

SUNSET ADVISORY COMMISSION

FINAL REPORT

Credit Union Department

July 2009



Sunset Advisory Commission



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* Senator Kim Brimer served on the Commission from December 2005 through December 2008.

** Charles McMahan was appointed to fill the unexpired term of Michael Stevens.

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

CREDIT UNION DEPARTMENT



SUNSET FINAL REPORT
JULY 2009



This document is intended to compile all recommendations and action taken by the Sunset Advisory Commission and the Legislature for an agency under Sunset review. The following explains how the document is expanded and reissued to include responses from agency staff and members of the public, as well as action taken by the Sunset Commission and the Legislature in each step of the Sunset process.

- ◆ *Sunset Staff Report* – Contains all Sunset staff recommendations on an agency, including both statutory and management changes, developed after extensive evaluation of the agency.
- ◆ *Hearing Material* – Summarizes all responses from agency staff and members of the public to Sunset staff recommendations, as well as new policy issues raised for consideration by the Sunset Commission.
- ◆ *Decision Material* – Includes additional responses, testimony, or new policy issues raised during the public hearing for consideration by the Sunset Commission in its decision meeting on an agency.
- ◆ *Commission Decisions* – Contains the decisions of the Sunset Commission on staff recommendations and new policy issues. Statutory changes adopted by the Commission are presented to the Legislature in the agency’s Sunset bill.
- ◆ *Final Report* – Summarizes action taken by the Legislature on Sunset Commission recommendations and new provisions added by the Legislature to the agency’s Sunset bill.



Staff Report – August 2008

Commission Decisions – January 2009

Final Report – July 2009

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SUMMARY



Summary

The Credit Union Department supervises 220 state-chartered credit unions, with three million members and \$19.3 billion in assets, to ensure the safety and soundness of these institutions. In 1969, the Legislature created the Credit Union Department as a separate entity from the Department of Banking, which had previously regulated state-chartered credit unions. The question of whether the Credit Union Department should continue to be a separate entity has been considered by the Legislature numerous times since then, and still persists today.

Credit unions are the only financial institutions that are regulated separately from the Finance Commission of Texas, an umbrella regulatory body that oversees the Department of Banking, the Department of Savings and Mortgage Lending, and the Office of the Consumer Credit Commissioner. Sunset staff evaluated placing the Credit Union Department under the umbrella of the Finance Commission. While such a merger could result in benefits for the State – such as coordination of similar functions, ability to address issues affecting all financial institutions, and possible administrative savings – it could also have negative results – including the loss of an independent regulator that has specific knowledge of credit unions. Sunset staff concluded that the Credit Union Department is well run and the benefits of transferring its functions to the Finance Commission are not sufficient to justify such a significant change.



No significant problems were found to justify moving credit union regulation under the Finance Commission.

Sunset staff also found opportunities to improve the agency's operations and regulations to better meet the needs of consumers and the industry. Credit unions have traditionally offered more limited, basic financial services, such as deposit accounts and small personal loans. However, over time many credit unions have evolved into larger and more sophisticated institutions, in terms of both the products and services they offer, as well as their business decisions and structure. These efforts have helped credit unions widen their customer base and achieve greater stability through diversification, but they have also led to greater risk. These changes in the industry necessitate greater transparency for credit union members, stronger enforcement powers for the Department, and expanded stakeholder input into the Credit Union Commission's policymaking process.

A summary of the Sunset staff recommendations on the Credit Union Department is provided in the following material.

Issues and Recommendations

Issue 1

Texas Has a Continuing Need for the Credit Union Department.

Key Recommendation

- ◆ Continue the Credit Union Department as an independent agency for 12 years.

Issue 2

Members Often Have Limited Access to Basic Information Needed to Effectively Monitor Their Credit Union's Financial Condition and Management.

Key Recommendations

- ◆ Require the Credit Union Commission to adopt rules requiring state-chartered credit unions to submit a report, updated annually, providing basic financial and management information to their members through their website.
- ◆ Require state-chartered credit unions to inform their members on a regular basis that they have access to certain documents related to their credit union's finances and management.
- ◆ Remove statutory language authorizing the Department to file a consolidated IRS Form 990 for state-chartered credit unions.
- ◆ Require state-chartered credit unions to provide information through their websites and newsletters about how consumers may file a complaint with the Department, in addition to posting this information in their offices.

Issue 3

The Department Lacks Certain Key Enforcement Tools Needed to Ensure Safety and Soundness in the Credit Union Industry.

Key Recommendations

- ◆ Authorize the Commissioner to levy administrative penalties against state-chartered credit unions for legal or regulatory violations, and require the Credit Union Commission to adopt rules governing this authority.
- ◆ Extend the Commissioner's cease and desist authority to include unchartered entities holding themselves out as credit unions.
- ◆ Give the Commissioner statutory authority to assess penalties for delinquent operating fees.

Issue 4

The Legislative Advisory Committee Does Not Conform With Statutory Standards for Agency Committees and Is No Longer Needed.

Key Recommendations

- ◆ Require the Commission to adopt rules for its use of advisory committees, ensuring the committees meet standard structure and operating criteria.
- ◆ The Commission should abolish the Legislative Advisory Committee and seek more effective ways of gaining stakeholder input.

Fiscal Implication Summary

None of the recommendations in this report would have a significant fiscal impact to the State.

Summary of Legislative Action

H.B. 2735 Flynn (Estes)

The Legislature adopted all of the Sunset Commission's recommendations and made no additions to House Bill 2735. The bill continues the Credit Union Department as an independent agency for 12 years, requires greater transparency between credit unions and their members, and provides the Department with additional enforcement tools. The list below summarizes the major provisions of H.B. 2735, and more detailed discussion is located in each issue.

Sunset Provisions

1. Continue the Credit Union Department for 12 years.
2. Require state-chartered credit unions to provide more information about their financial condition and management to their members.
3. Authorize the Credit Union Commissioner to issue cease-and-desist orders against unchartered credit unions and to assess late penalties for delinquent operating fees.
4. Require the Credit Union Commission to adopt rules governing its use of advisory committees.

Provisions Added by the Legislature

None added.

Fiscal Implication Summary

House Bill 2735 will not have a fiscal impact to the State.

ISSUES



Issue 1

Texas Has a Continuing Need for the Credit Union Department.

Summary

Key Recommendation

- ◆ Continue the Credit Union Department as an independent agency for 12 years.

