Sunset Advisory Commission

Staff Report with Commission Decisions

Credit Union Department

2020–2021

87th Legislature

Sunset Advisory Commission

Cover photo: The Texas Capitol is a marvel of craftsmanship down to the smallest details. Elaborate, custom-designed hardware accentuates the beautifully carved wooden doors. The Sargent and Co. of New Haven, Connecticut created the glass molds especially for the building in the 1880s. The Capitol hardware features incised designs of geometric and stylized floral motifs. This reflects the shift from the Renaissance Revival style of the building's interior architecture to the simpler Aesthetic Movement for its decorative details. Photo credit: Janet Wood

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How to Read Sunset Reports

For each agency that undergoes a Sunset review, the Sunset Advisory Commission publishes three versions of its staff report on the agency. These three versions of the staff report result from the three stages of the Sunset process, explained in more detail at sunset.texas.gov/how-sunset-works. The current version of the Sunset staff report on this agency is noted below and can be found on the Sunset website at sunset.texas.gov.

Sunset Staff Report

The first version of the report, the Sunset Staff Report, contains Sunset staff's recommendations to the Sunset Commission on the need for, performance of, and improvements to the agency under review.

CURRENT VERSION: Sunset Staff Report with Commission Decisions

The second version of the report, the Sunset Staff Report with Commission Decisions, contains the original staff report as well as the commission's decisions on which statutory recommendations to propose to the Legislature and which management recommendations the agency should implement.

Sunset Staff Report with Final Results

The third and final version of the report, the Sunset Staff Report with Final Results, contains the original staff report, the Sunset Commission's decisions, and the Legislature's final actions on the proposed statutory recommendations.

Table of Contents

Page

Sunset Commission Decisions

Summary

The following material summarizes the Sunset Commission's decisions on the staff recommendations for the Credit Union Department as well as a new recommendation raised during the public hearing.

Texas regulated banks and credit unions under one agency from 1913 until 1969, when increasing competition and regulatory friction between them led the Legislature to create the Credit Union Department. In 2009, the Legislature gave the department self-directed semi-independent (SDSI) status to set its own fees, budget, and performance measures outside of the legislative appropriations process.

The Sunset review evaluated whether the department and its functions are still needed and should remain separate from the Finance Commission of Texas, which oversees three other SDSI agencies that regulate banks and other financial institutions and occupations. The Legislature also has considered but decided against moving the department to the Finance Commission nine times in the past four decades.

Texas-chartered credit unions have fared well under the state's current regulatory framework, and the Sunset Commission again found the existing organizational structure is the best option and transferring the department would have no benefit at this time. The Sunset Commission also recommends changes to align the department's funding policies and procedures with best practices, and to improve its operations, handling of complaints, and communications with the industry and the public.

Issue 1

The Department Lacks Key Data and Processes to Ensure Adequate Resolution of Regulatory Complaints.

Recommendation 1.1, Adopted — Require the department to track more comprehensive complaint and enforcement data to support analysis and guide regulatory activities.

Recommendation 1.2, Adopted — Direct the department to regularly analyze and report on complaint and enforcement data and trends. (Management action – nonstatutory)

Recommendation 1.3, Adopted — Direct the department to establish clear procedures for processing and investigating all complaints it receives. (Management action – nonstatutory)

Recommendation 1.4, Adopted — Direct the department to disclose summary complaint resolution information to complainants and document final disposition. (Management action – nonstatutory)

Recommendation 1.5, Adopted — Direct the department to develop a penalty matrix. (Management action – nonstatutory)

Recommendation 1.6, Adopted — Direct the department to more clearly communicate its authority, processes for investigating complaints, and complaint determinations. (Management action – nonstatutory)

Recommendation 1.7, Adopted — Direct the department to incorporate examiners' review of all jurisdictional complaints into the exam process. (Management action – nonstatutory)

Issue 2

The Department Should More Effectively Use Its SDSI Status to Provide Adequate Resources and Improve Operations.

Recommendation 2.1, Adopted — Direct the Credit Union Commission to implement a more streamlined and reliable fee assessment policy and process. (Management action – nonstatutory)

Recommendation 2.2, Adopted — Direct the commission to update its reserve fund policy to address long-term capital funding needs and maintain an adequate reserve balance. (Management action – nonstatutory)

Recommendation 2.3, Adopted — Direct the commission to implement an independent audit process for the department. (Management action – nonstatutory)

Issue 3

Texas Has a Continuing Need for the Credit Union Department.

Recommendation 3.1, Adopted — Continue the Credit Union Department for 12 years.

Recommendation 3.2, Adopted — Require the department to develop a process for notifying credit unions about federal regulatory changes that override state regulations.

Recommendation 3.3, Adopted — Eliminate the statutory notarization requirement for articles of incorporation in new charter applications.

Recommendation 3.4, Adopted — Update the standard across-the-board requirement related to board member training.

Recommendation 3.5, Adopted — Direct the department to regularly update its website content. (Management action – nonstatutory)

Adopted New Recommendation

Complaints Information Update

Update the standard across-the-board requirement related to developing and maintaining a complaints system and making information on complaint procedures available to the public. Specify agencies may not inform parties of the status of complaints if doing so would jeopardize an ongoing investigation.

Fiscal Impact Summary

The Sunset Commission's recommendations would not have a fiscal impact to the state because the department is an SDSI agency exempt from the legislative appropriations process. These recommendations also would not have a significant fiscal impact to the department or the credit unions it regulates, since the department could address them with existing resources. Further, the department could use existing reserve funds set aside to pay for audits to fund an independent audit program.

Summary of Sunset Staff Report

For more than a century, Texans have benefitted from state-chartered nonprofit, member-owned credit unions, many of which provide affordable financial service options in rural or economically disadvantaged communities. Texas-chartered credit unions have fared well under the state's regulatory framework — of the 45 states that regulate credit unions, Texas ranked second in number of state-chartered credit unions, fourth in credit union membership, and sixth in total assets in 2019.

This regulatory structure has changed significantly since the Texas Legislature enacted the state's chartering laws in 1913. Initially, the Legislature limited state-chartered credit unions to serving rural communities, but soon granted them authority to operate statewide to meet a growing demand for their services. The Texas Department of Banking regulated them until 1969, when the Legislature created the Credit Union Department in response to increasing competition and regulatory friction between credit unions and banks. In 2009, the Legislature gave the department self-directed semi-independent (SDSI) status, a coveted designation that authorizes state agencies to set their own fees, budgets, and performance measures outside of the legislative appropriations process. This Sunset review of the department is the first since it gained SDSI status.

As required by the Texas Sunset Act, the review examined whether the department's functions are still needed and if the current organizational structure is the most effective and efficient approach. Sunset staff gave particular consideration to the Finance Commission of Texas, which oversees three other SDSI agencies that regulate banks and other types of financial institutions and occupations. The Legislature has considered moving the department to the Finance Commission nine times in the past four decades, through Sunset reviews, proposed legislation, interim studies, and other evaluations. Sunset staff again found that transferring the department to the Finance Commission would have no benefit at this time and the current organizational structure is the best option.

Restructuring the department would have no benefit at this time.

Sunset staff also concluded the department is generally well-run, but identified several opportunities to improve operations, handling of complaints, and communications with the industry and the public. Further, some of the department's funding policies and procedures do not align with best practices or make the most effective use of the department's SDSI status.

The following material highlights Sunset staff's key recommendations for the Credit Union Department.

Sunset Staff Issues and Recommendations

Issue 1

The Department Lacks Key Data and Processes to Ensure Adequate Resolution of Regulatory Complaints.

The department receives about 300 complaints against Texas-chartered credit unions each year but does not maintain adequate data to effectively track, analyze, and report complaint dispositions and trends. More robust data tracking and trend analysis would help the department identify and resolve specific issues affecting credit unions and their members and improve its rules, examination processes, and regulatory communications. The department also could more clearly explain its regulatory jurisdiction and investigation procedures and outcomes to minimize credit union members' confusion about the types of complaints the department has authority to address.

Key Recommendations

- Require the department to track more comprehensive complaint and enforcement data to support analysis and guide regulatory activities.
- Direct the department to regularly analyze and report on complaint and enforcement data and trends.
- Direct the department to establish clear procedures for processing and investigating all complaints it receives.
- Direct the department to more clearly communicate its authority, processes for investigating complaints, and complaint determinations.

Issue 2

The Department Should More Effectively Use Its SDSI Status to Provide Adequate Resources and Improve Operations.

Overall, the department has used its SDSI status in a responsible manner, but its operating fee assessment process and reserve fund policies do not align with best practices of other SDSI agencies. The department should also identify ways to improve its financial controls and operational processes with an independent audit program. Directing the department to streamline its fee assessment process and develop better oversight tools would provide more consistent fees; an adequate financial cushion for unexpected expenditures and capital projects; and greater accountability to state policymakers, the commission, and the industry.

Key Recommendations

- Direct the commission to implement a more streamlined and reliable fee assessment policy and process.
- Direct the commission to update its reserve fund policy to address long-term capital funding needs and maintain an adequate reserve balance.
- Direct the commission to implement an independent audit process for the department.

Issue 3

Texas Has a Continuing Need for the Credit Union Department.

Texas benefits from having a strong credit union industry and the current organizational structure is the most efficient and effective approach to regulation at this time. The department should improve its communications, especially on federal regulatory changes that affect Texas-chartered credit unions, and establish clearer boundaries with the credit union industry.

Key Recommendations

- Continue the Credit Union Department for 12 years.
- Require the department to develop a process for notifying credit unions about federal regulatory changes that override state regulations.

Fiscal Implication Summary

These recommendations would not have a fiscal impact to the state because the department is an SDSI agency exempt from the legislative appropriations process. These recommendations also would not have a significant fiscal impact to the department or the credit unions it regulates, since the department could address them with existing resources. Further, the department could use existing reserve funds set aside to pay for audits to fund an independent audit program.

Agency at a Glance

The Texas Legislature first authorized credit unions to operate in rural areas of the state in 1913 and appointed the Texas Department of Banking as their regulator. In 1929 the Legislature broadened that authorization to all areas of Texas and in 1969 transferred credit union regulation to the newly created Credit Union Department. In 2009, the Legislature granted the department self-directed semi-independent (SDSI) status, removing it from the state appropriations process.

The department's mission is to safeguard the public interest, protect the financial interests of credit union members, and promote public confidence in the credit union industry. To fulfill this mission, the department carries out the following key activities:

- Approves new charters, charter conversions, mergers, and other structural or operational changes for Texas-chartered credit unions.
- Examines Texas-chartered credit unions on a regular basis to assess their financial safety and soundness and compliance with state and federal laws.
- Takes enforcement actions when necessary to address regulatory problems and financial risk concerns identified through exams, quarterly financial reports, complaints, media stories, and other sources.
- Approves Texas branches of credit unions chartered by other states, called foreign credit unions.
- Responds to complaints against credit unions filed by the public.

