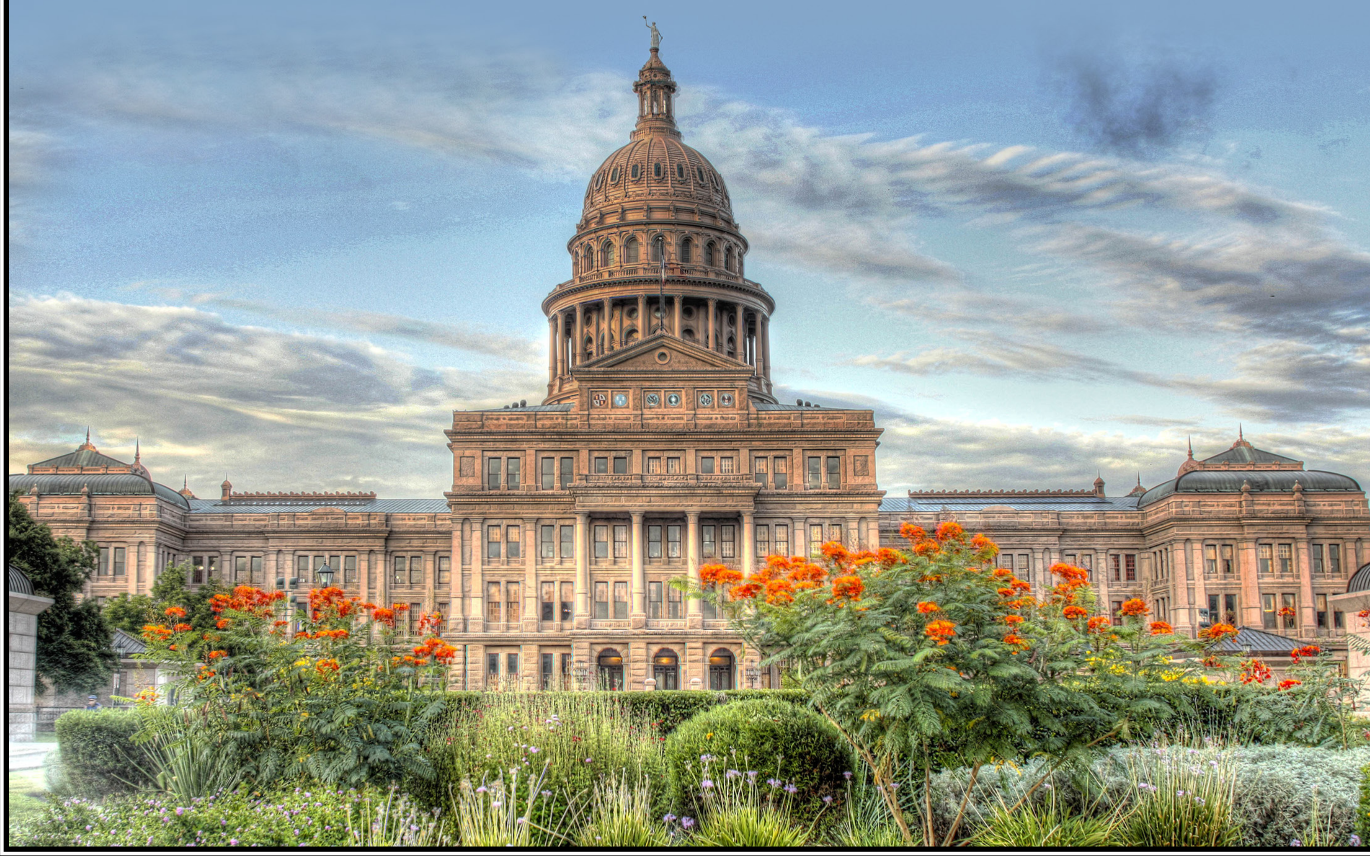
Sunset Advisory Commission

Staff Study with Final Results

Self-Directed Semi-Independent Status of State Agencies

July 2015



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Cover Photo: The Texas State Capitol was completed in 1888. With the Goddess of Liberty atop the dome, the Texas State Capitol Building is 19 feet taller than the U.S. Capitol Building in Washington, D.C. The photo shows the north facade of the Capitol. The gardens in the foreground sit atop a 667,000 square foot underground structure, the Capitol Extension, which houses many legislators' offices and committee rooms. Photo Credit: Janet Wood

Self-Directed Semi-Independent Status of State Agencies

Sunset Staff Study with Final Results

July 2015

This document is intended to compile all recommendations and action taken by the Sunset Advisory Commission for an agency under Sunset review. The following explains how the document is expanded and reissued to include responses from agency staff and the public.

- *Sunset Staff Study, October 2014* – Sunset staff develops a separate report on each individual agency, or on a group of related agencies. Each report contains both statutory and management recommendations developed after the staff's extensive evaluation of the agency.

- *Sunset Staff Study with Hearing Material, November 2014* – Adds responses from agency staff and the public to Sunset staff recommendations, as well as new issues raised for consideration by the Sunset Commission at its public hearing.

- *Sunset Staff Study with Decision Material, December 2014* – Adds additional responses, testimony, or new issues raised during and after the public hearing for consideration by the Sunset Commission at its decision meeting.

- *Sunset Staff Report with Commission Decisions, December 2014* – Adds the decisions of the Sunset Commission on staff recommendations and new issues. Statutory changes adopted by the Commission are presented to the Legislature in the agency's Sunset bill.

- *Sunset Staff Report with Final Results, July 2015* – Adds action taken by the Legislature on Sunset Commission recommendations and new provisions added by the Legislature to the agency's Sunset bill.

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Summary of Final Results

S.B. 217 Hinojosa (Gonzales) — Not Enacted

Although the 83rd Legislature required the Sunset Commission to develop recommendations for the administration of the State's self-directed semi-independent (SDSI) process, the 84th Legislature did not pass the Sunset bill containing these recommendations. The eight state agencies that currently have SDSI status would have been affected by the Sunset Commission recommendations. However, since the agencies themselves and their SDSI status were not under Sunset review specifically, the agencies will continue to operate as SDSI agencies.

The Sunset Commission concluded the State lacks a comprehensive approach to granting, overseeing, and revoking SDSI status resulting in agencies being granted SDSI status in a haphazard way, with inconsistent ongoing oversight. The Commission recommended that the Legislative Budget Board develop and oversee an application process for all agencies seeking SDSI status, and provide ongoing monitoring for State agencies with SDSI status. In addition, the Commission found that having SDSI agencies operating under different SDSI statutes limits effective oversight of these agencies and recommended placing all the SDSI agencies under the SDSI Act.