Key Findings

- ◆ Texas has a continuing interest in regulating state-chartered credit unions.
- ◆ While other organizational options exist, the Department effectively regulates the industry as a stand-alone agency.
- ◆ Most states regulate credit unions, but they use a different organizational structure than Texas.

Conclusion

Texas has a continuing need to regulate credit unions to ensure the safety and soundness of these financial institutions. The Sunset review evaluated the continuing need for a single, independent agency to perform this function. Sunset staff assessed whether the agency's responsibilities could be successfully transferred to another agency. Sunset staff found that while the Finance Commission regulates other financial institutions, the benefits of transferring the Credit Union Department's functions are not sufficient to justify such a significant change.

Support

The Credit Union Department regulates state-chartered credit unions to ensure they are safe and sound for the benefit of members and the economy as a whole.

State-chartered credit unions in Texas have three million members and \$19.3 billion in assets.

- ◆ The Legislature passed the Texas Credit Union Act in 1969, creating the Credit Union Department as a separate entity from the Banking Department. Previously, the Banking Department had regulated state-chartered credit unions. Today, the Credit Union Department supervises 220 state-chartered credit unions, with three million members and \$19.3 billion in assets, to ensure the safety and soundness of these institutions. The Department's mission is to safeguard the public interest, protect the interests of credit union members, and promote public confidence in credit unions.
- ◆ To accomplish its mission, the Department carries out the following key activities.
 - Approves new charters, charter conversions, mergers, and other structural or operational changes for state-chartered credit unions.
 - Examines every state-chartered credit union on a regular basis.
 - Oversees out-of-state credit unions operating in Texas.
 - Assists the public by helping to resolve complaints against credit unions and providing informational materials.
- ◆ For fiscal year 2008, the Department's operating budget totals nearly \$1.9 million. Credit unions pay for the entire cost of this regulation through various operating fees. The agency has authority to employ up to 26 staff. The Credit Union Commission oversees the Department. The Commission is composed of nine Governor-appointed members, including five public members and four representatives of the credit union industry.

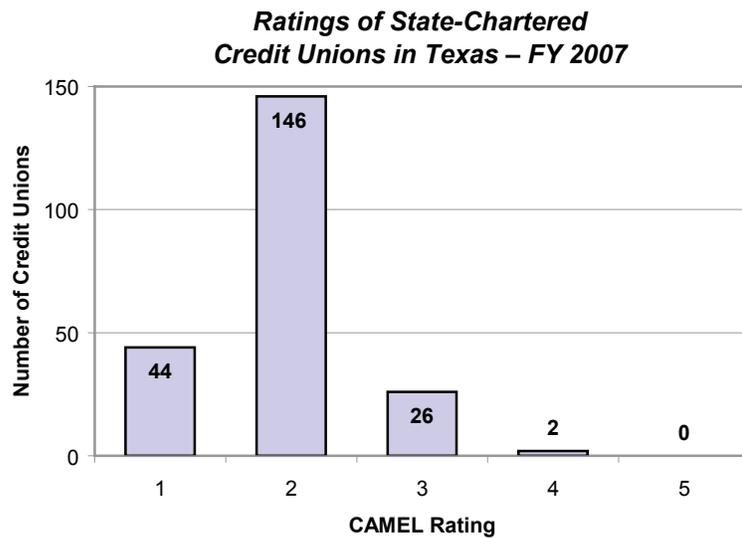
Texas has a continuing interest in regulating state-chartered credit unions.

Regulation helps ensure the sound operation of Texas credit unions.

- ◆ The State has an interest in regulating credit unions to maintain their sound operations, thus safeguarding the assets of depositors. The large number of Texans who are members of credit unions and the high dollar value of their deposits points to the continuing need to protect the soundness of these deposits through regulation. Oversight of credit unions by the Department is designed to ensure that credit unions remain financially healthy and that potential problems are identified and dealt with before the soundness of the institution is threatened.
- ◆ To ensure the safety and soundness of Texas credit unions, the Department supervises credit unions through its applications and examinations processes. The Commissioner reviews and approves applications from

credit unions to become chartered, merge, or change their bylaws. In fiscal year 2007, the Department received 83 applications and approved 80 of them. The Department conducts annual on-site examinations and quarterly monitoring of financial data, uses remedial examinations to address specific problems, and takes enforcement action against credit unions that fail to comply with rules or laws. The Department's examiners conducted 192 regular examinations and 35 remedial examinations in fiscal year 2007. The Department also mediates complaints between the public and credit unions. The agency received 86 written complaints in fiscal year 2007 and numerous phone calls.

- ◆ In its examinations of credit unions, the Department uses an evaluation system, called a CAMEL code, to rate credit unions on a scale from one to five, with one being the best. This rating system is described in more detail on page 41 of this report. The graph, *Ratings of State-Chartered Credit Unions in Texas*, shows the distribution of CAMEL codes assigned by the Department to the credit unions it examined in fiscal year 2007.



Most credit unions in Texas have a CAMEL code of one or two, meaning they are generally well run with few risks. The Department performs remedial examinations of credit unions with a CAMEL code of three or below and requires them to submit written reports detailing their efforts to address the agency's areas of concern. In fiscal year 2007, no Texas-chartered credit unions had a CAMEL code of five, which would indicate the presence of extremely unsafe and unsound practices or conditions in an institution.

- ◆ Although the federal government also oversees credit unions, continuing the state charter is still needed to allow Texas to control the regulation of its credit unions and to set the policies and procedures appropriate for Texas. Credit unions have the option of choosing either a federal or state charter based on what is more beneficial for their members. About one-third of credit unions operating in Texas are state chartered, the other two-thirds are federally chartered. If Texas were to eliminate the Credit Union Department and the state charter, all credit unions operating in Texas would have to convert to a federal charter or some other type of financial institution, such as a mutual savings bank.

The state charter allows Texas to control the regulation of its credit unions.

While other organizational options exist, the Department effectively regulates the industry as a stand-alone agency.