Key Facts

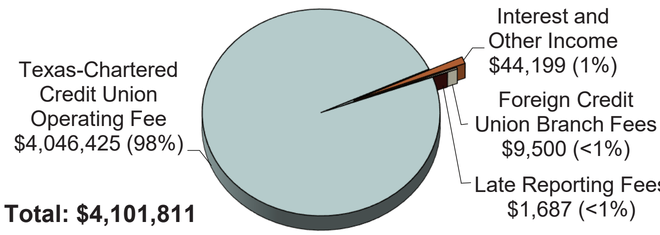
- **Governance.** The governor appoints the nine members of the Credit Union Commission with the advice and consent of the Senate to six-year staggered terms.[1] The commission has five public members appointed on the basis of their recognized business ability, and four credit union industry members who must have five or more years of experience as a director, officer, or committee member of a credit union with a principal office in Texas. Only one industry member may be from a federally chartered credit union. The governor appoints the commission's chair, who appoints the vice chair.

  The commission sets the department's regulatory and operational policies and appoints the department's commissioner, who is responsible for department administration; approving applications for mergers, consolidations, foreign branches, and other actions; examining credit unions; investigating complaints; and taking enforcement actions.[2] Credit unions may appeal the commissioner's orders to the commission.

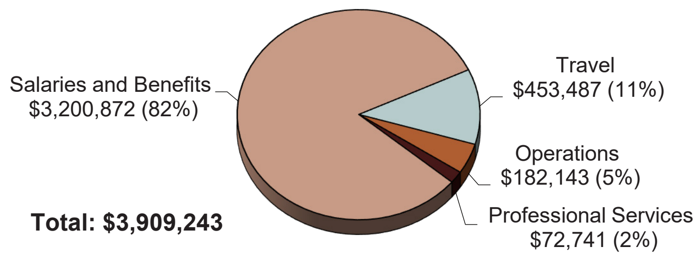
- **Funding.** As an SDSI agency, the department does not receive a legislative appropriation and instead funds itself through fees on Texas-chartered credit unions. In fiscal year 2019, the department collected about $4.1 million in revenue, almost entirely from operating fees, and spent about $3.9 million.[3] Two charts on the following page, *Credit Union Department Sources of Revenue* and *Expenditures*, show the types and amounts of fees the department collected from the industry and how the department spent the funds in fiscal year 2019. Appendix A describes the department's use of historically underutilized businesses in purchasing goods and services for fiscal years 2017–19.

To fund its operations, the department charges each Texas-chartered credit union an annual operating fee. The department calculates each credit union's annual operating fee based on its total assets and collects the fee in two installments per year. The department typically discounts the second installment to reflect mid-year adjustments in projected revenues and expenditures for the current fiscal year and unspent funds from the previous fiscal year. In fiscal year 2019, the discount totaled about $500,000, which is not reflected in the revenue chart because the department did not collect it. The table, *Annual Operating Fees for 181 Texas-Chartered Credit Unions*, shows the operating fee formula set in rule.[4]

Credit Union Department Sources of Revenue – FY 2019



Credit Union Department Expenditures – FY 2019



Annual Operating Fees for 181 Texas-Chartered Credit Unions – FY 2019

Total Assets	Base Fee	Surcharge on Portion of Assets	Credit Unions	Fee Range
$2 billion and above	$157,410	.000062	4	$157,410–$249,094
$1 billion–less than $2 billion	$88,410	.000069	7	$88,410–$157,410
$500 million–less than $1 billion	$52,410	.000072	15	$52,410–$88,410
$100 million–less than $500 million	$20,410	.000080	37	$20,410–$52,410
$50 million–less than $100 million	$10,910	.00019	23	$10,910–$20,410
$25 million–less than $50 million	$6,660	.00017	25	$6,660–$10,910
$10 million–less than $25 million	$4,560	.00014	33	$4,560–$6,660
$1 million–less than $10 million	$1,500	.00034	31	$1,500–$4,560
$200,000–less than $1 million	$200	.001625	6	$200–$1,500
Less than $200,000	$200	0	0	$200

The department maintains a reserve fund for unplanned and emergency expenditures, which commission policy capped at $845,000 and allocated among six dedicated subaccounts in fiscal year 2019. The table on the following page, *Credit Union Department Reserve Fund*, shows the balance of each subaccount.[5] As an SDSI agency, the department also owns its only office building, located in Austin.[6]

- **Staffing.** In fiscal year 2019, the department employed 29 full-time staff, including 10 administrative staff in Austin and 19 field examiners who work from home and travel across Texas to examine Texas-chartered credit unions. Appendix B compares the department's workforce composition to the percentage of minorities in the statewide civilian workforce for the past three fiscal years.

Credit Union Department Reserve Fund

Subaccount	Commission-Authorized Expenditures	FY 2019 Balance
Enforcement and Regulatory	Increased monitoring of credit unions, unusual legal costs for agency operations, or enforcing credit union compliance with applicable laws.	$300,000
Operations	Funding for the department's operations during an unexpected financial crisis or emergency.	$235,000
Lump Sum Leave	Accrued vacation and sick leave.	$200,000
Building and Equipment	Fixed asset purchases and deferred maintenance projects for the department's headquarters.	$70,000
Audit	Funding for unanticipated audits by the State Auditor's Office or other state agencies.	$30,000
Insurance	Extraordinary liability claims and deductibles in the department's insurance policy.	$10,000
Total		**$845,000**

- **Charters and insurance.** Credit unions must have either a federal or state charter to operate in Texas, but the department does not have authority to regulate federally chartered credit unions.[7] The department issues Texas charters to allow credit unions to form and operate in the state, and authorizes foreign credit unions chartered by a different state to operate branches in Texas. In fiscal year 2019, nine foreign credit unions chartered by seven different states operated 18 branches in Texas. Additionally, 263 federally chartered credit unions operated in Texas in 2019. The textbox, *Types of Credit Unions in Texas*, further explains the differences between the different credit unions operating in Texas. The department also receives notices and applications for mergers, federal and state charter conversions, and amendments to bylaws and articles of incorporation.

Types of Credit Unions in Texas

A credit union must have one of these credentials to operate in Texas:

- **Texas charter:** The Credit Union Department issues charters to Texas-based credit unions and regulates them.
- **Foreign branch certificate:** Credit unions chartered by another state may operate in Texas with the department's approval. The chartering state is the primary regulator and the department has regulatory authority over the Texas branch.
- **Federal charter:** The National Credit Union Administration issues federal charters to credit unions and regulates them, and also insures member deposits at federally chartered and most state-chartered credit unions.

In fiscal year 2019, Texas-chartered credit unions had about $44 billion in assets and state laws require them to have insurance for their members' deposits.[8] Texas is one of 10 states that allows credit unions to choose between federal or private insurance.[9] Most Texas-chartered credit unions have federally backed insurance through the National Credit Union Share Insurance Fund.[10] Five Texas-chartered credit unions have private insurance through American Share Insurance.

- **Exams.** The department's field examiners perform risk-based exams of Texas-chartered credit unions to ensure they comply with financial safety and soundness standards and federal and state regulations. Examiners also perform remedial exams to address concerns identified in the regular exam and to evaluate the credit union's progress in resolving findings or taking agreed upon corrective actions. In fiscal year 2019, examiners conducted 151 regular exams and 32 remedial exams.

Examiners have broad authority to review a credit union's policies, procedures, records, loan files, member communications, and other financial and operational documents. The department schedules regular exams every 12 to 18 months based on a credit union's asset size, financial safety and soundness, and degree of risk. The department assigns each credit union a confidential rating to indicate its degree of risk using an internationally recognized system described in the textbox, *Assessing Financial Risk*.[11]

The department also conducts joint exams with federal and private deposit insurers of Texas-chartered credit unions. The department only examines federally chartered credit unions if they are converting to a Texas charter. The commissioner also has authority to examine foreign credit union branches and certain entities that provide management, operations, and member services to credit unions.[12]

Assessing Financial Risk

The department uses the Uniform Financial Institutions Rating System, also known as CAMELS, to assess a credit union's financial safety, soundness, and risk based on six factors:

- **C**apital adequacy
- **A**sset quality
- **M**anagement
- **E**arnings capacity
- **L**iquidity
- **S**ensitivity to market risk

The department assigns each Texas-chartered credit union a confidential rating ranging from one to five, with one indicating the strongest performance and risk management practices and least degree of regulatory concern. The department assigned the following CAMELS ratings in fiscal year 2019:

- 1: 50 credit unions (28%)
- 2: 110 credit unions (61%)
- 3: 19 credit unions (10%)
- 4: 2 credit unions (1%)
- 5: 0 credit unions

- **Complaints and enforcement.** The department responds to complaints from the public about Texas-chartered credit unions. In fiscal year 2019, the department took 16 days on average to process 376 complaints. The department has both informal and formal tools to enforce state credit union regulations, including written agreements, cease and desist orders, conservatorship, and liquidation.[13] The department also has authority to assess between $100 to $10,000 a day in administrative penalties against institutions and individuals for noncompliance with cease and desist or removal orders; charge daily late fees for untimely quarterly reports and operating fee payments; and seek criminal penalties against entities that are not authorized to operate as a credit union falsely identifying themselves as credit unions.[14] In fiscal year 2019, the department took three enforcement actions: a removal order, a cease and desist order against a Texas-chartered credit union, and a liquidation of a Texas-chartered credit union. Additionally, the department assessed late fees totaling $1,687 for credit unions that submitted quarterly financial reports after the deadline.

[1] All citations to Texas statues are as they appear on http://www.statutes.legis.texas.gov/. Section 15.201, Texas Finance Code.

[2] Sections 15. 301 and 15.403, Texas Finance Code.

[3] Credit Union Department, *Annual Financial Report*, accessed July 15, 2020, https://cud.texas.gov/wp-content/uploads/2015/11/2019_Annual_Financial_Report.pdf.

[4] 7 T.A.C. Section 97.113(b).

[5] Credit Union Department, *Texas Credit Union Commission Policy Manual*, accessed May 15, 2020, https://cud.texas.gov/wp-content/uploads/2019/09/Commission_Policies_Manual-09-16-19-1.pdf, 28–31.

[6] Credit Union Department, *Self-Evaluation Report*, accessed July 15, 2020, https://www.sunset.texas.gov/public/uploads/files/reports/Credit%20Union%20Department%20SER.pdf, 13.

[7] Section 15.403(a), Texas Finance Code.

[8] Section 15.410, Texas Finance Code.

[9] American Share Insurance, *Private Share Insurance in the History of Credit Unions*, accessed July 15, 2020, https://www.americanshare.com/history/.