The Sunset Commission's statutory recommendations were incorporated into Senate Bill 217. The Senate passed the bill, with changes made to accommodate each of the agencies that would have been placed under the SDSI Act, but in the end, Senate Bill 217 never passed out of the House State Affairs Committee. The Legislature did support the Sunset Commission's recommendation to establish a moratorium on expanding SDSI status during the 84th Legislative Session by not granting SDSI status to any new agencies.

Summary of Sunset Staff Recommendations

Summary

In 2001, the Legislature enacted the Self-Directed Semi-Independent (SDSI) Project Act and granted the Accountancy, Architecture, and Engineers boards SDSI status. Having SDSI status gives an agency the authority to operate outside of the appropriations process by making the agency entirely responsible for its own operations and expenses, including establishing its own budget and setting its fees accordingly.

From the beginning, oversight agencies and the Legislature had questions and concerns about the soundness of the policy decision to give state agencies so much independence, and whether or not the SDSI concept would prove effective. Proponents of the SDSI concept pointed to benefits such as agencies being able to offer higher salaries to recruit and retain more experienced staff and to respond more quickly to changing regulatory environments. However, these claims were tempered by the inherent risks associated with the significant loss of legislative oversight of these agencies.

The State's piecemeal approach to granting SDSI status limits needed and consistent oversight.

These ongoing questions and concerns led to several legislatively directed Sunset evaluations of the SDSI Act. In each of these evaluations, Sunset found no evidence of agencies running amok, as many feared. In fact, Sunset's evaluation of the SDSI Act in 2012 found that the three original SDSI agencies were operating appropriately and that the SDSI Act was working as intended. As such, the Sunset Commission recommended continuing the SDSI Act and removing its pilot project status in 2013, and the Legislature agreed. However, the Sunset evaluation also found that the SDSI Act did not provide needed safeguards to ensure ongoing oversight and prevent potential abuse. In response, the Legislature enacted several additional requirements to address these concerns. While these requirements addressed Sunset's concerns, they only applied to the three original agencies under the SDSI Act.

Since 2001, five other agencies gained SDSI status through provisions added to their own individual agency statutes, not through the SDSI Act (the Texas Department of Banking, Texas Department of Savings and Mortgage Lending, Office of Consumer Credit Commissioner, Credit Union Department, and Texas Real Estate Commission, including the Texas Appraiser Licensing and Certification Board). This piecemeal approach to granting SDSI status has resulted in inconsistent statutory requirements among the SDSI agencies — in particular, the new safeguards that are only found in the SDSI Act — which limits needed and consistent oversight.

To address concerns with the inconsistent approach to granting SDSI status and continued reservations about the SDSI concept overall, the 83rd Legislature directed Sunset to conduct yet another SDSI study and report its results and recommendations to the Legislature prior to the 84th Legislative Session. This

> ***SDSI Agencies Study***
>
> The Sunset Commission study must address the following aspects of the State's approach toward managing the SDSI status of state agencies:
>
> - criteria and processes for determining whether a state agency should be given SDSI status or if this status should be revoked;
> - appropriations issues related to transitioning an agency to SDSI status or back to regular agency status;
> - reporting and measures to ensure adequate state oversight of SDSI agencies;
> - procedures for SDSI agencies to contract with other agencies;
> - procedures for Sunset review of SDSI status; and
> - criteria for review of complaint procedures and disposition.

current study focuses on the State's approach to the SDSI process overall, specifically the criteria for granting and revoking SDSI status, requirements to ensure adequate oversight of SDSI agencies, and any appropriations issues related to transitioning an agency to and from SDSI status. The textbox, *SDSI Agencies Study*, details this charge. Several elements of the study have already been addressed, as SDSI status already authorizes SDSI agencies to contract for services, including with other state agencies, and criteria related to the review of complaints already exist as part of Sunset's model standards and would be applied during the review of an SDSI agency under a Sunset review.

Overall, this study determined that the State has an undefined and inconsistent approach to managing the SDSI process, which exposes the State to unnecessary risk. No single entity is responsible for administering and overseeing the SDSI process. Therefore, a comprehensive process with clearly-defined requirements for obtaining and retaining SDSI status does not exist. Instead, the Legislature has granted SDSI status haphazardly, through various statutes, resulting in agencies gaining SDSI status with minimal vetting, and operating with different reporting requirements and inconsistent oversight. Without a single SDSI process in place, agencies will continue to ask for and potentially gain unique SDSI provisions within their own statutes that undermine effective oversight. Additionally, the concerns about accountability and oversight of SDSI agencies are magnified when considering granting SDSI status to health-related and larger licensing agencies, where fiscal mismanagement and lax regulation can directly affect the lives of thousands of Texans.

> ***Please note: Summaries of Sunset Commission decisions on each of the following staff recommendations are located at the end of the detailed discussion of each issue.***

Summary of Results

As a result of this study, Sunset staff provides the Sunset Commission the following recommendations regarding the self-directed semi-independent status of state agencies.

- Require the Legislative Budget Board to develop and administer a process for obtaining SDSI status and overseeing SDSI agencies.
- Expand reporting and monitoring requirements of agencies subject to the SDSI Act to help improve oversight.
- Place all current SDSI agencies under the SDSI Act.
- The Senate Finance and House Appropriations Committees should consider establishing a moratorium on expanding SDSI status during the 84th Legislative Session.

Study Results

The Lack of a Comprehensive and Consistent Approach to Self-Directed Semi-Independent State Agency Oversight Creates Risks for the State.

Background

In 2001, the Legislature enacted the Self-Directed Semi-Independent (SDSI) Agency Project Act, which exempts agencies with SDSI status from the General Appropriations Act and process, and other state laws inconsistent with this status. The SDSI agencies must still comply with other general state laws such as the Public Information and Open Meetings acts and with general state agency provisions.

Having SDSI status is meant to improve agency operations by providing greater flexibility in budget development, including allowing for higher salaries to recruit and retain staff, enabling agencies to respond more quickly to changing regulatory environments, and helping agencies address their capital needs, such as maintenance and information technology. The SDSI Act allows agencies to control their own funds and budgets to take care of their operations without having to request funding and receive budgetary oversight from the Legislature. SDSI agencies set their own fees and operate on the revenue collected, and their governing boards approve their annual budgets rather than the Legislature. The SDSI Act makes each agency responsible for all direct and indirect costs, including employee benefits and retirement costs, and costs incurred by any state agency, including work performed by the State Auditor's Office (SAO) and the Office of the Attorney General (OAG). In addition, each agency must annually remit a specified fixed sum to general revenue.