- ◆ The Finance Commission of Texas supervises the State's other financial regulatory agencies, which perform functions similar to the Credit Union Department. This nine-member policymaking body oversees three independent departments – the Department of Banking, the Department of Savings and Mortgage Lending, and the Office of the Consumer Credit Commissioner. The only financial industry that is regulated separately from the Finance Commission is the credit union industry. Therefore, Sunset staff evaluated the potential for placing the Credit Union Department under the umbrella of the Finance Commission.
- ◆ Consolidating credit union regulation with the regulation of other financial institutions could produce greater efficiency and effectiveness by having similar regulation all under one board. The Finance Commission could deal with issues that affect all financial institutions – such as mortgage fraud, home equity lending, increasingly complex information systems, and identity theft – in a more coordinated fashion. The members of the Commission have expertise in the banking, mortgage lending, savings, and consumer credit industries and at least one of the five public members must be a certified public accountant. All financial institutions are regulated in much the same way, so consolidation could result in administrative savings from the increased efficiencies of a combined agency.
- ◆ Consolidating the regulation of credit unions under the Finance Commission's umbrella could however result in disadvantages as well. The credit union industry strongly opposes such a change, stating the following key points.
 - As nonprofit, cooperative organizations, credit unions differ significantly from other financial institutions.
 - A regulator that is responsible for so many diverse sectors of the financial industry would not have adequate understanding of or pay close enough attention to credit unions' specific needs.
 - Pressures from the competitive industries represented on the Finance Commission, particularly banks, could harm credit unions' ability to serve their members.
 - Since credit unions pay the full cost of their regulation, transferring the Department to the Finance Commission would not save taxpayers any money.
- ◆ Sunset staff evaluated the arguments for and against transferring the Department's functions to the Finance Commission, and concluded that the Department has no specific performance problems that would justify such a significant change. The Department effectively carries out the duties assigned to it by the Legislature. Both examiners and managers



Credit unions are the only financial institutions regulated separately from the Finance Commission.



While the Finance Commission certainly could oversee credit unions, Sunset staff found no problems to justify such a change.

at the Department have significant levels of experience and training. Further, the Credit Union Commission is composed of four members with many years of experience in the credit union industry and five public members who have gained the necessary level of knowledge about the industry during their tenures to effectively contribute to complex policy discussions.

- ◆ The Legislature has studied the issue of consolidation many times during the past 25 years, always reaching the same conclusion to maintain the Credit Union Department as an independent agency. In the past two Sunset reviews of the Department, in 1983 and 1997, the Sunset Commission considered consolidating the Department with other financial regulators. Sunset also performed a special review on the question of consolidation as part of the review of the Finance Commission in 2000. More recently, the House Financial Institutions Committee, as an interim charge in 2006, considered the issue. In all cases, the Legislature discussed the advantages and disadvantages of consolidation, but in the end, maintained the Credit Union Department as an independent agency.

Most states regulate credit unions, but they use a different organizational structure than Texas.

- ◆ Texas, Alabama, and Kansas are the only states with stand-alone regulatory agencies for credit unions. Three states, Delaware, South Dakota, and Wyoming, do not regulate credit unions, meaning credit unions in these states must have a federal charter to operate. All other states regulate credit unions, along with other financial service providers, through larger umbrella agencies.

Forty-four states regulate credit unions through larger umbrella agencies.

Recommendation

Change in Statute

1.1 Continue the Credit Union Department as an independent agency for 12 years.

This recommendation would continue the Department as an independent agency, responsible for supervising state-chartered credit unions in Texas.

Fiscal Implication

If the Legislature continues the current functions of the Department, using the existing organizational structure, the agency's annual appropriation of \$1.9 million would continue to be required for its operation. This appropriation is entirely offset by the operating fees the agency collects from credit unions.

Responses to Issue 1

Recommendation 1.1

Continue the Credit Union Department as an independent agency for 12 years.

Agency Response to 1.1

The agency agrees that there is a continuing need to regulate the \$20.3 billion Texas-chartered credit union industry. Further, the agency agrees with the Sunset staff's conclusion that the advantages of consolidating the Credit Union Commission under the Finance Commission do not compensate for the disadvantages. As a result, the agency believes the benefits from the current regulatory structure outweigh any potential gains from combining the commissions. (Harold E. Feeney, Commissioner – Credit Union Department)

For 1.1

Melodie Stegall, Executive Director – Credit Union Legislative Coalition, Austin

Against 1.1

None received.

Commission Decision

Adopted Recommendation 1.1.

Legislative Action

House Bill 2735 continues the Department as an independent agency, responsible for supervising state-chartered credit unions in Texas. (Recommendation 1.1)

Issue 2

Members Often Have Limited Access to Basic Information Needed to Effectively Monitor Their Credit Union's Financial Condition and Management.

Summary

Key Recommendations

- ◆ Require the Credit Union Commission to adopt rules requiring state-chartered credit unions to submit a report, updated annually, providing basic financial and management information to their members through their website.
- ◆ Require state-chartered credit unions to inform their members on a regular basis that they have access to certain documents related to their credit union's finances and management.
- ◆ Remove statutory language authorizing the Department to file a consolidated IRS Form 990 for state-chartered credit unions.
- ◆ Require state-chartered credit unions to provide information through their websites and newsletters about how consumers may file a complaint with the Department, in addition to posting this information in their offices.

Key Findings

- ◆ Credit union members have a vested interest in the financial condition and management of their institution.
- ◆ Credit union members often do not have convenient access to basic information about the financial condition and management of their credit union.
- ◆ As credit unions expand services to stay competitive, boards and managers may increase their institution's risk exposure without members' knowledge.
- ◆ The Department's consolidated IRS Form 990 filing limits access to public information about individual credit unions, and could pose a liability to the Department.
- ◆ Credit union members may not know who regulates their credit union or how to file a complaint.

Conclusion

State-chartered credit unions are owned and governed by their members. Members own shares, elect board members, and vote on issues such as mergers and charter conversions. Board and management decisions affect fees members pay, interest rates they are charged for loans, services credit unions offer, and whether members receive dividend payments. Sunset staff found that despite the vested financial interest credit union members have in their institution, members often have limited access to basic information about their credit union's financial condition and management. The Credit Union Department requires that credit unions provide certain types of information to members, but these requirements are limited. Expanded access to information would allow for greater transparency and help members monitor their institution.

Support

Credit union members have a vested interest in the financial condition and management of their institution.

- ◆ State-chartered credit unions in Texas are nonprofit, member-owned and governed institutions. The members elect the board of directors that governs the credit union, vote on issues such as mergers and conversions to another type of financial institution, and own shares in the credit union.

Credit unions are nonprofit, member-owned and governed financial institutions.