[10] The National Credit Union Administration offers deposit insurance to Texas-chartered, foreign-chartered, and federally chartered credit unions. National Credit Union Administration, *Share Insurance Fund Overview*, accessed May 15, 2020, https://www.ncua.gov/support-services/share-insurance-fund.

[11] Federal Deposit Insurance Corporation, *Uniform Financial Institutions Rating System*, accessed June 19, 2020, https://www.fdic.gov/regulations/laws/rules/5000-900.html.

[12] Sections 15.411(a), 122.013(c), and 15.4032, Texas Finance Code.

[13] Sections 122.257, 122.2575, 126.001, and 126.201, Texas Finance Code.

[14] Sections 122.260, 122.101, 15.4044, and 122.003, Texas Finance Code.

ISSUE 1 | The Department Lacks Key Data and Processes to Ensure Adequate Resolution of Regulatory Complaints.

Background

The mission of the Credit Union Department is to safeguard the public interest, protect the financial interests of credit union members, and promote public confidence in credit unions.[1] To accomplish this mission, the department examines and monitors the financial safety and soundness of Texas-chartered institutions. Department examiners also ensure credit unions comply with applicable state and federal laws. At the end of fiscal year 2019, the department regulated 181 Texas-chartered credit unions.

Department rule requires Texas-chartered credit unions to post a notice informing their members how to file complaints with both the credit union and the department.[2] The department accepts complaints against Texas-chartered credit unions and receives about 300 complaints each year.[3] The textbox, *Complaint Types Filed with the Department*, describes the three classifications of complaints the department receives. The chart, *Credit Union Department Complaint Process*, on the following page describes how the department handles complaints it receives.[4]

Complaint Types Filed With the Department

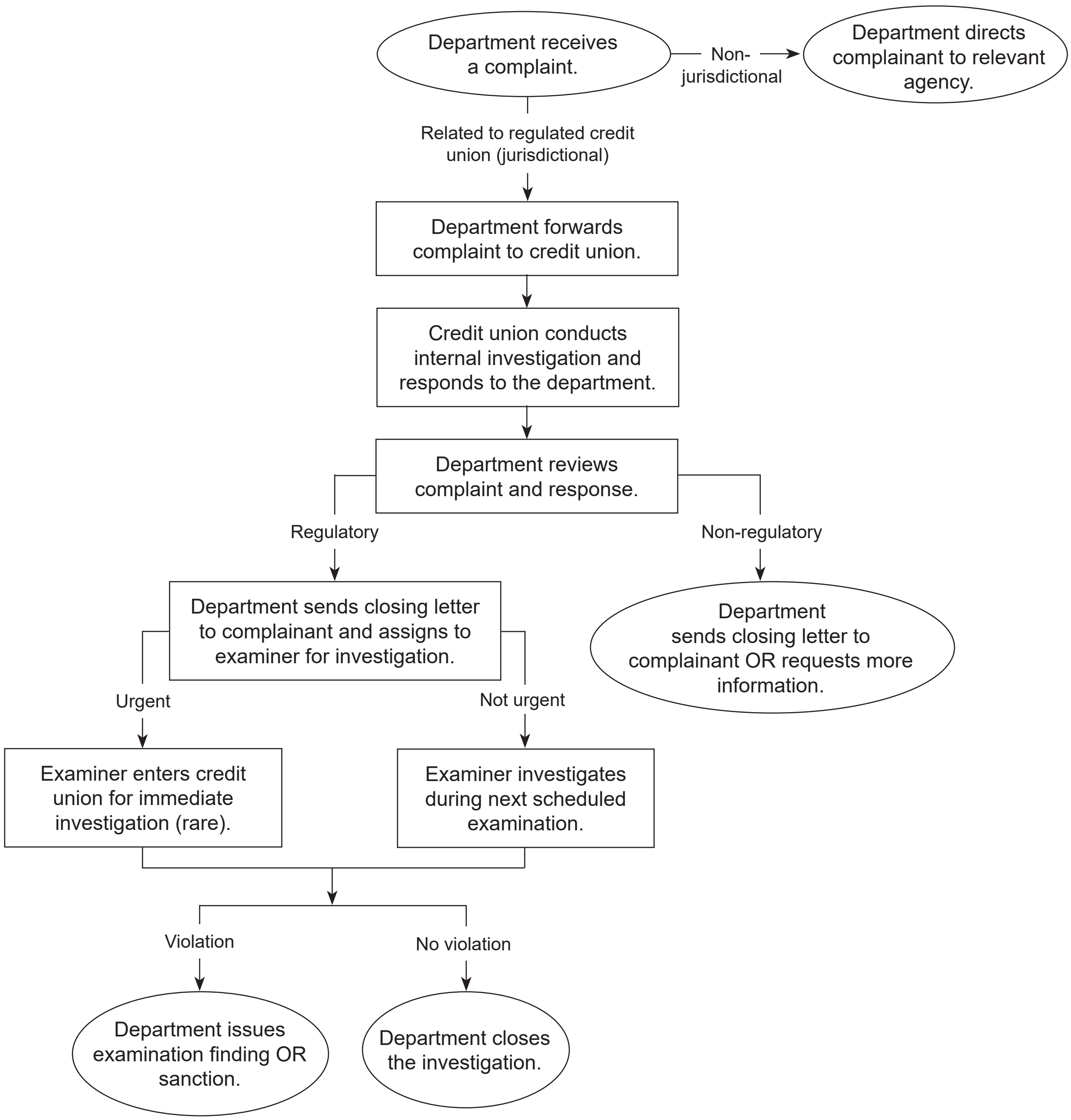
Non-jurisdictional: Complaints against credit unions the department does not charter, and alleged violations of state or federal laws other than credit union regulations (e.g., compliance with the Americans with Disabilities Act).

Non-regulatory: Jurisdictional complaints unrelated to state or federal credit union laws or rules (e.g., customer service).

Regulatory: Jurisdictional complaints alleging violations of state or federal credit union laws or rules.

When the department receives a complaint, staff determines if it concerns a Texas-chartered credit union and is thus within the department's jurisdiction. If the complaint is non-jurisdictional, staff directs the complainant to the appropriate state or federal agency. The department forwards a jurisdictional complaint to the credit union that is the subject of the complaint and requests a response within 15 days. Once the credit union responds, department staff reviews the complaint, the response, and any documentation provided to determine whether the complaint relates to a regulatory issue. If the complaint is about a non-regulatory issue, staff forwards the credit union's response in a letter to the complainant and closes the complaint file. If the complaint concerns a regulatory issue, staff takes the aforementioned steps and also forwards the information to an examiner to either investigate immediately or during the credit union's next scheduled exam.

Credit Union Department Complaint Process



Findings

The department's lack of comprehensive complaint data obscures a full picture of the regulatory environment.

The department primarily investigates complaints by gathering information from credit unions, but in some cases it does so as part of an exam. However, while complaints about regulatory issues may lead to an exam that results in enforcement actions, the department bifurcates its complaints and exam data because it views complaint investigations and exams as two separate processes.

According to the department, most complaints are customer service related and thus non-regulatory, but the department does not maintain complaint data in a way that would support this assertion nor does the department track all complaints to their final disposition. This inadequate collection, tracking, and analysis of complaint and enforcement data could result in an inaccurate picture of the department's performance and the regulatory environment. During the Sunset review, the department was developing a new database and adding new fields for complaint data. As discussed in the following material, Sunset staff identified opportunities to improve the department's data approach as part of this effort.

The department's complaint data collection, tracking, and analysis is inadequate.

- **Incomplete tracking of complaint data.**

  No tracking of non-jurisdictional complaints. Regulatory agencies should track their referrals of non-jurisdictional complaints to the appropriate agency, but the department does not have a formal process for doing so. The department directs individuals with complaints against federally chartered credit unions to the National Credit Union Administration, but does not track these complaints. The department also does not track referrals of non-jurisdictional complaints to other Texas state agencies or credit union regulators in other states. Tracking all complaints received and documenting referrals would better position the department to identify potential areas of regulatory change, greater coordination with other government entities, and opportunities to more clearly communicate the types of complaints the department has authority to investigate.

  No distinction between regulatory and non-regulatory complaints. Department staff generally considers both regulatory and non-regulatory complaints against Texas-chartered credit unions to fall within the department's jurisdiction. However, the department's complaints database does not categorize complaints as either regulatory or non-regulatory. This distinction is important to track because regulatory complaints go through an additional investigation process and the complaint disposition is not final until the process is complete.

  No clear tracking of regulatory complaint disposition. Regulatory agencies should keep a complete record of complaints from receipt to disposition. In 2009, the Legislature adopted the Sunset across-the-board recommendation to statutorily require the department to maintain information about complaints, including the parties, subject matter, summary of investigation results, and disposition.[5] However, the department's complaints database does not track the disposition of regulatory complaints or identify enforcement actions and regulatory violations that originated from a complaint. A separate database tracks exam and enforcement actions, but this information is completely divorced from complaint data. The department also does not track when complainants contest the department's decisions or provide additional information to support their complaints. Tracking this information would provide a more comprehensive picture of both the department's performance and the regulatory environment.

The complaints database does not track regulatory complaint disposition.

- **Lack of trend analysis.** State agencies maintain, analyze, and report statistical information on complaints in part to identify regulatory problem areas. Rule directs the department to use its complaints database to identify trends or issues related to violations.[6] However, the department's incomplete tracking of complaint data impedes effective trend analysis that could better inform and improve its operations, such as examiner training, member education initiatives, and rulemaking processes.

Incomplete tracking of complaint data impedes effective trend analysis.

- **No publicly accessible information on complaints.** The public and the regulated industry should have access to statistical information about the complaints a regulatory agency receives. The department reports basic aggregate information about complaints to the commission on a quarterly basis in commission meeting books. The department temporarily posts the meeting books on its website, but removes them after each commission meeting. In contrast, agencies under the Finance Commission of Texas publish detailed statistical complaints data in commission books, which are later archived online and accessible to the public.[7] Publishing detailed aggregate complaint information online or in annual reports would provide important regulatory information to the public and the industry while protecting the confidentiality of information about specific institutions.

A more robust complaint investigation process could strengthen the department's regulatory efforts.

Rule directs department staff to request information from the credit union that is the subject of a complaint, assess the information from both parties, and process the complaint.[8] A Sunset staff review of 50 randomly selected complaint case files from fiscal years 2017–19 indicated department staff does not always conduct independent, fact-based assessments of complaints. Instead, the case files suggest staff often just relays information between parties and sends a closing letter to the complainant repeating the credit union's response, without explicitly stating the department's findings and determination or reason for closing the complaint. In multiple cases of alleged embezzlement, fraud, discrimination, and faulty quality control practices at credit unions, the department has no documentation indicating it followed up on these complaint allegations as part of the exam process.

