the Commissioner during fiscal year 1995 because it was unnecessary to cover the Department's expenses. The Department collects the fees and deposits the funds in a dedicated account in the General Revenue Fund, the Credit Union Department Expense Fund Account. Because of the Legislature's action in 1995 to consolidate funds within the General Revenue Fund, revenues in excess of appropriations will no longer be dedicated for credit union regulation, but will be available for other purposes. In addition, interest will no longer accrue to the Department. The chart, *Sources of Revenue — Fiscal Year 1995*, shows the amount of the Department's income sources.

Sources of Revenue
Fiscal Year 1995



Two goals have been identified by the Credit Union Department in its strategic plan — effective regulation of credit unions and effective supervision of credit unions. In fiscal year 1995, the Department implemented its two strategic goals with a budget of about $1.25 million. The chart, *Expenditures by Strategy — Fiscal Year 1995*, shows a breakdown of the agency's total expenditures for each goal and its component strategies.



The Legislature has established a statewide goal of 30 percent of all agency contracts to be made with Historically Underutilized Businesses (HUBs). The Legislature also requires the Sunset Commission, in its reviews, to consider agencies' compliance with laws and rules regarding HUB use. The chart, *Purchases from HUBs — Fiscal Year 1995*, shows the Department's HUB participation for 1995.

Purchases from HUBs
Fiscal Year 1995

Total purchases of goods and services	$43,614
Total spent with certified HUBs	$22,387
Percent spent with certified HUBs	51.3%
Statewide average	15.9%
State goal	30%