Even though member deposits are insured against loss in the event a credit union fails, members still have an interest in the overall finances and management of their credit union. Credit union boards and managers make decisions that affect the institution's overall financial position and ability to serve members. For example, boards and managers decide how to use the credit union's operating income. They can choose to use the income to offer lower interest rates on loans, dividend payments, higher interest rates on deposit accounts, more and higher quality services, and lower fees. On the other hand, boards and managers can also choose to use income to further institutional goals, which may or may not benefit members.

- ◆ Credit union members can obtain information about their credit union by attending the annual meeting for the membership, specifically requesting information from the credit union, reading credit union newsletters, and accessing information on their credit union's website. The textbox, *Information Credit Unions Must Provide to Members*, lists current requirements under federal law, state law, Department rules, and the standard credit union bylaws created by the Department.

Information Credit Unions Must Provide to Members

Posted in Credit Union Offices

- ◆ Notice that deposits are insured, to what amount, and by whom¹
- ◆ Sign explaining how to file a complaint with the Credit Union Department²
- ◆ Notice of permanent branch closing³

Available Upon Request

- ◆ Articles of incorporation and bylaws⁴
- ◆ Balance sheet⁵
- ◆ IRS Form 990 information return⁶
- ◆ Non-confidential pages of quarterly call reports⁷

Provided at Annual Meeting

- ◆ Amendments to bylaws or articles of incorporation⁸
- ◆ Summary of annual audit⁹

Credit union members often do not have convenient access to basic information about the financial condition and management of their credit union.

- ◆ Members should have access to basic information about their institution, such as how their credit union is spending its excess income, how much the credit union has in assets, and who is on the board of directors. Some opportunities exist for members to inform themselves and participate in overseeing their credit union, but these opportunities are limited. Beyond the information the Department already requires, as described in the textbox on the previous page, individual credit unions vary substantially in how much and what types of information they make conveniently accessible to their members. While many credit unions go beyond current requirements, others do not. Many credit unions have websites and newsletters, but only some use them as a way to provide basic financial and management information to members.
- ◆ A credit union's annual membership meeting is the primary channel members have to receive information and actively participate in governing their credit union. At this meeting, members elect board members, receive a summary of the annual audit, and learn of any changes to the credit union's business.

Generally, member attendance at these meetings is very low. Members who do not attend their annual meetings may not have access to the same information as members who do attend. Some credit unions in Texas have members who live in different areas of the state, such as those serving employees of large corporations or state agencies. For members of these credit unions, but also for credit union members who are simply too busy with their daily lives, having to attend this meeting is not an efficient way to keep up with their credit union's financial or administrative affairs.

- ◆ Current requirements defining how credit unions must provide information to members assume credit union members do business at their credit union office, know they have access to certain information, and attend the annual meeting. However, with more and more credit unions offering drive-thru and online services and few members attending the annual meetings, credit unions should make information more accessible to members by providing it through alternative means.
- ◆ Credit unions submit various types of information to state and federal regulators, some of which is open to the public. The Department and the National Credit Union Administration (NCUA) require each credit union to submit quarterly financial reports, known as call reports. The textbox, *Information Included in Call Reports*, lists the types of information in these reports. The Department and NCUA use this data to monitor the financial condition of credit unions. NCUA

Information Included in Call Reports

- ◆ Assets and liabilities
- ◆ Net worth
- ◆ Income and expenses
- ◆ Number, amount, and type of outstanding loans
- ◆ Delinquent loans and charge-offs
- ◆ Investments
- ◆ Number and type of deposit accounts

While some credit unions use websites to communicate with members, others simply rely on annual meetings.

makes these reports available to the public on its website, but credit union members may not know they exist or know where to find them.¹⁰

As credit unions expand services to stay competitive, boards and managers may increase their institution’s risk exposure without members’ knowledge.

- ◆ Credit unions have traditionally offered more limited, basic financial services, such as deposit accounts and small personal loans. However, over time many credit unions have evolved into larger and more sophisticated institutions, in terms of both the products and services they offer, as well as their business decisions and structure. Many now have expanded fields of membership that include entire communities, putting credit unions in direct competition with other credit unions and other types of financial institutions, such as banks.
- ◆ To enhance their financial viability and compete more effectively in attracting members, some credit unions have started offering products and services not traditionally offered by credit unions. These services might include commercial lending, credit cards, insurance services, and investment services, among others. Providing many of these services involves significantly more risk, making transparency to members even more important.
- ◆ In a 2006 report, the Government Accountability Office (GAO) raised the issue of transparency for members of federal credit unions. GAO compared members of federal credit unions to stockholders of publicly-traded companies. The Securities and Exchange Commission requires publicly-traded companies to make financial disclosures to stockholders, who are partial owners. Although credit union members are partial owners of their credit union, they do not typically enjoy the same level of access to information about their institution.¹¹ NCUA legal opinions have also concluded that members of federal credit unions are similar to stockholders of publicly-traded companies.¹²



As credit unions provide services with more risk, transparency becomes more important.

The Department’s consolidated IRS Form 990 filing limits access to public information about individual credit unions, and could pose a liability to the Department.

- ◆ The Internal Revenue Service (IRS) requires all tax-exempt organizations, including state-chartered credit unions, to file an annual information return, or Form 990. The IRS requires these returns to review nonprofits’ operations and activities and ensure they continue to meet statutory requirements for the tax exemption. These returns are available to the public by request from the IRS or from individual nonprofits. In addition, GuideStar, a nonprofit organization that gathers and publicizes information about nonprofits, makes these documents available through its website.¹³ These information returns contain detailed financial and management information, as shown in the textbox, *Information Included in the IRS Form 990*.

- ◆ For all but two state-chartered credit unions in Texas, the Department files a consolidated information return. Although authorized and approved by the IRS, the consolidated return reports all credit unions' financial information in aggregate, effectively limiting the transparency of individual credit union operations. If credit unions filed their own information returns, members would have easier access to several types of financial and management information from one source.

Information Included in the IRS Form 990

- ◆ Expenses by source
- ◆ Income by source
- ◆ Assets
- ◆ Liabilities
- ◆ Changes in net assets
- ◆ Board member and executive compensation

- ◆ The Texas Credit Union Department is one of only eight state regulators that continue to file a consolidated information return for the credit unions they regulate. Previously, many states filed consolidated returns as a service to their credit unions, but most have stopped due to the potential liability to the regulator for missing or incorrect information and the increasing level of detail that the IRS now requires. Further, filing the consolidated return uses valuable agency resources. In fiscal year 2007, the Department spent approximately \$7,500 in staff time and for a contract with a certified public accountant to compile information and complete the IRS form.