In 2001, the Legislature first granted SDSI status to the Texas State Board of Public Accountancy, Texas Board of Professional Engineers, and Texas Board of Architectural Examiners and, since that time, has granted SDSI status to five additional agencies, as shown in the textbox on the following page, *SDSI Timeline*. The Legislature has also granted very limited SDSI status to two divisions within the Texas Department of Insurance. However, as statutorily directed, this study only addresses granting, monitoring, and revoking the self-directed status of agencies.[1] While the first three agencies received SDSI status under the actual SDSI Act, the finance and real estate-related agencies received SDSI status through provisions in their enabling statutes, as shown in the textbox, *Sources of Agencies' SDSI Status*.[2]

In 2012, the Sunset Commission reviewed the SDSI Act and found that it should be continued but with additional safeguards to ensure adequate controls and oversight.[3] The review also recommended that the Legislature consider temporarily halting further enactment of SDSI agency status until it can assess the overall approach to SDSI and the impact it has on effective agency oversight.

Sources of Agencies' SDSI Status

Chapter 472, Government Code (SDSI Act)

- Texas State Board of Public Accountancy
- Texas Board of Professional Engineers
- Texas Board of Architectural Examiners

Chapter 16, Finance Code

- Texas Department of Banking
- Texas Department of Savings and Mortgage Lending
- Office of Consumer Credit Commissioner
- Credit Union Department

Chapter 1105, Occupations Code

- Texas Real Estate Commission, including the Texas Appraiser Licensing and Certification Board

SDSI Timeline

2001 Legislature enacts SDSI Project Act and grants SDSI status to:

- Texas State Board of Public Accountancy
- Texas Board of Professional Engineers
- Texas Board of Architectural Examiners

2002–2003 Sunset Commission reviews the SDSI Act and recommends its abolishment. However, the Legislature continues the SDSI Act and requires Sunset to conduct a subsequent review in 2009, giving SDSI agencies more time to establish a record under the SDSI Act. (Senate Bill 1382, Armbrister)

2009 The Legislature postpones the Sunset review of the SDSI Act to align it with the review of the SDSI agencies in 2013. (House Bill 3249, Truitt)

Legislature grants SDSI status to the following agencies but not under the SDSI Act (House Bill 2774, Truitt):

- Texas Department of Banking
- Texas Department of Savings and Mortgage Lending
- Office of Consumer Credit Commissioner
- Credit Union Department

2011 Legislature grants SDSI status to the following agencies but not under the SDSI Act:

- Texas Real Estate Commission (Senate Bill 1000, Eltife)
- Texas Appraiser Licensing and Certification Board (Senate Bill 1000, Eltife)
- Two divisions within the Texas Department of Insurance (Senate Bill 1291, Hegar)

2012–2013 Sunset Commission reviews the SDSI Act and recommends its continuation. The Legislature continues the SDSI Act. (House Bill 1685, Price)

The Legislature requires Sunset to review the standards for granting SDSI status to state agencies and issue a report in 2015. (House Bill 1675, Bonnen)

As a result, the 83rd Legislature clarified that agencies under the SDSI Act must comply with all state laws that do not conflict with SDSI status and use the comptroller's Uniform Statewide Accounting System. In addition, the Legislature required these SDSI agencies to remit administrative penalties to general revenue and include more detailed budgetary and performance data in their annual reports. The Legislature also required the Sunset Commission to review the SDSI status of all agencies under the SDSI Act as part of their Sunset review and required SDSI agencies to pay these review costs.[4]

Further, the Legislature required Sunset, in consultation with the Legislative Budget Board (LBB), to perform another study on the SDSI status of state agencies to specifically address criteria for granting and revoking SDSI status, adequate oversight of SDSI agencies, and any appropriations issues related to transitioning an agency to and from SDSI status.[5] This study fulfills these requirements but does not take on the more fundamental policy question of whether the SDSI concept is an appropriate suspension of legislative authority and oversight.

Results

Not having a consistent approach for granting, overseeing, and revoking SDSI status exposes the State to unnecessary risk.

Controlling revenues and expenditures, and holding agencies accountable for performance through the appropriations process is at the heart of legislative authority and oversight. The appropriations process allows the Legislature to closely monitor agency operations and set agency priorities through the power of the purse. For several of the current SDSI agencies, the appropriations process was the primary opportunity for the Legislature to oversee their operations and performance. In addition, the reporting requirements associated with the appropriations process, such as Legislative Appropriations Requests and performance measures, provided consistent and valuable information for other oversight entities such as LBB, SAO, and Sunset.

Removing agencies from the appropriations process and allowing them to operate without close fiscal oversight has potential risks, including the opportunity for abuse of this flexibility and possibility that without the appropriations process as a buffer, regulatory programs may be overly influenced by the regulated community that underwrites the cost of these agencies. Even though agencies with SDSI status tend to be smaller occupational licensing agencies, they can experience significant problems when operating outside of appropriations due to inadequate expertise and budgetary controls. For example, an SAO report found significant problems with the Texas Real Estate Commission's (TREC) ability to meet statutory requirements for developing accurate financial reports and correctly accounting for licensing revenues.[6]

The Legislature has granted SDSI status to eight state agencies.

In 2012, Sunset found that the disparate treatment of agencies caused by the State's incremental approach to granting SDSI status increases the risk that the State may lose control of one of the SDSI agencies.[7] Based on Sunset staff's most recent assessment of the State's approach to SDSI, these concerns continue to exist, as do significant concerns with the SDSI concept overall. This report recommends implementing a more comprehensive and consistent method of evaluating, approving, and overseeing the SDSI status of state agencies to help mitigate these ongoing concerns as well as the potential risks associated with the loss of legislative oversight through SDSI.

- **Inconsistent approach to granting SDSI status.** As previously noted, only three of the eight SDSI agencies operate under the actual SDSI Act. The remaining five agencies gained SDSI status through independent legislation and ultimately their own separate statutes. While each agency must abide by similar SDSI statutory provisions, as time goes on, the potential for any of these statutes to be separately modified increases, allowing for numerous variations on the statutory SDSI requirements. For example, the previous Sunset review of the SDSI Act resulted in a significant expansion of reporting requirements to improve legislative oversight; however, the five agencies not under the SDSI Act are not subject to these requirements or any of the other statutory improvements added to the SDSI Act. These different requirements and the potential for even greater statutory disparities in the future, make oversight difficult and agency comparisons impossible.