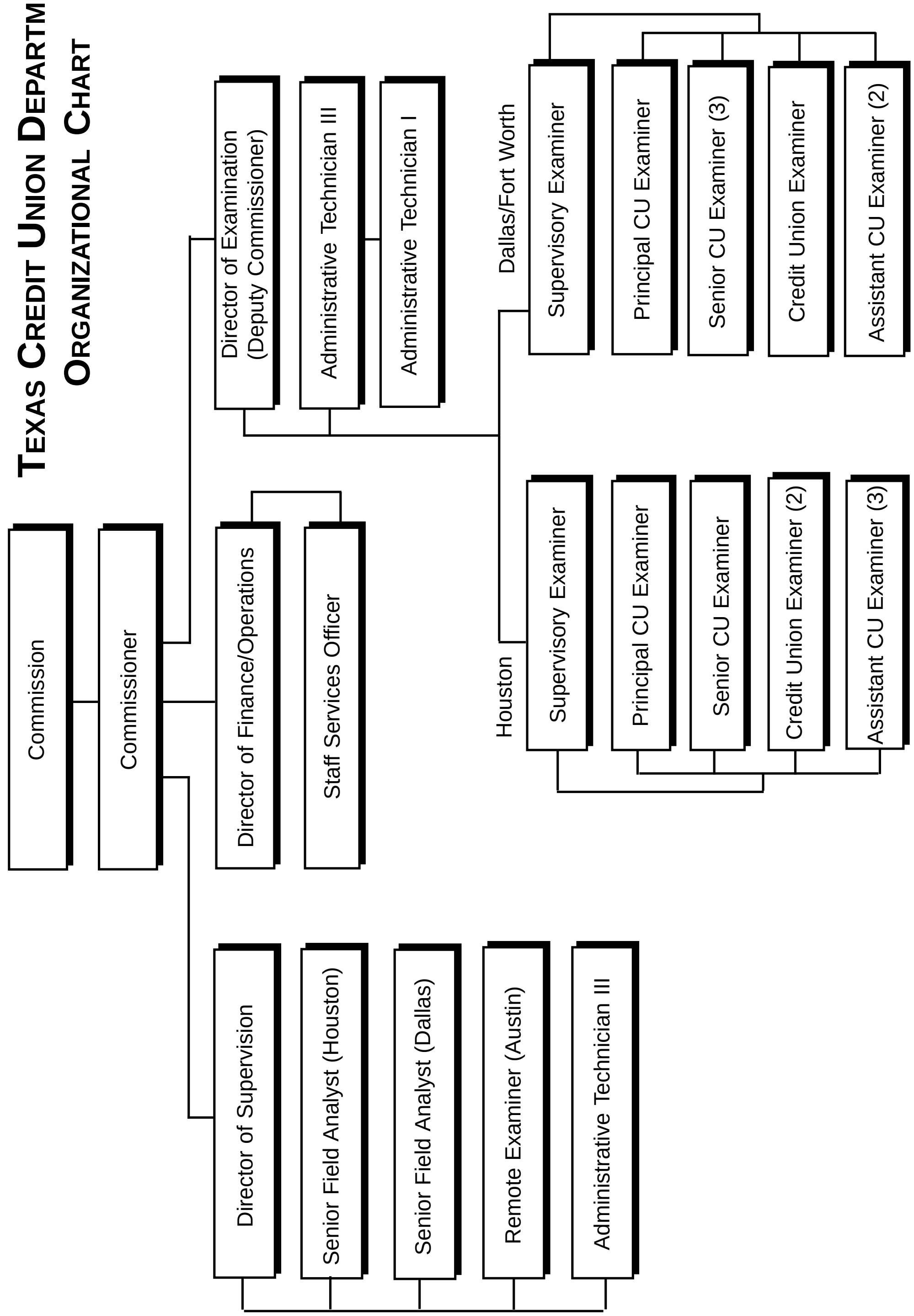
ORGANIZATION

The Credit Union Department employed 26 full-time equivalent employees (FTEs) in fiscal year 1995. The Department's headquarters is in Austin with eight FTEs. The majority of the Department's personnel perform examinations of credit unions and are located in the Houston and Dallas/Fort Worth areas. Because the Department does not maintain any district offices, field examiners work out of their homes. The organizational structure of the agency's divisions is illustrated in the chart, *Credit Union Department Organizational Chart*. A comparison of the agency's workforce composition to the state's minority workforce goals is shown in the chart, *Credit Union Department Equal Employment Opportunity Statistics — Fiscal Year 1995*.

Equal Employment Opportunity Statistics
Fiscal Year 1995

Job Category	Total Positions	Minority Workforce Percentages					
		Black		Hispanic		Female	
		Agency	State Goal	Agency	State Goal	Agency	State Goal
Officials/Administration	4	0%	5%	0%	8%	0%	26%
Professional	18	22%	7%	6%	7%	22%	26%
Technical	N/A		13%		14%		41%
Protective Services	N/A		13%		18%		15%
Para-Professionals	N/A		25%		30%		55%
Administrative Support	4	25%	16%	25%	17%	100%	84%
Skilled Craft	N/A		11%		20%		8%
Service/Maintenance	N/A		19%		32%		27%

Texas Credit Union Department Organizational Chart



Agency Operations

The Credit Union Department has adopted two main goals in its strategic plan that reflect the Department's major functions — effective regulation of credit unions and effective supervision of credit unions. Regulation generally refers to Department rulemaking that guides credit union operations, chartering of new credit unions, mergers of existing credit unions, and resolution of consumer complaints and contested cases. Supervision refers to the examination of credit unions for financial soundness and compliance with the Texas Credit Union Act (Act), and the remedial monitoring of credit unions with financial deficiencies. The Department's operations to meet these goals are described in the following material.

Goal One: Effective Regulation of Credit Unions

To fulfill its goal of effectively regulating credit unions, the Credit Union Commission sets rules that establish the standards for credit unions to operate safely and soundly protecting the financial interests of their members. Regulation is mainly accomplished through approving credit union charter applications, approving credit union mergers, and setting operational requirements in rule. The Department also investigates consumer complaints and resolves credit union administrative appeals.

While all credit unions must be chartered to operate in Texas, the Department only has authority over those credit unions with a state charter.

Approving Credit Union Charter Applications

The Credit Union Act requires all credit unions operating in Texas to be chartered. Charters may be obtained from the state, federal government, or from regulatory bodies of other states or countries (referred to as 'foreign' credit unions). The Department has regulatory authority over credit unions chartered in Texas and foreign chartered credit unions operating a branch office in Texas, but no authority over federal charters.