Credit union members may not know who regulates their credit union or how to file a complaint.

- ◆ Several different agencies regulate financial institutions in Texas, so credit union members may not be aware of who to go to if they have a complaint. Members may not know if they belong to a state or federal credit union, and that each has a different regulator. Some may think the Texas Department of Banking regulates credit unions.
- ◆ To ensure better awareness, statute directs the Credit Union Commission to adopt rules requiring credit unions to provide the Department's contact information for members who wish to file complaints.¹⁴ Though statute indicates several possible options for communicating this information, the Commission has chosen to require only that credit unions post the agency's contact information on a sign in their place of business.

While this may have been adequate in the past, posting the Department's contact information only in credit union offices no longer effectively ensures all members are aware of how to contact the Department. Most credit unions now offer online services, so fewer members go to their credit union on a regular basis, if at all. Some credit unions have widely-dispersed membership or a significant number of members who may not live near the credit union. Without additional mechanisms to communicate information on how to file complaints with the Department, many members may never find out how to do this. As a result, members may have difficulty making inquiries or informing the Department about potential problems at their credit union.

With online services, fewer members visit their credit union in person.



*Increasing
awareness ensures
people's concerns
can be heard.*

- ◆ While the Department does not require credit unions to post this information on their websites, in 2004 the Department started posting information about how to file a complaint, as well as a standard complaint form, on its website. The Department also started allowing consumers to submit complaints electronically. From 2000 to 2003, the Department received an average of 42 complaints per year, but starting in 2004, the average increased to 85. Department staff believe the increase in the number of complaints could be due to increased awareness of the agency's website and the ease of filing complaints by e-mail. Unfortunately, many credit union members may not know to go to this website.
- ◆ As a result of a recommendation by the Sunset Commission in 2001, the Department of Banking began requiring state-chartered banks to provide more information on how consumers can file complaints. The Finance Commission adopted rules requiring banks to provide this information in privacy statements, in places of business, and on bank websites. Since instituting these requirements, the Department of Banking has experienced a significant increase in complaints, enabling the Department to better address consumer concerns.

Recommendations

Change in Statute

2.1 Require the Credit Union Commission to adopt rules requiring state-chartered credit unions to submit a report, updated annually, providing basic financial and management information to their members through their website.

Under this recommendation, the Commission would adopt rules to define what information credit unions must include in the report. At a minimum, the report should include a summary of changes over the past year in a credit union's management, financial condition, size of the membership, services offered, bylaws, and articles of incorporation. More detailed financial information, such as a balance sheet and income and expense statement, should also be standard elements of this report. The name and term of office of each member of the credit union's board of directors should be included in the report, as well as any other information the Commission deems necessary to ensure members have adequate knowledge of their credit union's financial condition and management. Commission rules should require credit unions to update their reports annually, so as to make new information available to members at their annual membership meeting.

Credit unions should make their report available to members year-round by posting it on their website. The Commission would need to adopt rules to accommodate smaller credit unions that do not have a website. These rules should require credit unions without websites to provide the report to their membership through other means, such as in their newsletter, at their place of business, or, at a minimum, at their annual meeting.

This change would improve credit unions' transparency by making operational information more easily accessible to members on an ongoing basis. A report to the membership that includes standard elements would ensure all state-chartered credit unions provide the same basic level of information to every member.

2.2 Require state-chartered credit unions to inform their members on a regular basis that they have access to certain documents related to their credit union's finances and management.

Under this recommendation, credit unions should provide a permanent notice on their website and a biannual notice in their newsletter. To accommodate credit unions without websites or newsletters, the Credit Union Commission should adopt rules to define alternative means of providing this information to members. Credit unions should inform their members that the following items, at a minimum, are available upon request:

- ◆ most recent version of the articles of incorporation;
- ◆ most recent version of the bylaws;
- ◆ minutes of the most recent annual membership meeting;
- ◆ minutes of special membership meetings from the last year;
- ◆ summary of the most recent annual audit;
- ◆ most recent statement of financial condition, such as the pages of the quarterly call reports that are not confidential;
- ◆ IRS Form 990 for the last year; and
- ◆ other items at the discretion of the Commission.

Currently, credit union members may not be aware they have access to information about their credit union. This recommendation would ensure that all state-chartered credit union members are aware they may inspect certain documents, which are already available to them, to learn about their institution.

2.3 Remove statutory language authorizing the Department to file a consolidated IRS Form 990 for state-chartered credit unions.

Under this recommendation, all state-chartered credit unions would have to file their own information return with the IRS. As a result, credit union members would have better access to this public information about their institution. The Department would also avoid the potential liability associated with filing a consolidated return.

2.4 Require credit unions to provide information through their websites and newsletters about how consumers may file a complaint with the Department, in addition to posting this information in their offices.

In addition to posting information about how to file a complaint in their offices, credit unions would also be required to add this information to their websites and newsletters. The Credit Union Commission should adopt rules to direct credit unions without websites or newsletters on how to make this information more widely available to consumers. The posting should include the Department's name, address, phone number, and website address. This change will help ensure that consumers who use online services or may not visit their credit union on a regular basis are aware of how to file a complaint if they encounter a problem and cannot resolve it through their credit union.

Fiscal Implication

Sunset staff do not anticipate any significant fiscal impact to the State resulting from these recommendations. Not compiling the consolidated IRS form would save the agency approximately \$7,500 per year. However, more broadly posting information about how to file a complaint may lead to the agency receiving more complaints. As the increased number of complaints cannot be predicted, Sunset staff cannot estimate a specific cost, but assume the agency could handle the complaints with existing resources.

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¹ By Department rule, credit unions with private deposit insurance must post notice of deposit insurance coverage in their offices and on their websites. By federal regulation, federally-insured credit unions must post a notice of insurance wherever deposits are accepted, in advertisements for deposit accounts, and on their website. Texas Administrative Code, Title 7, part 6, rule 95.400; Code of Federal Regulations, Title 12, part 740.

² Texas Administrative Code, Title 7, part 6, rule 97.106, as required by Texas Finance Code, sec. 15.409.