The State lacks a means to ensure each agency considered for SDSI status is capable of operating effectively outside the appropriations process.

Having a disjointed approach to granting SDSI status not only leads to agencies operating under different statutory requirements but also fails to ensure that each agency being considered for SDSI status is uniformly and adequately screened for the ability to operate with fiscal restraint and effectively carry out its mission outside of the appropriations process. Currently, no process exists to thoroughly evaluate each agency's financial and operational performance to ensure it can function effectively under the considerable funding and oversight flexibility granted by SDSI status. Given concerns about the ability of current SDSI agencies to operate effectively, expansion of SDSI status to other professional licensing and regulatory agencies should be approached consistently and deliberately, with sufficient information and data to support the decision to grant SDSI status or not.

- **Lack of continuing oversight.** Currently, LBB, SAO, Sunset, and the Comptroller of Public Accounts have limited oversight and assistance responsibilities related to SDSI agencies. Oversight efforts are limited to reviewing reports, conducting audits, and providing technical assistance. However, no single entity is tasked with regular monitoring of SDSI agencies. The SDSI Act does require SAO to contract with SDSI agencies for financial and performance audits. However, the SDSI Act does not specify the frequency of these audits to ensure SAO regularly reviews these agencies to help identify any problems early, before they become potential liabilities for the State.[8] While the Sunset Commission has authority to review SDSI status as part of each SDSI agency's regular Sunset review, the agencies typically only undergo Sunset review every 12 years. Sunset is not in a position to evaluate an agency's ongoing SDSI reports and performance data to detect problems sooner than every 12 years. Further, should an SDSI agency experience a significant problem of any sort, no single oversight entity is responsible for alerting the Legislature.

No single entity is tasked with regular monitoring of SDSI agencies.

While the Legislature recently added more detailed reporting requirements to the SDSI Act, this review identified the need to further strengthen the requirements. For example, Sunset found that a lack of consistent, detailed budget information makes it difficult to understand SDSI agency budgets and accurately track the flow of revenues and expenditures. As noted in the SAO report, TREC did not provide a full accounting of its budget, omitting $33.1 million in nonoperational pass-through revenues, expenditures, and transfers.[9] While the SDSI Act requires SDSI agency budgets be developed using Generally Accepted Accounting Principles, this does not ensure budget documents are completed in standard formats and with sufficient detail to provide a clear picture of all revenues and expenditures. In addition, the SDSI Act currently requires the agencies to report their annual financial and performance data on November 1, but this date does not coincide with the required November 20 submission date for their annual financial report, creating additional work for the agencies and potentially undermining the accuracy of the reported data.[10] If the Legislature chooses to grant SDSI status to larger, more complex agencies, reporting budgetary and performance information with greater transparency and detail will become increasingly important.

- **No process for transitioning agencies back to the appropriations process.** While the future is uncertain, the potential exists for an SDSI agency to move back to the appropriations process. However, the SDSI Act provides no guidance on how to effectively transition an SDSI agency back to the appropriations process, and a defined transition process does not exist. The SDSI Act does not address key steps such as developing transitional budgets, performance measures, and standard oversight mechanisms. Without a well-defined transition process, if the Legislature were to revoke an agency's SDSI status, LBB would likely need to treat the agency as if it were newly created. While an SDSI agency would have a budget and some performance measures in place, LBB would likely have to create a baseline budget and new performance measures since SDSI agencies do not typically budget in the same way as appropriated agencies and are able to set their own performance measures.

Recommendations

Change in Statute

1.1 Require the Legislative Budget Board to develop and administer a process for obtaining SDSI status and overseeing SDSI agencies.

Under this recommendation, LBB would develop and manage the SDSI process for the state. The process would include developing and administering an application process that any state agency requesting SDSI status would be required to complete. Agencies that currently have SDSI status would be exempt from the application process. The process would also provide for ongoing oversight of all SDSI agencies and a consistent way to revoke SDSI status and transition agencies back to the appropriations process if needed.

SDSI Application Process

To be considered for SDSI status, a state agency would be required to:

- undergo an SAO financial and performance audit within four years of submitting the application for SDSI status;
- hold a public hearing on the need for SDSI status and decide by an official vote of the agency's governing board whether or not to apply to LBB for SDSI status; and
- submit an SDSI application to LBB, concurrent with the agency's Legislative Appropriations Request, four years in advance of when the SDSI status would become effective.

As part of the SDSI application, agencies must include a statement of need for SDSI status, including anticipated benefits and potential drawbacks; data showing a history of and continuing ability to operate effectively and protect the public's interest; documentation of adequate budgetary processes and controls; any fiscal impacts to other state accounts or other state agencies; and documentation showing that SDSI status would be revenue neutral to the State.

LBB would be authorized to determine the format of the application and could require any additional information to best evaluate an agency's ability to effectively operate under the SDSI Act, such as the financial expertise of board members and staff; certification that no conflicts of interest between board members, staff, and regulated professions or entities exist; any public and stakeholder comments related to the agency's SDSI status; and any affected contracts, facilities, properties, and leases. Based on its review and analysis of the application and other materials, LBB staff would make a recommendation to the appropriative committees on whether or not an agency should be granted SDSI status.

Ongoing Oversight

An agency with SDSI status must continue to demonstrate its effectiveness in carrying out its mission, including protecting the public's interest; financial soundness, including its ability to raise sufficient revenues and maintain operating reserves; ability to meet all financial obligations, including retirement and health benefit costs; and ongoing compliance with all application requirements and statutory reporting requirements, as well as a satisfactory audit history, including the agency's ability to remedy findings.

LBB would be expected to monitor SDSI agencies on a regular basis and authorized to develop any additional reporting requirements for this purpose. LBB staff could make recommendations to address any identified problems to the appropriative committees and the Legislature, including a recommendation to revoke an agency's SDSI status. LBB would be authorized, but not required, to recover the costs associated with the SDSI application process and any ongoing oversight.