The Act provides specific requirements for groups wishing to obtain a state charter for a new credit union. Applications must be submitted by a group of at least seven Texas residents and contain articles of incorporation describing the credit union's principal location, the prospective board of directors, potential members, and the common bond shared by the members. The members' common bond must exist through occupation, association or residence. Applicants must also submit business plans, financial statements, and proposed bylaws, and obtain federal deposit insurance, which is discussed in greater detail under the next strategy. As part of this process, the Department conducts an on-site investigation, evaluates the suitability of proposed directors, and provides technical assistance to groups wishing to qualify for a charter. Upon completion of the filing requirements, the Commissioner has the authority to approve or deny the charter. In fiscal year 1995, the Department approved two charter applications from Texas groups wishing to start new credit unions. Only one other charter application was received in fiscal year 1995 and that application was withdrawn.

The Department is also responsible for approving the applications of foreign credit unions to open a branch in Texas. Only credit unions from states or nations that permit the operation of Texas credit unions may branch into Texas. Foreign credit unions must pay permit and annual operating fees, and submit to the Department annual examinations performed by the primary regulatory body in the home state or country. Ten credit unions from seven states operate in Texas. Although authorized in statute, no credit union with a charter from another nation operates in Texas. In fiscal year 1995, the Department approved two foreign credit union applications from existing credit unions in other states wishing to serve Texas residents.

Although the Commissioner can force credit unions to merge when necessary, none have merged involuntarily in the past ten years.

Approving Credit Union Mergers

Texas law provides for the merger of existing credit unions. To merge, the credit unions must submit to the Commissioner a plan that has been approved by the boards and memberships of both credit unions. The Commissioner has the authority to approve or deny the merger. In fiscal year 1995, the Department approved eight mergers out of eight requests.

The Commissioner may also authorize credit unions to merge in emergency cases if a credit union is in danger of insolvency. Emergency mergers do not require the concurrence of the credit unions' boards or members. Although the Commissioner has this authority to force a merger, no credit unions have been merged involuntarily in the past ten years.

Setting Operational Requirements

Credit Union Commission rules govern the operations of credit unions by specifically directing the administrative and financial practices of credit unions. These operational requirements range from how to start a credit union to what types of investments a credit union can make. The operational requirements generally fall into the categories shown in the chart, *Credit Union Business Practices Governed by Administrative Rule*.

Credit Union Business Practices Governed by Administrative Rule
Director qualifications
Credit union purchase, leasing and sale of credit union property
Records retention
Credit union board membership and qualifications
Financial reporting, audits and accounts verification
Share and deposit account requirements
Confidentiality for credit union member records
Safe deposit box facilities
Loan regulations covering terms, security, escrowing, loan to value ratio, recording, title insurance, loans to credit union officials
Credit union investment guidelines
Use of credit union service organizations
Capital reserve requirements
Federal insurance requirements

Other Regulatory Efforts

The Department investigates complaints filed against credit unions. These complaints generally range from dissatisfaction with the level of member service to dissatisfaction with the credit union's lending policies. The Department requires a response from the affected credit union before deciding on what action to take on the complaint. In fiscal year 1995, the agency received 57 complaints.

The Act grants credit unions the right to appeal decisions of the Commissioner to the Commission on issues such as charters, mergers, and field of membership changes. The Commissioner attempts to resolve these appeals informally or through a mediator before the case is heard by the Commission. In fiscal year 1995, the Department resolved 11 appeals informally or through mediation. If the party is still not satisfied by the Commission's ruling, the case is referred to the State Office of Administrative Hearings (SOAH). Since the creation of SOAH in 1991, the Department has only referred one contested case for hearing. No cases were referred by the Department to SOAH in fiscal year 1995.

Goal Two: Effective Supervision of Credit Unions

The Department strives to examine every state credit union on an annual basis. These on-site reviews by Department staff are to identify unsafe and unlawful business practices and credit unions that need follow-up remedial examinations to resolve the identified deficiencies.

Examination of Credit Unions

The Department's standard examination of credit unions focuses on two elements — the credit union's financial condition and its compliance with state and federal laws and regulations. The Department evaluates the financial status of credit unions using a standard evaluation and rating system used by most other states and the federal government in their examinations of credit unions, banks, and savings and loans. This rating system is based on a scale, referred to as a CAMEL code. The term, CAMEL, is an acronym for the components on which financial institutions are rated: capital adequacy, asset quality, management, earnings, and liquidity.