³ Texas Administrative Code, Title 7, part 6, rule 91.5005.

⁴ Texas Credit Union Department, *Standard Bylaws for State Chartered Credit Unions*, Chapter IV, Section 4.01(b) (February 20, 2004). Online. Available: <http://www.tclud.state.tx.us/PDFFiles/Forms/Bylaw/State%20Standard%20Bylaws.pdf>. Accessed: July 2, 2008.

⁵ The majority of credit unions operate under an older version of the Department's standard bylaws, which requires them to post balance sheets updated monthly in their offices instead of simply making them available as required under current bylaws. Ibid. Chapter V, sec. 5.11(e).

⁶ Federal law requires the Form 990 to be a publicly available document. United States Code, Title 26, sec. 6104.

⁷ The National Credit Union Administration requires call reports to be public documents and makes them available on its website. National Credit Union Administration, Credit Union Data, www.ncua.gov/indexdata.html. Accessed: July 10, 2008.

⁸ Texas Finance Code, sec. 122.011.

⁹ Texas Administrative Code, Title 7, part 6, rule 91.516.

¹⁰ National Credit Union Administration, Credit Union Data, www.ncua.gov/indexdata.html. Accessed: July 10, 2008.

¹¹ U.S. Government Accountability Office, *Credit Unions: Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangements*. (November 2006), p. 34. Online. Available: <http://www.gao.gov/new.items/d0729.pdf>. Accessed: March 20, 2008.

¹² Ibid., p. 33.

¹³ GuideStar, Nonprofit and Donation Search, www.guidestar.org/index.jsp. Accessed: July 2, 2008.

¹⁴ Texas Finance Code, sec. 15.409.

Responses to Issue 2

Recommendation 2.1

Require the Credit Union Commission to adopt rules requiring state-chartered credit unions to submit a report, updated annually, providing basic financial and management information to their members through their website.

Agency Response to 2.1

The agency agrees with the recommendation. As member-owned financial cooperatives, credit unions are democratic organizations. The agency supports the concept that improvements can be made to ensure that members have reasonable access to pertinent information about the operations of their credit union in order to cast an informed vote. (Harold E. Feeney, Commissioner – Credit Union Department)

For 2.1

None received.

Against 2.1

None received.

Recommendation 2.2

Require state-chartered credit unions to inform their members on a regular basis that they have access to certain documents related to their credit union's finances and management.

Agency Response to 2.2

The agency agrees with the recommendation. Credit unions share with other cooperatives a fundamental set of values: belief in the basic equality of people and that people have the right – and the ability – to control their organizations. The agency supports the idea of additional transparency and the continuing need for more openness, communication, and accountability. (Harold E. Feeney, Commissioner – Credit Union Department)

For 2.2

None received.

Against 2.2

None received.

Modification

1. Modify Recommendation 2.2 by deleting the following items from the list of items credit unions would be required to inform their members are available upon request:

- ◆ most recent version of the articles of incorporation;
- ◆ most recent version of the bylaws;
- ◆ minutes of the most recent annual membership meeting; and
- ◆ minutes of special membership meetings from the last year.

(Charles McMahan, Member – Sunset Advisory Commission)

Recommendation 2.3

Remove statutory language authorizing the Department to file a consolidated IRS Form 990 for state-chartered credit unions.

Agency Response to 2.3

The agency agrees with the recommendation. The agency reports that it began studying this issue prior to the review, made a similar recommendation, and is currently working on a Transitional Plan to discontinue the Consolidated Group filing. (Harold E. Feeney, Commissioner – Credit Union Department)

For 2.3

None received.

Against 2.3

Richard “Dick” Ensweiler, President and CEO – Texas Credit Union League, Farmers Branch

Recommendation 2.4

Require credit unions to provide information through their websites and newsletters about how consumers may file a complaint with the Department, in addition to posting this information in their offices.

Agency Response to 2.4

The agency agrees with the recommendation. The agency believes that assisting credit union members in receiving a fair and timely resolution of their complaints, if they are unable to resolve their problems with a credit union, is an important component in the agency’s efforts to carry out its mission. Communicating agency contact information more broadly supports this concept. (Harold E. Feeney, Commissioner – Credit Union Department)

For 2.4

None received.

Against 2.4

None received.

Commission Decision

Adopted Recommendations 2.1, 2.2 with Modification 1, and 2.4.

Legislative Action

House Bill 2735 requires state-chartered credit unions to provide an annual report to their members providing basic financial and management information. The bill requires credit unions to update the report before their annual meeting and make the report available to members through their website, or other method if they do not maintain a website. It also requires the Commission to adopt rules governing the content and distribution of the annual report. (Recommendation 2.1)

The bill requires state-chartered credit unions to inform their members on a regular basis that they have access to certain documents related to their credit union's finances and management. The bill requires credit unions to give notice to their members through their website and newsletter, and also requires the Commission to adopt rules prescribing an alternative method for credit unions to inform their members if they do not have a website or newsletter. (Recommendation 2.2 with Modification 1)

House Bill 2735 requires state-chartered credit unions to provide information through their websites and newsletters about how consumers may file a complaint with the Department, in addition to posting this information in their offices. (Recommendation 2.4)

Issue 3

The Department Lacks Certain Key Enforcement Tools Needed to Ensure Safety and Soundness in the Credit Union Industry.

Summary

Key Recommendations

- ◆ Authorize the Commissioner to levy administrative penalties against state-chartered credit unions for legal or regulatory violations, and require the Credit Union Commission to adopt rules governing this authority.
- ◆ Extend the Commissioner's cease and desist authority to include unchartered entities holding themselves out as credit unions.
- ◆ Give the Commissioner statutory authority to assess penalties for delinquent operating fees.

Key Findings

- ◆ The Credit Union Commissioner lacks administrative penalty authority to deter violations of statute or regulations and hold credit unions accountable for committing violations.
- ◆ The Commissioner cannot take immediate action to stop unauthorized credit union activity.
- ◆ The Commissioner does not have statutory authority to assess penalties for delinquent credit union operating fees.