SDSI Revocation Process

LBB would be statutorily authorized to develop a process and criteria to determine when recommending revocation of an agency's SDSI status to the Legislature is warranted. If the Legislature revokes an agency's SDSI status, LBB would facilitate the transition of an SDSI agency back to the appropriations process. The transition would likely include establishing a new budget pattern and performance measures; determining the placement and use of agency funds; developing any necessary riders; and evaluating the status and disposition of agency contracts, facilities, properties, and leased space. In addition to any SDSI revocation process that LBB develops, the Legislature could also revoke an agency's SDSI status based on a recommendation from the Sunset Commission through the agency's Sunset review.

1.2 Expand reporting and monitoring requirements of agencies subject to the SDSI Act to help improve oversight.

This recommendation would require all agencies operating under the SDSI Act to provide more complete budget information, including reporting all nonoperational and pass-through revenues and expenditures in a consistent format prescribed by LBB. The SDSI agencies would also be required to undergo an SAO financial and performance audit every six years to ensure more consistent and ongoing oversight, but this requirement would not prevent SAO from performing a risk-based audit any time it deems necessary. Finally, this recommendation would align the SDSI agency annual performance and financial data reporting date with the submission date of the annual financial report by changing the reporting date from November 1 to November 20. Requiring SDSI agencies to provide more detailed and transparent financial data would give oversight agencies, such as LBB, SAO, and Sunset, a more accurate picture of the SDSI agencies' financial status. Also, presenting this information in a consistent format would allow for easier comparison of SDSI agency performance.

1.3 Place all current SDSI agencies under the SDSI Act.

While not specifically required as part of this study, Sunset staff identified a significant risk in having essentially three different sets of SDSI statutes in place governing eight state agencies. To provide for more consistent administration and effective oversight of all SDSI agencies, the following finance and real estate-related SDSI agencies would be made subject to the SDSI Act and the separate SDSI provisions would be removed from their individual statutes.

- Texas Department of Banking
- Texas Department of Savings and Mortgage Lending
- Office of Consumer Credit Commissioner
- Credit Union Department
- Texas Real Estate Commission/Texas Appraiser Licensing and Certification Board

Placing these agencies under the SDSI Act would ensure a single set of reporting requirements and controls applies to all SDSI agencies. Further, these agencies would be held to the same standard of remitting all administrative penalties to general revenue, as the agencies currently under the SDSI Act do. In addition, TREC would no longer pay annual retainers to SAO, OAG, and the State Office of Administrative Hearings. Instead, TREC would reimburse these agencies for any services rendered. Also, each agency's SDSI status would be evaluated as part of the agency's regular Sunset review.

Change in Appropriations

1.4 The Senate Finance and House Appropriations committees should consider establishing a moratorium on expanding SDSI status during the 84th Legislative Session.

This recommendation expresses the intent of the Sunset Commission that the Senate Finance and House Appropriations committees temporarily suspend granting SDSI status to any other state agencies until the Legislature is able to adopt a more comprehensive and consistent approach for managing the SDSI process.

Fiscal Implication

These recommendations would have an overall positive fiscal impact to the State based on the administrative penalty revenues that would be deposited to the General Revenue Fund. However, the amount of these revenues could not be estimated since administrative penalties collected by agencies vary year to year. Regarding Recommendation 1.1, LBB would be authorized, but not required, to recover any costs associated with overseeing SDSI agencies by assessing a cost reimbursement fee to be paid by the SDSI agencies. Under Recommendation 1.2, TREC would no longer pay annual retainers to SAO, OAG, and the State Office of Administrative Hearings; however, this would not have a significant fiscal impact because under the SDSI Act, TREC would reimburse these entities for the actual costs of any services rendered.

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[1] Self-Directed Budget for Certain Divisions, Subchapter F, Texas Insurance Code.

[2] H.B. 2774, 81st Texas Legislature, Regular Session, 2009 and S.B. 1000, 82nd Texas Legislature, Regular Session, 2011.

[3] Sunset Advisory Commission (Sunset), *Sunset Final Report with Legislative Action on Self-Directed Semi-Independent Agency Project Act* (Austin: Texas, Sunset Advisory Commission, October 2012).

[4] H.B. 1685, 83rd Texas Legislature, Regular Session, 2013.

[5] H.B. 1675, 83rd Texas Legislature, Regular Session, 2013.

[6] State Auditor's Office (SAO), *The Real Estate Commission: A Self-directed Semi-independent Agency, Report No.14-037* (Austin: State Auditor's Office, September 2014), pp. 1-2.

[7] Sunset, *Final Report with Legislative Action Self-Directed Semi-Independent Agency Project Act*, p. 43.

[8] Section 472.103, Texas Government Code.

[9] SAO, *The Real Estate Commission: A Self-directed Semi-independent Agency*, p. 18.

[10] Section 2101.011(b), Texas Government Code.

Responses to Study Results

Overall Affected Agency Responses to Staff Study

Texas State Board of Public Accountancy. The October 2014 study takes a broad brush approach that encompasses all SDSI agencies. We would ask that the report make it clearer that the SDSI agencies that underwent Sunset review in 2013 received a finding that they are operating responsibly. We also ask that you include greater emphasis on the positive aspects of SDSI that were contained in the final results of the Sunset report of July 2013 and highlight the safeguards that were put in place with the enactment of House Bill 1685 in response to the 2012–2013 report recommendations. (William Treacy, Executive Director – Texas State Board of Public Accountancy)

Texas Board of Professional Engineers. As one of the original SDSI agencies, the Texas Board of Professional Engineers (TBPE) has found the SDSI program to be very effective and we have worked hard to be a model of efficiency, transparency, and accountability. This is evident through our various awards, audits, Sunset reviews, and multiple and detailed reports to the governor's office, Legislature, and various oversight agencies. During the 83rd Legislative Session, the SDSI program underwent a full Sunset review and the involved agencies were found to be operating appropriately and the SDSI Act was working as intended. (Lance Kinney, P.E., Executive Director – Texas Board of Professional Engineers)

Texas Board of Architectural Examiners. Regarding the recommendations made in the study, we generally do not object to those affecting this agency. We feel that increased oversight and reporting requirements, crafted to be reasonable and feasible, will do nothing other than bolster the State's confidence that its SDSI agencies are operating according to the wishes of the Legislature. Our only potential concerns are with the details of how legislation might be written and implemented – which is to say, our concerns lie outside the scope of your study. The Texas Board of Architectural Examiners would hope that the scope of the proposed increased oversight is reasonable and mindful of the legislative intent of SDSI, and that the cost of the increased oversight is not so high that it would seriously impact agency finances. We hope that proposed legislation would not adversely affect the board's ability to balance our annual budget. (Glenn Garry, Interim Executive Director – Texas Board of Architectural Examiners)