The department does not explicitly state its findings or reason for closing a complaint.

When investigating a complaint, the department clearly requests the credit union to provide all documentation to support its position. Sunset staff's case file review found the credit unions' documentation ranged from one-paragraph emails to multiple pages of records, with few instances of the department requesting additional information or more detail before closing the complaint. In 44 of the 50 case files reviewed, the department accepted the credit union's initial response as sufficient to close the complaint file.

Simply repeating the credit union's response in the closing letter to the complainant without a clear, independent conclusion gives the appearance the department defers to credit unions rather than prioritizing the public's interest, which could undermine the department's credibility as a regulator.

Among the nearly 70 respondents to a Sunset survey of previous complainants, many believed the department always sides with credit unions. More than a third of respondents indicated filing a complaint was pointless because the department took the credit union's word without conducting an independent, objective investigation. The textbox, K*ey Findings From Sunset Complainant Survey*, shows other responses indicating dissatisfaction with the department's complaints process.

Key Findings From Sunset Complainant Survey

- Only 30 percent of respondents believed the department's process for investigating complaints is fair.
- Only 32 percent of respondents believed the department's investigation of complaints is appropriate.
- Only 30 percent of respondents believed the department attempts to resolve complaints within its jurisdiction.

Nonstandard complaint investigation and enforcement practices hinder transparency and consistency of regulatory actions.

- **No clear timeline for resolving regulatory complaints.** An agency should ensure it completes investigations within a reasonable time. The department's website states staff will attempt to investigate and resolve complaints in 30 days.[9] However, if staff decides to postpone investigation of a regulatory complaint until the credit union's next exam, the complaint could take several months to resolve. This practice suggests 30 days may not be adequate to resolve regulatory complaints. Additionally, the department sends closing letters on regulatory complaints before the examiner has investigated the matter, which skews the department's complaint disposition data and is misleading for the complainant. Tracking the complete investigation timeline through the ultimate disposition of each complaint would enable the department to establish a more accurate resolution timeframe, useful performance metrics, and more realistic expectations for complainants.

The department sends closing letters on regulatory complaints before they have been investigated.

- **Insufficient complaint policies and procedures.** The entire complaint process should be guided by clear rules, policies, and procedures. The department lacks clear guidelines for when to investigate a complaint immediately or wait until the credit union's next scheduled exam and instead makes this judgment on a case-by-case basis. Department procedures only discuss when and how to investigate complaints made against a credit union's management or board of directors. Establishing clear policies and procedures for all complaint investigations would help ensure appropriate and consistent action by the department, better protecting both the public and the regulated institutions.

The department does not always inform complainants of the final disposition.

- **No informing of complainants about regulatory complaint disposition.** Regulatory agencies should provide complainants with information about the status of their complaints. Statute requires the department to regularly update complainants on the status of the complaint until final disposition.[10] However, the department was unable to demonstrate it informs complainants about the final disposition of complaints investigated through the exam process. Giving a general summary of a complaint's disposition to the complainant would better facilitate transparency.

- **No penalty matrix.** Agencies should establish a schedule of sanctions to help ensure that disciplinary actions relate appropriately to the nature and seriousness of the offense and are applied consistently. These guidelines, often called a penalty matrix, should also inform the determination of administrative penalty levels. The department's statute explicitly defines standards for issuing cease and desist, conservatorship, and liquidation orders, and department policy outlines differences between formal and informal enforcement actions. However, no such guidance exists for administrative penalties the commissioner can issue against credit unions or individuals for noncompliance with a final cease and desist order or order to remove a credit union employee or board member.[11] Additionally, neither statute nor rule provide guidance for the commissioner's authority to waive fees for late submission of call reports or operating fees.[12] A penalty matrix would clearly guide the commissioner's application of sanctions to ensure consistency and promote transparency.

Inadequate communication confuses complainants.

Unclear communication about the types of complaints the department has authority to resolve contributes to confusion among credit union members about the department's complaints process and seeming unwillingness to resolve certain matters. Less than half of the respondents to the Sunset survey of previous complainants believed the department provides sufficient information about which types of complaints fall within its jurisdiction.

The department sends the same ambiguous closing letter to all complainants.

Texas-chartered credit unions must post a notice that informs members they may file a complaint with the department if they are dissatisfied with the credit union's resolution of any dispute.[13] While this language suggests the department will resolve any complaint about credit unions, the department's rules imply it only has the authority to investigate alleged regulatory violations.[14] The department also provides information about its complaint process on its website. However, information about accepting and processing complaints is scattered across two separate webpages and an online Q&A document.[15] The Compact with Texans webpage indicates the department will take action specifically when credit unions violate the Texas Credit Union Act or commission rules, but this page is neither listed under consumer resources nor linked to the complaints page. Then, when closing complaints, the department sends the same ambiguous closing letter to all complainants stating the department's review only addresses matters under its jurisdiction, without clearly stating whether or not the complaint was deemed jurisdictional. Many of the respondents to the Sunset survey and complainants who reached out directly to Sunset staff cited the closing letter's unclear language as contributing to their confusion.

Instituting examiner review of all jurisdictional complaints could enhance the exam process.

The department does not require examiners to review all jurisdictional complaints about the credit unions they examine, which limits the thoroughness of the exam process. For example, an individual complaint against a credit union regarding unusually high interest rates for certain loans may be considered non-regulatory by itself and closed without an investigation or exam. However, having several of these individual complaints could point to a systemic regulatory issue such as predatory lending practices or discrimination.

Sunset Staff Recommendations

Change in Statute

1.1 Require the department to track more comprehensive complaint and enforcement data to support analysis and guide regulatory activities.

Under this recommendation the department would track all phases of the complaint and enforcement processes from complaint receipt, to investigation, to disposition, including related exam findings and enforcement actions. The department should track additional information, including but not limited to:

- Total number of complaints against credit unions in Texas.
- All resolved complaints per fiscal year by each type of action taken, such as non-jurisdictional, dismissed, cease and desist, administrative penalty, letter of understanding, and removal order.
- Breakdown of resolved complaints in each fiscal year by alleged violation, such as falsifying records, fraud, embezzlement, or discriminatory lending.
- Breakdown of each resolved complaint by source, such as another regulatory agency, credit union members, credit union employees, or the public.
- Administrative penalty or late fee assessed, if any.
- Number of days to resolve a complaint from the date of receipt until final disposition, including exam outcomes.

This recommendation would help the department better assess whether complaints lead to confirmed regulatory issues, more objectively review the efficiency of its investigation process, and proactively set goals for policy actions and industry or member education to address valid complaints.

Management Action

1.2 Direct the department to regularly analyze and report on complaint and enforcement data and trends.

This recommendation would direct the department to regularly evaluate its complaint and enforcement data to identify trends and opportunities for department actions. The department should also publish aggregate complaint data on its website or in annual reports. Conducting trend analysis would help the department identify specific issues facing credit union members and the industry, gaps in enforcement efforts or authority, and opportunities for changes to its rules and processes. Reporting aggregate information on the department's website or in annual reports would be more transparent to the public and the industry. The department should implement this recommendation by December 1, 2021.

1.3 Direct the department to establish clear procedures for processing and investigating all complaints it receives.

This recommendation would direct the department to establish and document clear procedures for handling all complaints it receives, including non-jurisdictional, non-regulatory, and regulatory complaints. The procedures should outline processes for referring non-jurisdictional complaints to the appropriate agencies, staff responsibilities for investigating both regulatory and non-regulatory complaints, examples of the types of documentation from credit unions the department might require to make a determination, and the method for documenting determinations. Standardizing complaint procedures would help ensure consistency of department actions. Aligning with recommendation 1.1 above, the department should document when issues raised by complaints require follow-up and the results of the follow-up. The department should implement this recommendation by December 1, 2021.

1.4 Direct the department to disclose summary complaint resolution information to complainants and document final disposition.

This recommendation would direct the department to give all complainants high-level information about the outcome of the department's complaint investigation and final disposition. For regulatory complaints investigated through an exam, the department could inform the complainant of the disposition in general terms without providing specific details that violate confidentiality laws. In the event a complaint investigation becomes a legal matter under a different jurisdiction, the department should inform the complainant of the final status the complaint had under the department's jurisdiction. The department should document final disposition with all other complaint information. This change would improve transparency of the department's complaint process.

1.5 Direct the department to develop a penalty matrix.

This recommendation would ensure the department has clear standards to assess administrative penalties and late fees in a fair and consistent manner. The department should develop a matrix with the following:

- Categories of potential violations by credit unions and individuals.
- Thresholds for department action.
- Standard administrative penalty and late fee amounts for each type of violation, and factors to consider for increasing or decreasing them, such as past compliance history.
- Any additional considerations the commissioner should take into account when determining sanctions, including administrative penalty amounts.

The department should identify types of mitigating and aggravating factors to inform but not dictate enforcement actions, ensure the matrix sets appropriate fees and penalty amounts for different types of violations based on their severity, and provide for increased penalties for repeat violations. The department should complete the proposed penalty matrix by December 1, 2021, and submit the matrix to the Credit Union Commission for approval at the subsequent public meeting.

1.6 Direct the department to more clearly communicate its authority, processes for investigating complaints, and complaint determinations.

This recommendation would direct the department to clarify the types of complaints that fall within its authority to resolve, thus reducing the potential for confusion about non-regulatory complaints. The department should clarify complaints information on its website and in complaint forms and correspondence templates, and should provide a clear determination regarding the complaint's resolution in closing letters to complainants.

1.7 Direct the department to incorporate examiners' review of all jurisdictional complaints into the exam process.

This recommendation would direct the department to have examiners review all jurisdictional complaints filed against a Texas-chartered credit union as part of its exam process. Having this information would assist examiners in identifying potential operational issues and regulatory violations.

Fiscal Implication

These recommendations would not have a fiscal impact to the state because the department is a self-directed semi-independent agency exempt from the legislative appropriations process. The recommendations also would not have a fiscal impact to the department or to the credit unions it regulates, since the department could implement them with existing resources.

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1 "Department Mission," Credit Union Department, accessed July 15, 2020, https://cud.texas.gov/.

2 7 T.A.C. 91.121(b).

3 Credit Union Department, *Self-Evaluation Report*, September 2019, p. 35, https://www.sunset.texas.gov/public/uploads/files/reports/Credit%20Union%20Department%20SER.pdf.

4 7 T.A.C. Section 91.121.

5 All citations to Texas statues are as they appear on http://www.statutes.legis.texas.gov/. Section 15.409(b), Texas Finance Code.

6 7 T.A.C. 91.121(c)(8).