Conclusion

The Credit Union Commissioner lacks certain key enforcement powers that are standard to other regulatory agencies in Texas and to credit union regulators in other states. Without these powers, the Commissioner has limited ability to take action to prevent or stop violations of credit union statutes or rules. As credit unions evolve into larger and more sophisticated financial institutions, the Commissioner needs greater ability to deter and sanction violators. Further, in the event that unscrupulous or unknowing businesses hold themselves out as credit unions, the Commissioner needs the ability to immediately stop such activity. Enhanced enforcement authority would enable the Commissioner to better protect consumers and ensure credit unions remain safe and sound.

Support

Regulating credit unions requires common enforcement activities that the Sunset Commission has observed and documented during more than 30 years of reviews.

- ◆ The Credit Union Department supervises credit unions to ensure the safety and soundness of these financial institutions. The Credit Union Commissioner has multiple enforcement tools to help ensure credit unions remedy violations of laws or rules or other issues that could affect their financial health. The textbox, *Commissioner's Enforcement Powers*, explains the Commissioner's existing enforcement tools. While most agencies take enforcement action through their governing board, the Credit Union Commissioner takes enforcement actions independently, though all actions are subject to appeal to the Credit Union Commission.

Commissioner's Enforcement Powers

- ◆ **Written Agreement:** Used to formally document a voluntary agreement between a credit union and the Commissioner. The written agreement defines steps a credit union must take to correct a problem.
- ◆ **Determination Letter:** Used to document what a credit union must do to address problems found during an examination and avoid further enforcement action. The Commissioner may use a determination letter if he cannot achieve voluntary compliance from a credit union.
- ◆ **Cease and Desist Order:** Used to order a credit union to stop a certain practice that is either in violation of laws or regulations or compromises the safety and soundness of the credit union. The Commissioner can assess administrative penalties if a credit union does not comply with a cease and desist order.
- ◆ **Removal Order:** Used to remove from office or employment the directors or employees of a credit union.
- ◆ **Conservatorship Order:** Used to place a credit union that is exhibiting extremely unsafe and unsound practices and conditions under the direction of the Commissioner.
- ◆ **Liquidation Order:** Used to order the liquidation of an insolvent or imminently insolvent credit union.

Enforcement actions are rare because the Department is usually able to achieve compliance informally through its examination process. Since fiscal year 2004, the Commissioner has entered into two written agreements and issued one conservatorship order, two cease and desist orders, and three determination letters.

- ◆ The Sunset Advisory Commission has a historic role in evaluating licensing agencies, as the increase of occupational licensing programs served as an impetus behind the creation of the Commission in 1977. Since then, the Sunset Commission has completed more than 93 licensing agency reviews. Sunset staff have documented standards in reviewing these programs to guide future reviews of licensing agencies. Though the Credit Union Department does not license individuals, it performs many regulatory functions in its supervision of credit unions, making many of the Sunset licensing standards applicable. The following material highlights areas where the Credit Union Department's statute and rules

differ from applicable model enforcement standards, and describes the potential benefits of conforming with standard practices.

The Credit Union Commissioner lacks administrative penalty authority to deter violations of statute or regulations and hold credit unions accountable for committing violations.

- ◆ The ability of regulatory agencies to impose a fine through an administrative process gives them a powerful tool to encourage compliance without having to rely on more drastic enforcement actions. Administrative penalties provide a means of sanctioning violators without having to resort to the courts. Over time, administrative penalties have been accepted as a standard enforcement tool for regulatory agencies in Texas. However, the Credit Union Department's statute only allows the Commissioner to assess administrative penalties in cases where a credit union violates a cease and desist order.

Having broader administrative penalty authority in supervising credit unions would give the Commissioner a necessary tool to encourage compliance. While the Commissioner can stop more serious violations using a cease and desist order, the ability to assess a wide range of administrative penalties would create a deterrent against credit unions engaging in a variety of prohibited practices, such as making loans or investments not permitted by the Credit Union Act.

- ◆ Agencies that have administrative penalty authority should follow standard practices to ensure the penalties they assess are fair and consistent for all violators. A penalty matrix establishes a wide range of penalties based on the nature and seriousness of different types of violations. Use of a matrix helps ensure agencies assess similar penalties for similar violations. The matrix should be adopted by an agency's policymaking body in rule to provide opportunity for public awareness and debate. Agencies should establish a process that allows them to negotiate with violators to arrive at an agreed penalty amount. If they cannot reach an agreement with the agency, violators should have the opportunity to appeal a penalty assessment.
- ◆ Administrative penalty authority is a standard enforcement tool for credit union regulators. The World Council of Credit Unions, the leading international credit union trade association, has recognized administrative penalty authority as a best practice and includes it in its Model Credit Union Regulations.¹ Credit union regulators in other states, including California, Arizona, New York, Michigan, and Florida, have administrative penalty authority for violations of law or rule.² The National Credit Union Administration (NCUA), which regulates federal credit unions, has authority to assess administrative penalties.³ NCUA rarely uses this enforcement tool, but has found it to be an effective deterrent.

The Commissioner can only assess administrative penalties if a credit union violates a cease and desist order.

Administrative penalty authority is a standard enforcement tool used by other credit union regulators.

*Unchartered,
uninsured entities
can steal or
misuse consumers'
money.*

*Other states have
encountered
problems with
unauthorized
entities holding
themselves out as
credit unions.*

The Commissioner cannot take immediate action to stop unauthorized credit union activity.

- ◆ A regulatory agency should have enforcement authority not only over the entities or persons it regulates, but over those who engage in unauthorized activity. Statute provides that the Commissioner can issue cease and desist orders against state-chartered credit unions. However, the Commissioner does not have the power to stop unchartered entities from holding themselves out as credit unions. The Commissioner could seek an injunction through the Attorney General, but this process can be time-consuming.

Cease and desist authority provides an immediate remedy to activity that could pose great harm to consumers. Unchartered, uninsured entities can steal or misuse consumers' money and obtain sensitive personal information that could be used in identity theft. Further, unchartered entities can easily use the Internet as a tool to do business, making it increasingly important that state regulators have the ability to take immediate action.

- ◆ Though unchartered credit union activity is not known to have occurred in Texas, it has happened in other states. States such as Missouri, Colorado, Florida, Maryland, Massachusetts, and Idaho have encountered problems with a person or entity attempting to do the business of a credit union without a charter. In those cases, state regulators stopped the activity by using a demand letter or cease and desist order and issuing a consumer alert.

For example, in Idaho several individuals and a company used the name of a legitimate credit union to solicit consumer loans from unsuspecting consumers.⁴ In Massachusetts, an unchartered entity calling itself the "Taxi Drivers Credit Union" advertised small loans and deposit accounts.⁵ In both cases, the credit union regulator used a cease and desist order to stop the activity.

