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Written Testimony of John Morgan
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"Criteria for Self-Directed Semi-Independent Agencies"

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My name is John Morgan. I was appointed to serve as the Texas Securities Commissioner in November 2011. I have served in various capacities at the State Securities Board for over 30 years, including Deputy Commissioner, Director of Enforcement, and attorney in the Enforcement Division.

In recent years, the State Securities Board has encountered difficulty obtaining adequate levels of funding necessary to maintain an appropriate salary structure and career ladder for front-line professional positions (financial examiners and attorneys) in the Inspections, Enforcement, and Registration strategies. Unfortunately, this has resulted in an unacceptably high rate of turnover in these critical positions.

This turnover represents not only lost investments in time and training for personnel to achieve competence in a highly complex area of the law, but also lost expertise that could otherwise facilitate greater efficiency and effectiveness in doing the work of the Agency going forward. Maintaining a well-trained and experienced professional staff is not only of great benefit to the State, but to the thousands of applicants, registrants, and Texas investors served by the Agency as well.

To find a more effective way for the Agency to manage its operations, consideration has been given in recent months to seeking approval for designation as a Self-Directed Semi Independent ("SDSI") agency during the upcoming legislative session.

I believe the staff of the Sunset Advisory Commission has done excellent work in its findings and certain recommendations set forth in the staff study, *Self-Directed Semi-Independent Status of State Agencies,* issued in October 2014. Designation of common oversight authority, consistent reporting requirements, and the establishment of certain objective criteria for qualification as an SDSI agency seems unquestionably sound. However, as part of the SDSI approval process, it may be appropriate for the Legislature to retain greater flexibility in determining whether to approve the SDSI designation for an agency than is contemplated in the recommendations.

Before further addressing that issue, it may be helpful to provide some very brief background information on the State Securities Board.

Although the State Securities Board is authorized for 104 FTEs, there are presently 92 positions filled. Despite its small size, the Agency manages a very large and growing caseload. In the last year, there were over 57,000 registrations and authorizations to sell securities in the state totaling $225 Billion; 321,000 registrations of securities dealers, agents, investment advisers and investment adviser representatives; timely inspections of Texas-only investment advisers located in every region of the state managing over $23 Billion in funds of Texas residents; and over 100 administrative, civil, and criminal enforcement actions.

Like other regulatory agencies, including those with SDSI status, the State Securities Board is required to set and collect certain fees to produce sufficient revenue to cover the costs of its operations. Unlike other regulatory agencies, there are also fees set by the Legislature and collected by the State Securities Board that result in deposits to the general revenue fund that are disproportionate to the Agency's budget. Last year the State Securities Board deposited approximately $195 million to the fund from all sources. The budget for the Agency specified in the General Appropriations Act is approximately $6.9 million.

The State Securities Board has a long tradition of managing an increasing workload by finding opportunities for efficiency. This approach has remained workable so long as the Agency has been able to retain experienced professional staff.

Unfortunately, the appropriations process has failed in recent years to provide adequate funds to permit the State Securities Board to effectively use the current state salary structure for professionals. It has prevented the Agency from creating a meaningful career ladder to compensate these critical employees based on years of experience advanced training, and higher levels of competence and responsibility. This has created pay compression between inexperienced and experienced professionals and has created unacceptable turnover rates for these positions of 53% in Inspections, 35% in Enforcement, and 16% in Registration in the period FY2011 - FY2013. In an effort to temporarily address the problem, some vacancies were not filled in FY 2014 and funds were used to increase salaries for these professionals. Although turnover numbers were lower in 2014, five financial examiners have departed for better economic opportunities in the last two months.

As is the case with other financial regulatory agencies, the State Securities Board is competing not only against private industry, but also with other regulators in this region. The Agency is losing well-trained and experienced financial examiners and attorneys to regulators who can afford to pay substantially more -- in the case of a federal regulator, twice as much. An additional concern is legislation pending in Congress that would authorize the U.S. Securities and Exchange Commission to hire additional examiners to improve the inspection cycle for federally-registered investment advisers (which has been described by regulators and the industry alike as clearly inadequate). If that authority is approved, the State Securities Board's most experienced and capable financial examiners will likely be recruiting targets for the federal regulator.

In many ways the State Securities Board is in the same position as the Department of Banking prior to its transition to SDSI status. The disparity of salaries for financial examiners that now exists between the Department of Banking and the State Securities Board is remarkable. It is apparent that the Department of Banking has done the good work necessary to effectively address the problem. Yet even the salary structure of the Banking Department is well below that of the SEC, which has just substantially increased the salaries of professionals doing examination and legal work.

These regulators have found an effective means to retain professionals who perform work critical to the effectiveness of the agencies. The State Securities Board desperately needs to do the same. To avoid further losses, and the accompanying impact on the Agency's ability to effectively regulate the securities industry, this work needs to be done sooner rather than later.

Unfortunately, the staff study recommends 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 and that such a process should require an application made concurrent with an agency's Legislative Appropriations Request four years in advance of when SDSI status would become effective.

The delays associated with these recommendations have the potential to significantly harm agencies that need to seek SDSI status. The application process and time line should allow greater flexibility for the Legislature to consider agency-specific information that allows for expedited or tiered review and approval 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. Depending on the size, complexity, or resources of an agency, it may be possible for this information to be quickly documented and submitted for evaluation. This flexible approach may better address the purposes for granting SDSI status than a fixed four-year application process applicable to all agencies that does not begin until the submission of a Legislative Appropriations Request.