Texas Department of Banking. The study suggests that there is a lack of oversight of the SDSI agencies, specifically noting the limited oversight of the Legislative Budget Board (LBB), State Auditor's Office (SAO), Sunset, and Comptroller of Public Accounts. With the exception of appropriation-related and performance measure reporting, we receive the same oversight as we did pre-SDSI from these agencies. While the Department of Banking (DOB) agrees that the legislative appropriation process is a powerful tool, it is not the only tool to evaluate performance and compliance. For example, in addition to the required state reporting, in our letter to your agency dated June 30, 2014, we provided samples of the periodic reports we provide to our oversight board, the Finance Commission. Also, in response to the inference that SDSI status may cause regulatory programs to be overly influenced by the regulated community, we point out that our 11-member Finance Commission requires a majority of six public members. The study further generalizes that small agencies have inadequate accounting expertise and budgetary controls which is not true with respect to our agency.

Being SDSI has enhanced and heightened our reporting, interaction, and transparency with our oversight board. This interaction provides a thorough and ongoing evaluation of the agency's financial and operational performance and allows DOB to function in a more business-like manner. In addition, we continue to have close communication with our oversight legislative committees, Senate Business and Commerce and House Investments and Financial Services. (Charles G. Cooper, Banking Commissioner – Texas Department of Banking)

Texas Department of Savings and Mortgage Lending. The Department of Savings and Mortgage Lending acknowledges that transparency, accountability, and accurate reporting are essential to being SDSI, but is concerned with the suggestion of a "one-size-fits-all" approach. As an SDSI agency we strive to be transparent, accountable, and good financial stewards. The current SDSI statute, as set out in the Finance Code, allows the department to successfully and efficiently fulfill our mission and regulatory responsibilities. The SDSI status allows the department to be run in a business-like manner, which further allows us to respond quickly to changes in the financial regulatory environments under our authority. As needed we can respond to these changes by either expanding or contracting our resources. (Caroline C. Jones, Commissioner – Texas Department of Savings and Mortgage Lending)

Office of Consumer Credit Commissioner. The Office of Consumer Credit Commissioner (OCCC) would respectfully note some of the findings in this report that the agency believes will challenge its ability to most effectively fulfill its mission. The report suggests that there is an undefined and inconsistent approach to managing SDSI agencies. The OCCC, along with DOB and the Texas Department of Savings and Mortgage Lending, believe that the Legislature has set sufficient safeguards in place to prevent exposing the State to unnecessary risk. The OCCC does not believe that there is a one-size-fits-all approach that will result in effectively administering and overseeing SDSI agencies. What works for one may not work for another. (Leslie L. Pettijohn, Commissioner – Office of Consumer Credit Commissioner)

Credit Union Department. In general, the study recommends the implementation of a more comprehensive and consistent method of evaluating, approving, and overseeing the SDSI status of agencies. The Credit Union Department fully supports the concept that SDSI agencies should be open, accountable, transparent, and fiscally-responsible. As a regulatory agency, we also recognize the benefits of early and realistic identification of problems or weaknesses before they develop into more serious issues or adversely affect the agency's ability to effectively carry out its mission. (Harold E. Feeney, Commissioner – Credit Union Department)

Texas Real Estate Commission. We are in full agreement that it would best serve the people of Texas and their representatives in the Legislature if some additional clarity were provided in the application and interpretation of SDSI agency requirements, especially in the area of reporting directives. While each agency is fully responsible for all funds that come into its possession and for the reports filed, a lack of consistent guidance from oversight agencies on the unique requirements of SDSI agencies has led to some inconsistent results. This lack of consistency has the potential to lead to some misleading conclusions if not clarified. (Douglas E. Oldmixon, Administrator – Texas Real Estate Commission and Commissioner – Texas Appraiser Licensing & Certification Board)

Recommendation 1.1

Require the Legislative Budget Board to develop and administer a process for obtaining SDSI status and overseeing SDSI agencies.

Affected Agency Responses to 1.1

Texas Board of Professional Engineers. TBPE has extensive experience in SDSI operations, monitoring, performance measure collection and analysis, budgeting, and reporting. There are currently numerous measures already required by statute for SDSI agencies to report, both legacy measures from the original SDSI program as well as measures newly added through the 2013 Sunset legislation. Therefore, TBPE would like to offer our assistance to LBB and the Sunset Commission with these charges and to help develop the most relevant and effective reporting and monitoring processes. We believe our experience with SDSI would be very valuable to assist in meeting the goals of transparency and accountability while keeping a focus on the intent of the SDSI program toward innovative and efficient state government. (Lance Kinney, P.E., Executive Director – Texas Board of Professional Engineers)

Texas Department of Banking. Transparency, accountability and accurate reporting are essential but should be relevant and tailored to the operations of each agency. The costs of ongoing LBB oversight that may be recovered from SDSI agencies could be a significant expense that would be passed on to our licensees. We believe the Legislature has set sufficient safeguards that prevent exposing the State to unnecessary risk.

Texas Department of Banking Modification

1. Reduce the gestation period of four years for the application process to no more than one year.

(Charles G. Cooper, Banking Commissioner – Texas Department of Banking)

For

James H. Willmann, J.D., General Counsel and Director of Governmental Affairs – Texas Nurses Association, Austin

Against

None recevied.

Modification

2. Allow for an expedited or tiered review and approval process for obtaining SDSI status in appropriate circumstances based on factors such as agency size, perceived fiscal risk, audit history, achievement of performance targets, reporting compliance, or industry-specific issues that may warrant more immediate attention. (John Morgan, Securities Commissioner – Texas State Securities Board, Austin)

Recommendation 1.2

Expand reporting and monitoring requirements of agencies subject to the SDSI Act to help improve oversight.

Affected Agency Responses to 1.2

Texas Department of Banking. A benefit of our specific SDSI statute is the elimination of standardized reports that have no relevance or bearing on the agency. We are not opposed to reporting, but reports for the sake of reporting are not the best use of agency resources. The frequency of SAO audits should be driven by SAO's annual risk assessment for the state. Periodically, other state agencies including the comptroller, Texas Workforce Commission, Department of Information Resources and the State Office of Risk Management, as well as external CPA firms performing the internal audit function, perform audits on DOB and other SDSI agencies that can be reviewed by the SAO in their risk assessment process. Our Annual Financial Report is due September 30th each year. Moving the date of SDSI reporting to November 20th serves no purpose for us.