7 "2020 Meeting Materials & Packets," Finance Commission of Texas, accessed July 15, 2020, https://www.fc.texas.gov/meetings/2020-archive.

8 7 T.A.C. 91.121(c-d).

9 "Compact with Texans," Credit Union Department, https://cud.texas.gov/home/compact-with-texans.

10 Section 15.409(d), Texas Finance Code.

11 Section 122.260, Texas Finance Code.

12 7 T.A.C. 91.209(a) and 7 T.A.C. 97.113(a)(1).

13 7 T.A.C. 91.121(b)(1).

14 7 T.A.C. 91.121(c)(2).

15 "File a Complaint against a Credit Union," Credit Union Department, accessed July 15, 2020, https://cud.texas.gov/consumer-resources/file-a-complaint-against-a-credit-union. "Compact with Texans," Credit Union Department, accessed July 15, 2020, https://cud.texas.gov/home/compact-with-texans.

Issue 2 | The Department Should More Effectively Use Its SDSI Status to Provide Adequate Resources and Improve Operations.

Background

In 2009, the Texas Legislature granted the Credit Union Department self-directed semi-independent (SDSI) status, removing the department from the General Appropriations Act and legislative appropriations process. Unlike most state agencies, SDSI agencies have the freedom to set their own fees and budgets, increase staff, change performance measures, and prioritize expenditures and programs with only the approval of their governing boards. These agencies also may carry forward reserve fund balances indefinitely because they cannot rely on the state to pay for large capital expenditures or unforeseen expenses. The department generates most of its revenue from an annual operating fee paid by Texas-chartered credit unions, and the fee varies based on their total assets, as described in the textbox, *Annual Operating Fee.*

Annual Operating Fee

The Credit Union Commission last amended its operating fees rule in 2009, when the department gained SDSI status. The department has used the same fee assessment formula since then to calculate the annual operating fee for each Texas-chartered credit union, based on its total assets.

At the beginning of the fiscal year, the department bills each credit union for half of the fee. Midway through the fiscal year, the department discounts the second bill based upon actual expenditures for the current year, revenues from other fees, interest from reserve and operating funds, and unexpended balances from the prior fiscal year.

Proponents of SDSI status point to the benefits, including the ability to offer higher salaries to recruit and retain more experienced staff, make large capital expenditures on technology and other resources, and respond quickly to changing regulatory conditions, such as more closely monitoring credit unions during the COVID-19 pandemic. By granting SDSI status, the Legislature has entrusted the department to use the flexibility the status affords to address operational needs and fulfill its regulatory mission.

Due to the degree of oversight delegated by the Legislature to the department, Sunset staff closely examined key issues related to agency management, efficiency, and transparency. Overall, the review found no major concerns to justify changing the department's SDSI status, but identified several instances in which the department could better maximize its SDSI status and implement best practices to improve its operations.

Findings

The department has not implemented key best practices to streamline its annual fee assessment process and enhance consistency.

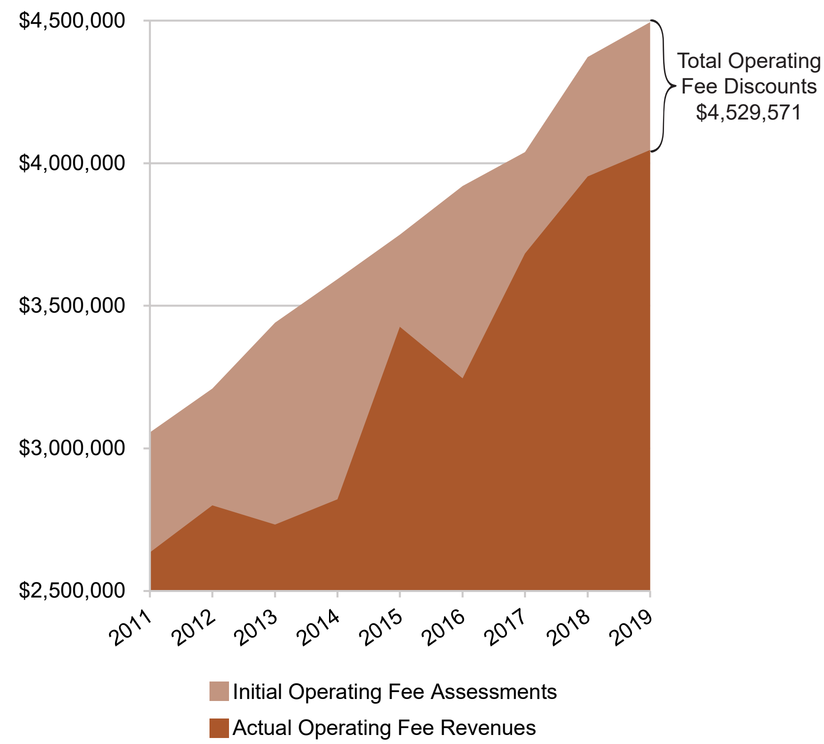
- **Regulatory fee setting.** Regulatory agencies should set fees to cover the anticipated cost of regulation. For SDSI agencies, setting accurate fees based on their budgeted needs is even more important to demonstrate overall stewardship of public funds. However, the fees also should provide financial predictability for the industry being regulated. Since 2009, the department has used the same formula to assess each credit union's annual

Credit unions do not know how much they will actually pay in operating fees for the year.

operating fee based on the credit union's total assets, not the department's approved budget. Under this approach, the department collects the fee in two billings during the fiscal year. At the beginning of the year, the department charges credit unions half the fee, then discounts the second billing midway through the year based on the department's unexpended funds in the current and previous fiscal years, other fee revenues, and interest earned from operating and reserve funds. As a result, under this method, credit unions do not know how much they will actually pay in fees for the year until they receive the second billing.

The chart, *Annual Operating Fee Discounts to Credit Unions*, shows credit unions pay a significantly higher initial fee payment compared to their discounted midyear fee payment. The department does not disclose this practice or report the operating fee discounts in annual financial reports or budget documents that are available to policymakers, oversight agencies, and the public.

Annual Operating Fee Discounts to Credit Unions, FYs 2011–2019



The department's annual fee assessment and midyear adjustment process is overly complicated for staff and leads to unpredictable, fluctuating fees for credit unions. A more streamlined and reliable approach would be to calculate annual operating fees once a year based on the department's approved budget, unexpended balances, and other revenues, allocate the fees based on credit unions' total assets, and reconcile actual revenues and expenditures at the end of the year for the next annual fee cycle. This method would establish more accurate fees at the beginning of the year, eliminate the need for department staff to calculate adjustments midyear, and enable credit unions to better plan for their regulatory expenses during the year.

- **Reserve fund policy.** The department has a reserve fund with six subaccounts that are restricted by commission policy to specific purposes and maximum balances. The department's current reserve fund policy addresses contingencies only, leaving unmet some important outstanding capital project needs such as major building repairs. Because funding for these needs is not contemplated or included in the reserve fund, the commission approves these projects as major expenses in the department's annual operating budget.

  This approach does not align with best practices for SDSI agencies, which cannot ask the Legislature for funding and typically use reserve funds to save up and pay for unexpected or large expenditures. Most SDSI agencies set aside enough reserves to provide an adequate financial cushion and accumulate funds for major projects, such as building improvements and information technology needs. The table, *SDSI Agencies' Reserve Fund Balances*, compares the reserve funds and expenditures of all SDSI agencies.

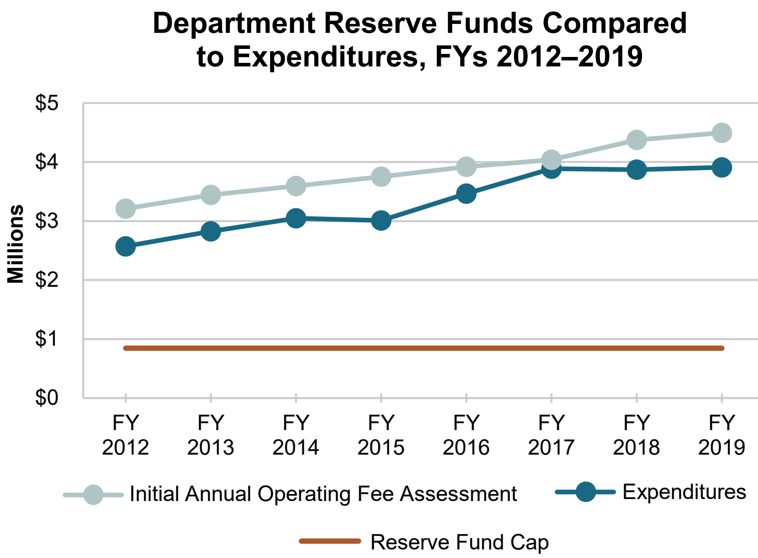
The department's reserve fund policy does not align with best practices for SDSI agencies.

SDSI Agencies' Reserve Fund Balances – FY 2019

SDSI Agency	Reserve Funds	Annual Expenditures
Texas Appraiser Licensing and Certification Board	$654,127	$1,356,729
Credit Union Department	$845,000	$3,909,243
Texas Board of Professional Engineers and Land Surveyors	$1,326,287	$3,859,264
Texas State Board of Public Accountancy	$2,628,248	$5,610,012
Texas Board of Architectural Examiners	$3,101,543	$2,999,280
Texas Real Estate Commission	$8,604,613	$9,967,637
Department of Savings and Mortgage Lending	$11,656,059	$5,875,320
Office of Consumer Credit Commissioner	$13,701,117	$8,759,143
Texas Department of Banking	$17,134,084	$26,669,028

SDSI agencies typically set aside reserve funds equal to at least three months of operating funds for unplanned expenses and revenue shortages. For example, the Finance Commission of Texas allows the three agencies it oversees to hold up to six months of operating funds in their reserves.[1] The department's reserve fund is the smallest of all the SDSI agencies, at 22 percent of annual expenditures, and has remained flat even as available revenues and actual expenditures have increased, as shown in the chart on the following page, *Department Reserve Funds Compared to Expenditures*.

While efforts to be fiscally responsible by keeping the reserve funds low are commendable, the department's reserve fund policy could leave the



department unprepared for economic downturns, emergencies, and other budgetary uncertainties. As the chart shows, the department's cap on the reserve fund has not kept pace with expenditures; the subaccount for emergency operating expenses has not even covered a full month of operating costs in recent years. The department's reserve fund level also has not met standards of the National Association of State Credit Union Supervisors (NASCUS), which accredits state credit union regulatory agencies.[2] Texas is one of 28 accredited states and the department is scheduled for re-accreditation in 2021. However, since the department's last re-accreditation in 2016, its expenditures gradually increased and the reserve fund cap fell below NASCUS' standard to cover a minimum of three months of operating expenses.[3]

In August 2020, the commission increased the reserve fund's cap to meet the NASCUS accreditation criteria.[4] While the commission has taken steps to meet national best practices, they did not revise the reserve fund policy to prevent inadequate reserves from recurring in the future. Other SDSI agencies use different methods of setting reserve fund balances, including some that tie the balance to agency budgets or actual expenditures.