The second element of the Department's standard examination concerns the credit union's compliance with state and federal laws and regulations. The Department's examiner evaluates the credit union's compliance with the Credit Union Act, Commission rules, the Texas Collection Practices Act, federal deposit insurance rules, and other federal laws such as Truth in Savings and Truth in Lending.

At the end of the examination process, the examiner conducts an exit conference with the credit union's management and board of directors to discuss the findings and reach agreements with officials regarding corrective action. The Department attempts to annually examine every credit union every year. In fiscal year 1995, the Department performed 280 regular examinations.

Remedial Examinations

When the Department's annual examination reveals significant financial or management deficiencies, a credit union becomes subject to closer oversight. At this point, the Department schedules frequent remedial examinations and issues directives to correct financial and management deficiencies. Examples of deficiencies that may place a credit union in this level of oversight include a high percentage of delinquent loans, unsound lending or investing practices, low cash reserves, inadequate management, and violations of the statutes. The Department requires these credit unions to submit monthly financial statements and frequent updates on how these problems are being addressed. The Credit Union Department provides technical assistance to credit unions who require additional expertise in correcting these problems. For example, if a credit union has a high number of delinquent loans, the Department will help management revise its lending policy to better control delinquency. In fiscal year 1995, the Department performed 98 remedial examinations.

Joint Examinations with the National Credit Union Administration

To protect member deposits, Commission rules require state-chartered credit unions to obtain deposit insurance from the National Credit Union Administration (NCUA). NCUA is a federal agency which maintains the National Credit Union Share Insurance Fund (the Fund) and charters federal credit unions. The Fund insures credit union members' accounts up to $100,000. NCUA sets minimum financial standards for credit unions insured through the Fund.

State-chartered credit unions are insured by a federal agency which results in some dual regulation.

The requirement for state-chartered credit unions to maintain federal insurance has resulted in some degree of dual oversight by the state and the federal government. While the Department is the primary regulator, NCUA is responsible for protecting the Fund from losses posed by a credit union's financial condition. The Department's relationship with NCUA is governed by a document of cooperation that covers such issues as financial reporting and joint-examinations. Under the terms of this agreement, NCUA receives all of the Department's annual examination reports and may conduct joint-examinations with the Department of deficient credit unions or other credit unions that could pose a potential risk to the Fund. In fiscal year 1995, the NCUA participated in 56 joint-examinations with the Department.

Enforcement Powers

The Department has a range of enforcement powers to address violations of laws or rules and unsafe or improper financial practices. These enforcement powers are structured so that the Commissioner may vary an enforcement action according to the seriousness of the credit union deficiency. Most violations or deficiencies are discovered during the Department's on-site examinations. The Department examiner drafts a document of resolution detailing the measures the credit union should take to resolve the problems. In most cases, the credit union's management and board of directors resolve these problems voluntarily. If the credit union fails to take corrective action, the Commissioner may issue a document referred to as a letter of understanding and agreement. This letter is an agreement between the Commissioner and credit union's board of directors that sets a time frame for the credit union to comply with the directives.

While most problems are resolved through these informal methods, the Commissioner may take stronger enforcement action when problems persist. The Commissioner's first formal action is usually to issue a cease and desist order — demanding the practices or violations be discontinued. In more severe cases, the Commissioner may issue an order removing from office or employment the directors or employees of the credit union. When necessary, the Commissioner is authorized to take over the operation of a credit union by placing it in conservatorship. Finally, if the interests of credit union members are sufficiently jeopardized through insolvency or imminent insolvency, the Commission may order involuntary liquidation. The chart, *Enforcement Actions — Fiscal Years 1986-1995*, details the number of formal actions taken by the Commissioner in the past 10 years.

Enforcement Actions Initiated
Fiscal Years 1986 - 1995

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	Total
Letters of Understanding and Agreement	0	0	1	2	4	0	3	0	8	8	26
Cease and Desist Orders	0	0	2	1	0	0	2	1	1	0	7
Orders of Removal	0	0	0	0	0	0	0	0	0	0	0
Conservatorships	6	12	11	9	11	20	14	0	0	0	83
Involuntary Liquidations	4	6	9	8	6	7	10	15	0	0	65

Credit Union Commission

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