Texas Department of Banking Modification

3. Require the scheduling and frequency of SAO audits be directed by SAO after it performs the annual risk assessment for the state.

(Charles G. Cooper, Banking Commissioner – Texas Department of Banking)

Texas Real Estate Commission. This agency collects much more revenue annually for "pass-through" to other agencies (approximately $16 million) than it retains to operate its core regulatory functions (approximately $10 million). The SDSI report for each year has been filed per the statutory requirements without adverse comment from any of the several statutory recipients. This report contained only the operating revenues and expenses and not any pass-throughs. The yearly annual financial report has contained the more comprehensive financial report, including all pass-throughs. It would seem to provide no obvious value for both of these reports to contain the same information. (Douglas E. Oldmixon, Administrator – Texas Real Estate Commission and Commissioner – Texas Appraiser Licensing & Certification Board)

For 1.2

James H. Willmann, J.D., General Counsel and Director of Governmental Affairs – Texas Nurses Association, Austin

Against 1.2

None received.

Recommendation 1.3

Place all current SDSI agencies under the SDSI Act.

Affected Agency Responses to 1.3

Texas Department of Banking. The SDSI Act includes several valuable provisions which DOB currently follows and believes should apply to all SDSI agencies. However, the SDSI Act is written for professional licensing agencies not financial regulatory agencies. A one-size-fits-all regulatory SDSI scheme is not the best solution. Our enabling SDSI legislation is tailored to the specific characteristics of financial regulatory agencies. We recognize the value of baseline standards but would prefer to see alignment by agency type. (Charles G. Cooper, Banking Commissioner – Texas Department of Banking)

Texas Department of Savings and Mortgage Lending. Prior to and since receiving the SDSI status the Department of Savings and Mortgage Lending, consistent with the other financial regulatory agencies (DOB, OCCC, and Credit Union Department), has been a self-leveling/self-funding agency. This is a significant difference between the department and the SDSI agencies under Government Code, Chapter 472. Under the self-leveling/self-funding methodology, an agency does not or very minimally contributes to general revenue, has no impact on the state budget, and sets fees and assessments to cover all its direct and indirect operating costs.

The department uses administrative penalties as a deterrent for non-compliance with and violations of statutory requirements. Administrative penalties collected are credited against the revenue budget of the applicable industry and ultimately result in a discount of fees charged to the industry. Using this strategy allows companies that maintain compliance to potentially pay less and companies with poor compliance to pay more. Remitting these penalties to general revenue would restrict the department's ability to incentivize entities to be compliant with statutory requirements and could potentially increase the fees assessed to the industries as a whole. Additionally, remitting administrative penalties to general revenue would be contrary to the existing self-leveling/self-funding statutory requirement. (Caroline C. Jones, Commissioner – Texas Department of Savings and Mortgage Lending)

Office of Consumer Credit Commissioner. The OCCC acknowledges the recommendation for standards for SDSI agencies and generally does not object to standards; however, the agency would prefer to see an alignment specifically for financial regulatory agencies within the governing statute for financial regulatory agencies, Chapter 16 of the Texas Finance Code. Placing all current SDSI agencies under the SDSI Act (Act) is a decision that must be thoroughly vetted. The OCCC does not shy away from change and governance, if it is in the right direction. The Act as written is for professional licensing agencies. It does not align well with fundamental regulatory concepts for financial service providers.

The report also recommends that SDSI agencies remit a specified fixed sum to the General Revenue Fund. The OCCC fully expects to pay for the costs of its operations and as a self-funded agency does not intend to place any additional burden on the General Revenue Fund. The OCCC pays for services that it uses from the Office of the Attorney General, SAO, and State Office of Risk Management, as well as its fair share assessment of the statewide allocation cost. Although we recognize the importance of providing funding for the State, this is counter to the self-leveling/self-funding model and the fundamental concept that assessments collected from regulated industries should pay for their costs of regulation, direct and indirect. Under the agency's enabling legislation, fees collected for regulators are to be used for that purpose and should not be diverted for an unrelated purpose, Texas Finance Code Section 14.107. The agency uses a mechanism to ensure the revenues collected correlate with fees assessed and the cost of operations.

The OCCC and the other regulatory agencies follow a self-leveling methodology. Under self-leveling methodology, the agency adjusts its assessments to the regulated industries to approximate the expenditures associated with the respective industries. Usually the methodology entails the use of assessments to manage and match the revenue level to the anticipated expenditure level. It is important to ensure that changes do not disrupt revenue and expenditure streams the agency has come to depend on to rapidly adapt and respond to dynamic changes and industry growth in the regulatory environment. For an SDSI agency that is self-leveling, predictability and flexibility are important in the exercise of good financial stewardship.

Lastly, the OCCC has been able to successfully use administrative penalties as a deterrent to noncompliance with regulatory statutes, while balancing the collection of administrative penalties as a credit for good compliance behavior with other regulated entities. Administrative penalties collected are credited against the revenue budget of the applicable industry and result in a discount to the assessment rate of the applicable industry. Using this strategy supports a philosophy supported by the regulated industries in which companies with high rates of compliance pay less and companies with low rates of compliance pay more. Diverting these funds into the General Revenue Fund would hinder the agency's ability to incentivize the "good players." Further, it would result in a greater cost to the respective regulated industry. (Leslie L. Pettijohn, Commissioner – Office of Consumer Credit Commissioner)

<u>Credit Union Department</u>. In commenting on the study, the Credit Union Department wishes to emphasize that it is not an occupational licensing agency. While the department does have authority to charter credit unions, its primary function is to ensure safety and soundness in the operations of credit unions. Therefore, most of its activities are designed to evaluate the condition of a credit union and ensure the safety and soundness of the institution, as well as its compliance with applicable laws and regulations. As a result, generic across-the-board reporting requirements usually fail to properly differentiate between the safety and soundness functions and general licensing functions. As a result, these generic reporting requirements generally provide less than a complete picture of this agency's operational performance. Therefore, if all SDSI agencies are placed under the SDSI Act, we would encourage some amendments to the Act's reporting requirements to provide more meaningful reporting for this and other financial regulatory agencies.