More regular independent audits could improve the department's financial controls and accountability.

The department's unreliable data and controls could erode its credibility.

- **Previous findings of unreliable financial and operational data and controls.** The department's lack of adequate tools, efficient procedures, and effective controls have led to continuing errors in financial and performance reports to the commission, the Legislature, and the governor. For example, a 2016 State Auditor's Office (SAO) report found problems with financial and process controls that resulted in the department under-reporting current liabilities by 67 percent and total liabilities by 96 percent, and over-reporting total net assets by 23 percent.[5] The SAO report also found accounting errors in the department's 2015 SDSI report.[6] The department agreed with SAO's findings and took steps to ensure more accurate reporting, but similar problems have continued to occur. For instance, the department's fiscal year 2019 financial report contained errors significant enough to warrant issuing a corrected version.[7] However, the corrected report also contained an error in reported expenditures due to the department's manual data tracking, analysis, and reporting processes. Continued errors in the department's reported financial and performance data could erode its credibility among the credit unions it regulates, Texas policymakers and oversight agencies, and other federal and state regulators.

- **Lack of periodic independent audits.** Independent financial and operational audits can help state agencies of all sizes identify and address problems and opportunities that can lead to more efficient, accurate, and compliant processes and controls. Their objective analyses, appraisals, recommendations, and pertinent comments can help agencies improve both accountability and effectiveness.[8]

  SDSI agencies have less state oversight than agencies that go through the legislative appropriations process. The department has even less regular oversight than most SDSI agencies because the Texas Internal Auditing Act exempts smaller agencies from having an internal audit process, and also exempts SDSI agencies from the act's alternative annual risk assessment reporting requirement for the smaller agencies.[9] Statute requires the department to file annual financial and operational reports with the governor, the Legislature, and the Legislative Budget Board, as shown in Appendix C, and the department voluntarily submits an annual risk assessment report.

  The department has less regular oversight than most SDSI agencies.

  The Texas Comptroller's Office, Department of Public Safety, SAO, and other state oversight agencies may examine the department at any time, but these reviews do not occur on a regular basis and are often narrowly focused on specific functions. For example, SAO has audited the department once, in 2016, after the department obtained SDSI status in 2009. The department does not have a regular independent audit process or contract for independent audit services. Such a process could help identify improvements and ensure the department fully addresses concerns other state oversight agencies have identified, such as the lack of controls that led to the accounting errors identified in the 2016 SAO report and continued to occur even after the department took corrective actions.[10]

- **Other SDSI agencies contract for independent audit services.** State agencies may procure independent audit services through a competitive selection process with SAO approval.[11] For example, statute requires the Finance Commission to employ an internal auditor to facilitate oversight and control of the three finance agencies it oversees.[12] The Finance Commission contracts with an independent audit firm and has an audit committee to oversee the independent audit process. SDSI agencies use annual risk assessments, issues identified by state oversight agencies, and rotation of key agency functions to identify areas of focus for independent audits. The table on the following page, *SDSI Agencies' Independent Audit Contracts*, shows the independent auditing services other SDSI agencies have contracted in the past three fiscal years and compares the cost of the contracted audits to the overall agency expenditures over the same three-year period. The cost of contracting for independent audits is economical compared to the agencies' overall expenditures and could help them identify and address issues and opportunities to increase efficiencies and save money.

  Audits can identify and address issues and increase efficiency.

SDSI Agencies' Independent Audit Contracts, FYs 2017–2019

Agency	Total Contracts	Sum of Contracts	Total Agency Expenditures
Finance Commission of Texas*	3	$194,790	$124,319,596
Texas Real Estate Commission and Texas Appraiser Licensing and Certification Board	3	$90,097	$29,257,094
Texas State Board of Public Accountancy	2	$50,000	$17,740,060
Credit Union Department	*0*	*0*	*$11,677,044*
Texas Board of Architectural Examiners	0	0	$7,613,340
Texas Board of Professional Engineers and Land Surveyors	1	$4,500	$3,859,264

* Oversees the Texas Department of Banking, Department of Savings and Mortgage Lending, and Office of Consumer Credit Commissioner.

Sunset Staff Recommendations

Management Action

2.1 Direct the Credit Union Commission to implement a more streamlined and reliable fee assessment policy and process.

Under this recommendation, the commission should update its operating fee rules, policies, and procedures by August 31, 2021, to more accurately assess operating fees based on the department's approved budget in addition to credit unions' total assets. While this recommendation may require a one-time change in rule, the new process should provide flexibility in calculating operating fees so the commission does not need to update its rules and policies annually. The policy also should discourage the practice of discounting the second assessment midyear, and instead reconcile unexpended funds and revenues from other sources when setting fees for the following fiscal year. This recommendation would streamline the department's fee assessment process and provide more consistent fees, enabling credit unions to better predict the cost of regulation and plan accordingly.

2.2 Direct the commission to update its reserve fund policy to address long-term capital funding needs and maintain an adequate reserve balance.

This recommendation would direct the commission to change its reserve fund policy by August 31, 2021, to base it on the department's budget and expenditures instead of setting a fixed amount that may not accurately reflect the department's long-term needs. The policy should provide flexibility to adjust to the department's fluctuating expenditures, similar to other SDSI agencies' reserve fund policies. The department's operating reserves should cover a minimum of three months of expenditures to meet best practices for state credit union regulatory agencies. The commission also should consider implementing a policy to gradually save money for major projects and expenditures, instead of relying on annual operating fee revenues to pay for them in a single year.

2.3 Direct the commission to implement an independent audit process for the department.

This recommendation would direct the commission to establish an independent audit process to regularly evaluate the department's operations, procedures, financial and performance data reporting, compliance with requirements for state agencies, and other areas to improve efficiency and increase accountability by

August 31, 2021. The commission and department should determine the scope for independent audits based on factors such as risk assessments, issues identified by other state oversight agencies, and periodic rotation of operational, administrative, and regulatory functions.

The commission and the department should coordinate with the State Auditor's Office to contract with an independent audit firm, with a focus on identifying and addressing weaknesses and opportunities for improving internal processes and controls, increasing staff efficiency, and compiling and reporting accurate financial and operational data. Additionally, the commission should consider appointing an audit committee to oversee the audit process, review audit reports, and make recommendations to the full commission on action items identified in the audit reports.

Fiscal Implication

These recommendations would not have a fiscal impact to the state because the department is a self-directed semi-independent agency that is exempt from the legislative appropriations process. The recommendation to improve the operating fee assessment process does not require or direct the department to increase these fees. Further, the department maintains a $30,000 balance in its reserve fund to pay for state oversight agencies' audits and could use these funds to pay for independent audits. The department would continue its current practice of replenishing the audit fund with operating fee revenues as needed. Additionally, any efficiencies and savings identified through the audit process could offset audit costs. The impact of the COVID-19 pandemic is still unknown but may impact credit unions' total assets and, as a result, the department's future revenue collections.

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1 Finance Commission of Texas, *Finance Commission Policies and Procedures*, accessed June 30, 2020, https://www.fc.texas.gov/sites/default/files/policies/polipro.pdf, 31–32.

2 National Association of State Credit Union Supervisors Accreditation Program, accessed June 23, 2020, https://www.nascus.org/state-activities/accreditation/.

3 National Association of State Credit Union Supervisors, *Accreditation Standards*, accessed June 16, 2020, https://www.nascus.org/wp-content/uploads/2020/01/SERA-Standards-1.23.2020.pdf.

4 Credit Union Commission, *Credit Union Commission Meeting*, accessed August 7, 2020, https://cud.texas.gov/wp-content/uploads/2015/11/Commission_08-07-2020.pdf, 34–46.

5 State Auditor's Office (SAO), *An Audit Report on the Credit Union Department: A Self-directed, Semi-independent Agency*, December 2016, accessed June 16, 2020, http://www.sao.texas.gov/reports/main/17-014.pdf.

6 Ibid.

7 Texas Credit Union Department, *Annual Financial Report*, accessed June 16, 2020, https://cud.texas.gov/wp-content/uploads/2015/11/2019_Annual_Financial_Report.pdf.

8 The Institute of Internal Auditors, *Internal Auditing in State Government*, accessed June 30, 2020, https://www.gao.gov/assets/80/78886.pdf, 6.

9 All citations to Texas statues are as they appear on http://www.statutes.legis.texas.gov/. Sections 2102.004 and 2102.013, Texas Government Code.

10 SAO, *An Audit Report on the Credit Union Department*.

11 Section 321.020, Texas Government Code.

12 Section 11.202, Texas Finance Code.

Issue 3 | Texas Has a Continuing Need for the Credit Union Department.

Background

Texas has regulated credit unions since 1913, initially under the Texas Department of Banking until the Legislature created the Credit Union Department in 1969. The department gained self-directed semi-independent (SDSI) status in 2009, allowing it to operate and raise its own revenue outside the state appropriations process. The Credit Union Commission has five public members with recognized business ability and four credit union industry members with five or more years of executive-level experience at a credit union based in Texas. The commission sets policy, approves the department's fees and budget, and appoints and oversees a commissioner who examines Texas-chartered credit unions and enforces state regulations.

In fiscal year 2019, the department regulated 181 Texas-chartered credit unions with about 700 locations, 11,000 employees, 4 million members, and $44 billion in total assets.[1] Texas is one of 45 states with a dual charter system, which means credit unions can operate in Texas if the state, federal government, or another state charters them. In fiscal year 2019, Texas also had nine foreign credit unions chartered by other states and 263 federally chartered credit unions.

Findings

Texas benefits from having a strong credit union industry and the department continues to be needed to effectively regulate it.

- **State regulation benefits and protects credit union members.** Texas has a vested interest in regulating its robust state-chartered credit union industry, which ranked second in the nation in number of credit unions, fourth in total membership, and sixth in total assets in 2019. Credit unions are member-owned nonprofit institutions that serve groups of consumers with shared interests and often provide smaller personal loans at more favorable rates than for-profit lenders. Many credit unions operate in rural or economically disadvantaged communities with limited options for financial services.

  If Texas stopped regulating credit unions, state-chartered credit unions would have to convert to a federal charter to stay in business. Federal regulatory fees are significantly higher than Texas fees, and credit unions that convert to a federal charter would likely pass these increased costs on to their members.[2] Also, residents of some communities could lose access to affordable personal loans and other financial services unless their state-chartered credit union converted to a federal charter.

Texas has a vested interest in regulating state-chartered credit unions.

- **State regulation pays for itself and generates tax revenue.** Texas-chartered credit unions pay the entire cost of their regulation through operating fees. They also pay Texas sales taxes and hotel occupancy taxes, unlike federally chartered credit unions.[3] If Texas no longer chartered credit unions, the state would lose these tax revenues.

While other state agencies also regulate financial industries in Texas, consolidation offers no substantial benefits at this time.

Overall, the department appears to be well-run, cost-effective, and efficient. Sunset staff considered two organizational alternatives but ultimately determined neither provided clear advantages to justify consolidation. Furthermore, changing the regulatory structure for Texas credit unions during the precarious economic conditions and long-term uncertainty caused by the COVID-19 pandemic could lead to regulatory instability and gaps during such a transition.

Restructuring the department would not increase efficiency or reduce costs.

- **Finance Commission of Texas.** The Finance Commission is the policymaking body that oversees the Texas Department of Banking, Office of Consumer Credit Commissioner, and Department of Savings and Mortgage Lending. Each agency under the Finance Commission has an independent staff to perform administrative, operational, and regulatory functions. For this reason, placing the department under the Finance Commission as currently structured would not increase the department's efficiency or reduce its costs. Eliminating the Credit Union Commission would save about $10,000 annually in commission members' travel expenses, but the department would be statutorily required to pay a proportional share of the Finance Commission's expenses.[4]

- **Department of Banking.** Of the three agencies under the Finance Commission's umbrella, the Department of Banking's regulatory functions are most similar to the Credit Union Department's. Banks and credit unions provide some similar services, such as deposit accounts and loans, but they fundamentally differ in key ways. Banks are for-profit entities, while credit unions are nonprofit organizations, and they have separate federal and state laws and rules, different federal regulators and deposit insurers, and industry-specific exam standards and procedures. They also have a history of competition, conflicting interests, and regulatory disputes.

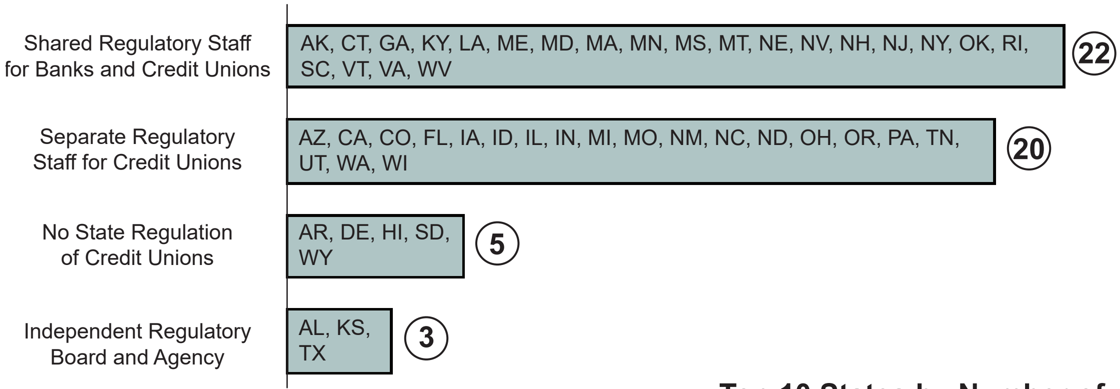
  The Sunset process often consolidates regulation of industries and occupations with highly similar practices and qualifications. However, Sunset tries to avoid creating regulatory structures that could result in an agency favoring one industry group at the expense of another, or harming public interest by favoring one group's interest over consumer choice. Transferring the regulation of credit unions to the Department of Banking, particularly at this time, would disrupt the state's delicate regulatory balance between these two competing segments of the finance industry.

Texas is one of 45 states that regulate credit unions.

Most other states regulate credit unions.

Sunset staff reviewed organizational structures of all 45 states that regulate credit unions, as shown in the chart on the following page, *State Regulation of Credit Unions in the United States*. All the states have a similar approach to funding regulation by assessing fees, but unlike the department, most other state regulatory agencies receive legislative appropriations.

State Regulation of Credit Unions in the United States



Texas regulates more credit unions than any other state except Illinois, as shown in the table, *Top 10 States by Number of State-Chartered Credit Unions*. Like Texas, Alabama and Kansas have an independent agency to regulate credit unions and an in-house staff to carry out administrative functions. The other 42 states have one regulatory agency for all financial institutions but use different organizational structures to regulate credit unions. About half have a separate department or division for credit unions. The rest combine regulation of banks and credit unions in one department, and examiners may be assigned to both institutions.

Top 10 States by Number of State-Chartered Credit Unions, as of 12/31/2019

State	State Credit Unions	Total Assets	Total Members
1. Illinois	187	$44 billion	3.1 million
2. Texas	179	$44 billion	4.0 million
3. Michigan	136	$55 billion	4.5 million
4. California	123	$119 billion	7.5 million
5. Wisconsin	121	$41 billion	3.2 million
6. Ohio	116	$24 billion	2.1 million
7. Missouri	97	$15 billion	1.5 million
8. Iowa	83	$21 billion	1.3 million
9. Tennessee	79	$14 billion	1.1 million
10. Minnesota	67	$16 billion	1 million

The department misses opportunities to more effectively communicate with regulated credit unions and the public.

- **No process to notify credit unions of federal changes that override state regulations.** Under Texas law, changes in federal credit union regulations immediately override state regulations for Texas-chartered credit unions, without requiring the commission or the department to first take action.[5] This parity law ensures Texas-chartered credit unions have the same powers and authorities as federally chartered credit unions, even if they conflict with state laws or rules. However, the department does not have a policy or process to uniformly notify credit unions of these changes when they occur. Instead, the department typically goes through the formal rulemaking process to update state rules to comply with new federal regulations, a process that can take six months or longer. In the meantime, credit unions may not know about the federal regulatory changes or have guidance from the department on how to apply them. Without a formal process in place, the department currently notifies credit unions about these changes inconsistently.

- **Website problems.** Credit unions, their members, and the public rely on the department's website for critical information about policies and programs, but the website contains broken links and outdated, missing, unclear, and incorrect information. For example:

The department's website has outdated, missing, and incorrect information.

  - Most online application and complaint forms do not have instructions on how to submit them to the department.
  - A list of department contracts has not been updated since fiscal year 2017.
  - Webpages with informational memorandums and regulatory bulletins for the industry do not provide a general explanation of these announcements or how credit unions should apply them.

Unnecessary notarization requirements reduce efficiency for staff and create burdens for credit unions.

Notarization is meant to verify identity, not truthfulness, and state law already prohibits a person from knowingly making a false entry in a government record.[6] Requiring applicants to notarize forms is a burden to the applicant that adds no value to the process. Statute requires applicants for a new credit union charter to notarize their application.[7] Most of the department's other forms also require notarization, including applications for conversions, mergers, amendments to articles of incorporation or bylaws, and notices of protest to proposed changes in fields of membership. To comply, applicants must print the forms, notarize them, and either mail or scan and email them to the department. However, department staff said they will accept forms that do not meet the notarization requirement, further demonstrating the requirement is unnecessary. Removing this requirement would simplify the application process without harming the department's ability to regulate credit unions.

The department's statute does not reflect standard language typically applied across the board during Sunset reviews.

The Sunset Commission has developed a set of standard recommendations that it applies to all state agencies reviewed unless an overwhelming reason exists not to do so. These across-the-board recommendations (ATBs) reflect an effort by the Legislature to place policy directives on agencies to prevent problems from occurring, instead of reacting to problems after the fact. ATBs are statutory administrative policies adopted by the Sunset Commission that contain "good government" standards for state agencies. The ATBs reflect review criteria contained in the Sunset Act designed to ensure open, responsive, and effective government.

- **Commission member training.** The department's statute contains standard language requiring commission members to receive training and information necessary for them to properly discharge their duties.[8] However, statute does not contain newer requirements for all topics the training must cover, such as a discussion of the scope of, and limitations on, the commission's rulemaking authority. Statute also does not require that the department create a training manual for all commission members or specify that commission members must attest to receiving and reviewing the training manual annually.

Also, the department typically invites a trade association to teach a section of the training for new commission members titled "The Credit Union Movement."[9] This practice is inappropriate for a regulatory agency because it creates the appearance of an unfair advantage for one stakeholder group over others and lacks transparency because the training is not open to the public.

A trade association inappropriately helps train new commission members.

The department's statutory reporting requirements continue to be needed.

The Sunset Act establishes a process for the Sunset Commission to consider if reporting requirements of agencies under review need to be continued or abolished. The Sunset Commission has interpreted these provisions as applying to reports that are specific to the agency and not general reporting requirements that extend well beyond the scope of the agency under review. Reporting requirements with deadlines or that have expiration dates are not included, nor are routine notifications or notices, or posting requirements.

State law requires the department to produce three reports that are specific to its operations and meet the parameters described above. Appendix C lists the three reporting requirements and Sunset staff's analysis of their need, which concluded all three reports continue to serve a useful purpose.

Sunset Staff Recommendations

Change in Statute

3.1 Continue the Credit Union Department for 12 years.

This recommendation would continue the Credit Union Department until September 1, 2033.

3.2 Require the department to develop a process for notifying credit unions about federal regulatory changes that override state regulations.

This recommendation would require the department to notify Texas-chartered credit unions about changes in federal regulations that immediately take effect in Texas but conflict with state regulations. This recommendation would ensure the department consistently provides information and guidance about these changes until the commission can go through the rulemaking process to formally update its rules.

3.3 Eliminate the statutory notarization requirement for articles of incorporation in new charter applications.

This recommendation would remove the statutory notarization requirement for individuals applying to incorporate a credit union and obtain a charter from the department. As part of this recommendation, the department should also remove its unnecessary notarization requirements on other application forms, such as those for conversions, mergers, amendments to articles of incorporation or bylaws, and notices of protest to proposed changes in fields of membership. Neither statute nor department rules require notarization of these forms, and the department already accepts forms that do not comply with the requirement. Current provisions of the Penal Code that make falsifying a government record a crime would continue to apply to these applications.

3.4 Update the standard across-the-board requirement related to board member training.

This recommendation would require the department to develop a training manual that each commission member attests to receiving annually, and require existing commission member training to include information about the scope of and limitations on the commission's rulemaking authority. The training should provide clarity that the Legislature sets policy, and agency boards and commissions have rulemaking authority necessary to implement legislative policy. As a management action, the commission should amend its commission member training policies to prohibit trade associations from participating in the training.

Management Action

3.5 Direct the department to regularly update its website content.

The department should develop a process to routinely monitor and update the website and ensure the information posted on it is current, clear, and accurate.

Fiscal Implication

These recommendations would not have a fiscal impact to the state because the department is a self-directed semi-independent agency exempt from the legislative appropriations process. These recommendations also would not have a significant fiscal impact to the department or the credit unions it regulates, since the department could address them with existing resources.