Since its inception, the department has been revenue neutral to the State's General Revenue Fund. The department has always been fully self-funding, meaning that it generates all its revenues through charges on its supervised credit unions. The department's revenues have, historically, also been fully self-leveling, meaning that, by statute, the agency can charge its supervised credit unions only what it expends to supervise and enforce the law. It is important to the supervised credit unions that they pay no additional amounts. Accordingly, it would be important, if all SDSI agencies are placed under the SDSI Act, that the Act specifically recognizes the self-leveling aspect of the department's statutes and budget operations.

Credit Union Department Modification

4. If all SDSI agencies are placed under the SDSI Act, incorporate provisions, similar to those contained in Texas Finance Code Section 16.007, which gives the Credit Union Department charge and control of the property known as the Credit Union Building and the use of staff, equipment, and facilities of the Department, into that Act.

(Harold E. Feeney, Commissioner – Credit Union Department)

Texas Real Estate Commission. We agree that the standardization of SDSI reporting requirements would have a positive result for the agencies themselves, the oversight agencies, and the Legislature but some flexibility should remain for other requirements to account for the unique responsibilities of each agency.

Texas Real Estate Commission Modification

5. Exempt the Texas Real Estate Commission and Texas Appraiser Licensing & Certification Board from the recommendation to remit all administrative penalties to the General Revenue Fund.

(Douglas E. Oldmixon, Administrator – Texas Real Estate Commission and Commissioner – Texas Appraiser Licensing & Certification Board)

Staff Comment: If all SDSI agencies are placed under the SDSI Act, the intent of the staff recommendation is that:

- SDSI agency annual remittances would be retained only for SDSI agencies that currently have them and would not apply to SDSI agencies that do not currently have them;
- SDSI agencies that currently own their own buildings would maintain ownership and control over this property; and
- only applicable reporting requirements would apply to the SDSI agencies. Recognizing that the finance-related agencies do not license individuals, they would instead report on the issuance of charters or other certifications, including number of charters or certificates, collected fees, average time to issue a charter or certificate, and related enforcement activities.

For 1.3

James H. Willmann, J.D., General Counsel and Director of Governmental Affairs – Texas Nurses Association, Austin

Against 1.3

Melodie Durst, Executive Director – Credit Union Coalition of Texas, Austin

John C. Fleming, General Counsel – Texas Mortgage Bankers Association, Austin

J. Eric T. Sandberg, Jr., President and CEO – Texas Bankers Association, Austin

Stephen Y. Scurlock, Executive Vice President – Independent Bankers Association of Texas, Austin

Sunset Member Modifications

6. Instead of placing the Texas Credit Union Department under the SDSI Act in the Government Code, retain the department's SDSI state agency status in the Finance Code; exempt the department from the recommendation to transfer administrative penalties to the General Revenue Fund from the Credit Union Department Fund; and require the department to comply with the additional reporting requirements found in the SDSI Act (Government Code, Section 472.104), by adding those reporting requirements to Chapter 16 of the Finance Code. (Representative Richard Peña Raymond, Member – Sunset Advisory Commission)

7. Instead of placing the finance-related SDSI agencies (Texas Department of Banking, Texas Department of Savings and Mortgage Lending, Office of Consumer Credit Commissioner, and Credit Union Department) under the SDSI Act in the Government Code, retain their SDSI state agency status in the Finance Code; exempt them from the recommendation to transfer administrative penalties to the General Revenue Fund; and add the additional reporting requirements found in the SDSI Act (Government Code, Section 472.104) to Chapter 16 of the Finance Code. (Representative Richard Peña Raymond, Member – Sunset Advisory Commission)

Modifications

8. Instead of placing the Texas Credit Union Department under the SDSI Act in the Government Code, retain the department's SDSI state agency status in the Finance Code. (Jeff Huffman, President – Texas Credit Union Association)

9. Exempt the Texas Credit Union Department from the recommendation to transfer administrative penalties to the General Revenue Fund from the Credit Union Department Fund. (Jeff Huffman, President – Texas Credit Union Association)

Recommendation 1.4

The Senate Finance and House Appropriations committees should consider establishing a moratorium on expanding SDSI status during the 84th Legislative Session.

Affected Agency Responses to 1.4

None received.

For 1.4

None received.

Against 1.4

John Morgan, Securities Commissioner – Texas State Securities Board, Austin

James H. Willmann, J.D., General Counsel and Director of Governmental Affairs – Texas Nurses Association, Austin

Commission Decision on Study Results
(December 2014)

The Sunset Commission adopted all of the staff recommendations in the study. In addition, the Commission modified and adopted Modification 7 to Recommendation 1.3 as follows.

- Exempts the finance-related SDSI agencies (Texas Department of Banking, Texas Department of Savings and Mortgage Lending, Office of Consumer Credit Commissioner, and Credit Union Department) from the recommendation to transfer administrative penalties to the General Revenue Fund.
- Adds the property provision found in Finance Code 16.007 to the SDSI Act, which would apply only to the finance-related agencies. In addition, clarifies that the property provision currently found in the SDSI Act allows SDSI agencies to own and maintain property. Also, add an additional reporting requirement to Government Code 472.104(b) requiring the SDSI agencies to report on the purchase or sale of any real property and ongoing lease and maintenance costs associated with real property.
- Makes the reporting requirements found in Government Code 472.104 apply appropriately to the finance-related SDSI agencies.

Final Results on Study Results
(July 2015)

Legislative Action

The Legislature did not adopt the following statutory recommendations.

Recommendation 1.1 — Require the Legislative Budget Board to develop and administer a process for obtaining self-directed semi-independent (SDSI) status and overseeing SDSI agencies.

Recommendation 1.2 — Expand reporting and monitoring requirements of agencies subject to the SDSI Act to help improve oversight.

Recommendation 1.3 — Place all current SDSI agencies under the SDSI Act.

Change in Appropriations

Recommendation 1.4 — The Legislature adopted the Sunset Commission recommendation to consider establishing a moratorium on expanding SDSI status during the 84th Legislative Session by not granting SDSI status to any new agencies.

NEW ISSUE

New Issue

The following issue was raised in addition to the issue in the staff report. This issue is numbered sequentially to follow the staff's recommendations.

2. Continue to allow the Texas Real Estate Commission and Texas Appraiser Licensing & Certification Board to set their own performance measures. (Douglas E. Oldmixon, Administrator – Texas Real Estate Commission and Commissioner – Texas Appraiser Licensing & Certification Board)

Commission Decision on New Issue

(December 2014)

The Sunset Commission did not adopt the new issue.

Sunset Staff Study of the

Self-Directed Semi-Independent Status of State Agencies

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