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[1] Credit Union Department, *Texas State-Chartered Credit Union System Profile*, as of December 31, 2019, https://cud.texas.gov/wp-content/uploads/2015/11/Texas_State_Chartered_Credit_Union_System_Profile-1.pdf.

[2] Credit Union Department, *Texas State-Chartered Credit Union System Profile*, 18.

[3] 12 U.S.C. Section 1768. All citations to Texas statutes are as they appear on http://www.statutes.legis.texas.gov/. Section 151.309, Texas Tax Code.

[4] Section 11.204, Texas Finance Code.

[5] Section 123.003, Texas Finance Code.

[6] Section 37.10, Texas Penal Code.

[7] Section 122.001(d), Texas Finance Code.

[8] Section 15.2041, Texas Finance Code.

[9] Credit Union Department, *Credit Union Commission Policy Manual*, Revised March 9, 2018, Policy VIII. New Commission Member Training and Appendix B, p 39, accessed July 10, 2020, https://cud.texas.gov/wp-content/uploads/2019/09/Commission_Policies_Manual-09-16-19-1.pdf

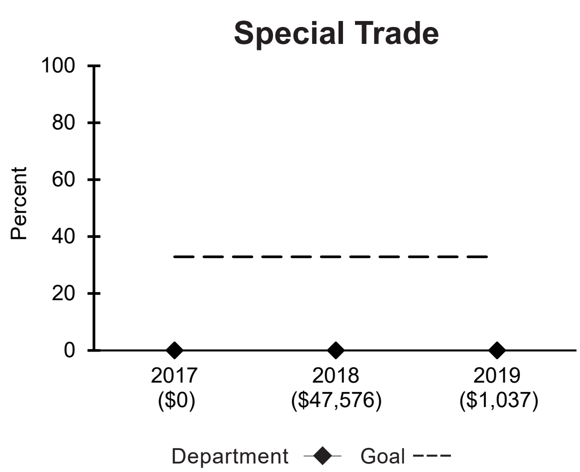
Appendix A

Historically Underutilized Businesses Statistics, FYs 2017–2019

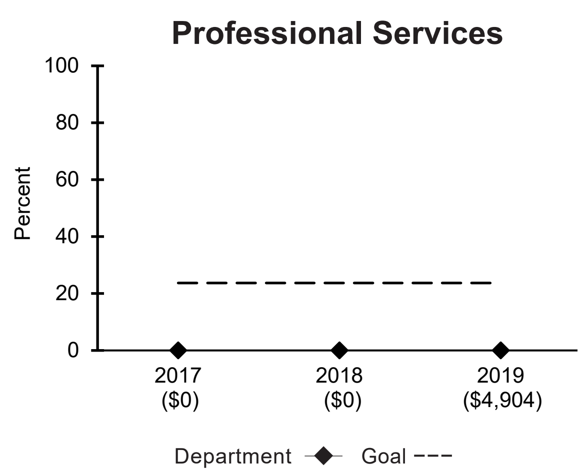
The Legislature has encouraged state agencies to increase their use of historically underutilized businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.[1]

The following material shows trend information for the Credit Union Department's use of HUBs in purchasing goods and services. The department maintains and reports this information under guidelines in statute.[2] In the charts, the dashed lines represent the goal for HUB purchasing in each category, as established by the comptroller's office. The diamond lines represent the percentage of department spending with HUBs in each purchasing category from fiscal years 2017–19. Finally, the number in parentheses under each year shows the total amount the department spent in each purchasing category.

The department did not have purchases in the heavy construction or building construction categories in the last three fiscal years. The department fell below the state's goal in the special trade and professional services categories in fiscal years 2018 and 2019. The department exceeded statewide goals in the last three fiscal years for the other services and commodities categories.

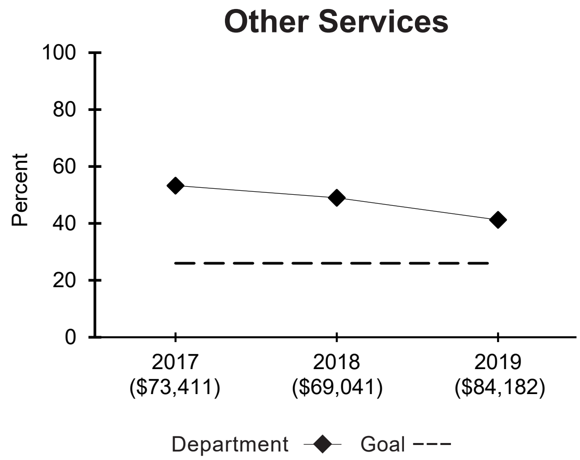


The department did not meet the statewide purchasing goal for special trade in fiscal years 2018–19.

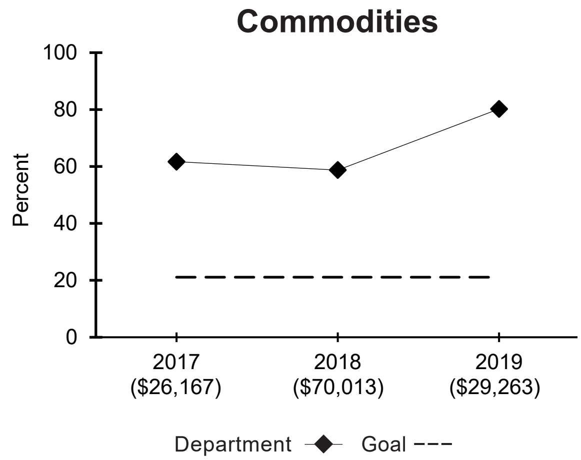


The department did not meet the statewide purchasing goal for professional services in fiscal year 2019.

Appendix A



The department exceeded the statewide purchasing goal for other services in fiscal years 2017–19.



The department far exceeded the statewide purchasing goal for commodities in fiscal years 2017–19.

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[1] All citations to Texas statutes are as they appear on http://www.statutes.legis.texas.gov/. Section 325.011(9)(B), Texas Government Code.

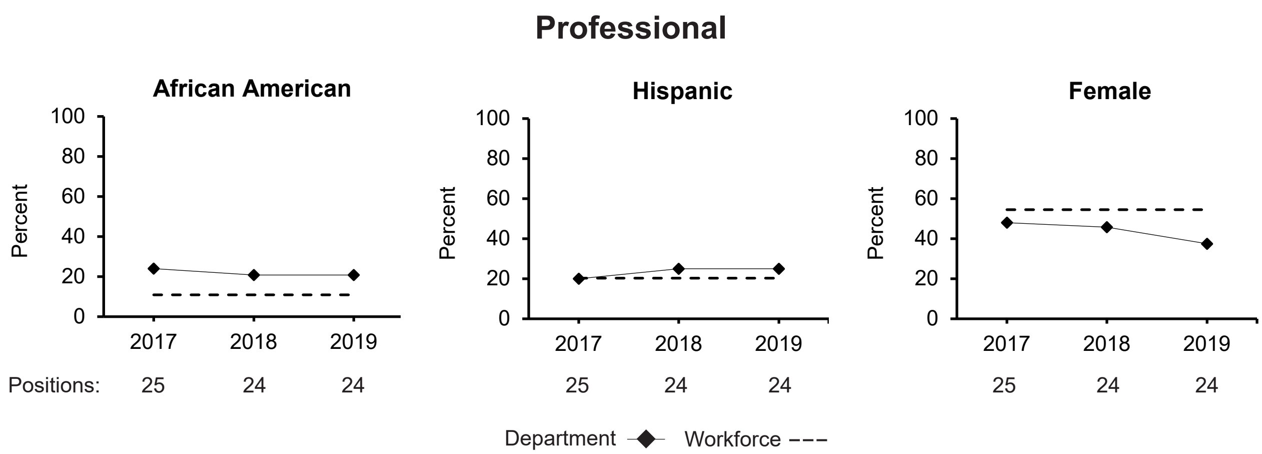
[2] Chapter 2161, Texas Government Code.

Appendix B | Equal Employment Opportunity Statistics, FYs 2017–2019

In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the Credit Union Department.[1] The department maintains and reports this information under guidelines established by the Texas Workforce Commission.[2] In the charts, the dashed lines represent the percentages of the statewide civilian workforce for African Americans, Hispanics, and females in each job category.[3] These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the department's actual employment percentages in each job category from fiscal years 2017–19.

Generally, the department met or exceeded state civilian workforce percentages in the last three fiscal years for African Americans and Hispanics in the professional category. However, the department has struggled to meet state civilian workforce percentages for females in this category.

The administration, technical, administrative support, service and maintenance, and skilled craft categories had too few employees to conduct a meaningful comparison to the overall civilian workforce.



The department met or exceeded the state civilian workforce percentages for African Americans and Hispanic in fiscal years 2017–19. The department fell below the state civilian workforce percentages for females in these same fiscal years.

1 All citations to Texas statutes are as they appear on http://www.statutes.legis.texas.gov/. Section 325.011(9)(A), Texas Government Code.

2 Section 21.501, Texas Labor Code.

3 Based on the most recent statewide civilian workforce percentages published by the Texas Workforce Commission.

Appendix C

Credit Union Department Reporting Requirements

Report Title	Legal Authority	Description	Recipient	Sunset Evaluation
1. Biennial Activities	16.005(b), Texas Finance Code	Describes activities in the previous biennium including audits, a financial report, changes in regulatory fees and jurisdiction, new rules adopted or repealed, and gifts and donations.	Governor, Legislature	Continue
2. Disclosure of Financial Conditions	16.005(c), Texas Finance Code	Provides staff salaries, per diem and travel expenses, operating plan, annual budget, and revenue received and expenses incurred in the previous 12 months.	Governor, Senate Finance and House Appropriations committees, Legislative Budget Board	Continue
3. Report on Legislative Recommendations	15.405, Texas Finance Code	Lists legislative recommendations for the next regular session.	Legislature	Continue

Appendix D | Staff Review Activities

During the review of the Credit Union Department, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with department personnel; observed commission meetings; spoke with staff from key legislative offices; conducted interviews and solicited written comments from state and national interest groups and the public; reviewed department documents and reports, federal and state statutes, commission rules, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research.

In addition, Sunset staff also performed the following activities unique to the department:

- Interviewed current and former Credit Union Commission members.
- Conducted a focus group meeting with field examiners.
- Reviewed a sample of complaint files and the department's complaint database.
- Surveyed regulated credit union executives and directors, stakeholders, and previous complainants.
- Interviewed staff from the National Credit Union Administration, Finance Commission of Texas, Comptroller of Public Accounts, Office of the Attorney General, and Department of Information Resources.

Sunset Staff Review of the
Credit Union Department

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