- ◆ A related situation occurred in Texas in March 2008. The Texas Banking Commissioner used his cease and desist authority to stop an unchartered bank from doing business.⁶ The entity, calling itself the "Houston Petroleum Bank, Inc.," used a website to solicit deposits, but did not have a bank charter and had no deposit insurance.⁷

The Commissioner does not have statutory authority to assess penalties for delinquent credit union operating fees.

- ◆ Regulatory agencies should have statutory authority to assess penalties against regulated entities that are delinquent in paying fees. Credit unions pay a semi-annual operating fee that funds the Department's regulatory program. In practice, the Commissioner fines credit unions when they do not pay their operating fees on time, but statute does not grant the Commissioner the specific authority to charge these penalties. To deter

late fee payments, the Department's rules establish time frames and penalty amounts for delinquent payments.⁸ If a credit union is 30 days late in paying a fee, it is subject to a penalty of 10 percent of the amount due. Giving the Commissioner the statutory authority to charge late penalties would provide legal justification for charging these penalties.

Recommendations

Change in Statute

3.1 Authorize the Commissioner to levy administrative penalties against state-chartered credit unions for legal or regulatory violations, and require the Credit Union Commission to adopt rules governing this authority.

This recommendation would authorize the Credit Union Commissioner to levy administrative penalties against credit unions that are in violation of the Finance Code or agency rules. Penalty amounts would be authorized in law up to \$5,000 per violation, per day. The Credit Union Commission would be required to create a penalty matrix in rule to match violations with penalty amounts based on the severity of the violation, and to ensure that the agency applies penalties fairly and consistently. The Commission should also adopt rules to delineate a negotiated settlement process and avenues for appeal to the full Commission of administrative penalties assessed by the Commissioner. Appeals of administrative penalties would follow the same process the Commission has established in rule for appeals of other types of enforcement actions. These standards would help ensure the Commissioner assesses penalties in a fair and consistent manner.

3.2 Extend the Commissioner's cease and desist authority to include unchartered entities holding themselves out as credit unions.

This recommendation would enable the Commissioner to take immediate action if unchartered credit union activity were to occur in Texas. The ability to immediately stop an unchartered entity from doing business would protect the public from potential fraud and financial loss.

3.3 Give the Commissioner statutory authority to assess penalties for delinquent operating fees.

This recommendation would give the Commissioner statutory authority to assess penalties for late operating fees. The Commission has already passed rules to define time frames and amounts, and this recommendation would provide legal justification for charging these penalties.

Fiscal Implication

These recommendations should not result in a significant fiscal impact. The recommendation to grant administrative penalty authority to the Commissioner could have a positive fiscal impact to the State. If the Commissioner were to assess penalties, the revenue would be deposited into the General Revenue Fund. However, given the small number of formal enforcement actions the agency has taken in the past, the Commissioner is not likely to assess significant penalties in the future.

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- ¹ World Council of Credit Unions, *Model Regulations for Credit Unions*, (February 2008), p. 40. Online. Available: <http://www.woccu.org/bestpractices/legreg>. Accessed: March 27, 2008.
 - ² Arizona Banks and Financial Institutions Code, sec. 6-132; Michigan Compiled Laws, sec. 490-220; Florida Statutes, Title XXXVIII, sec. 655.041; California Financial Code, article 2, sec. 216.3; Laws of New York, Banking Law, article 2, sec. 44.
 - ³ United States Code, Title 12, sec. 1786.
 - ⁴ “Second Phony Credit Union Ordered to Cease and Desist,” State of Idaho Department of Finance, March 22, 2004 (press release). Online. Available: <http://finance.idaho.gov/PR/2004/PressRel-CreditUnion-3-22-04.pdf>. Accessed: July 15, 2008.
 - ⁵ Massachusetts Department of Consumer Affairs and Business Regulation, *Taxi Drivers Credit Union, Allston, MA-Terminating Order*, (Boston, MA, January 5, 2004). Online. Available: http://www.mass.gov/?pageID=ocaterminal&L=5&L0=Home&L1=Business&L2=Banking+Industry+Services&L3=Banking+Legal+Resources&L4=Enforcement+Actions&sid=Eoca&b=terminalcontent&f=dob_taxiterm&csid=Eoca. Accessed: July 15, 2008.
 - ⁶ Texas Finance Code, sec. 35.207.
 - ⁷ “Banking Commissioner Issues Emergency Cease and Desist to Unlicensed Bank,” Texas Department of Banking, April 3, 2008 (press release). Online. Available: <http://www.banking.state.tx.us/news/press/2008/03-11-08pr.htm>. Accessed: July 2, 2008.
 - ⁸ Texas Administrative Code, Title 7, part 6, rule 97.113.

Responses to Issue 3

Recommendation 3.1

Authorize the Commissioner to levy administrative penalties against state-chartered credit unions for legal or regulatory violations, and require the Credit Union Commission to adopt rules governing this authority.

Agency Response to 3.1

The agency agrees with the recommendation. The agency concurs with the Sunset staff analysis that having broader administrative penalty authority in supervising credit unions would provide the agency with an important tool to encourage compliance. The agency also supports the concept that administrative penalties should follow standard practices to ensure that any penalties assessed are fair and consistent. (Harold E. Feeney, Commissioner – Credit Union Department)

For 3.1

None received.

Against 3.1

Richard “Dick” Ensweiler, President and CEO – Texas Credit Union League, Farmers Branch

Recommendation 3.2

Extend the Commissioner’s cease and desist authority to include unchartered entities holding themselves out as credit unions.

Agency Response to 3.2

The agency agrees with the recommendation. In order to maintain public confidence in the credit union system, it is important for the agency to have an immediate response to fraudulent schemes, illegal practices, and misrepresentations. The agency, therefore, supports the idea that we should have enforcement authority to stop unchartered entities from holding themselves out as credit unions. (Harold E. Feeney, Commissioner – Credit Union Department)

For 3.2

None received.

Against 3.2

None received.

Recommendation 3.3

Give the Commissioner statutory authority to assess penalties for delinquent operating fees.

Agency Response to 3.3

The agency agrees with the recommendation. The agency welcomes the clarification of our legal authority to assess penalties against credit unions for the late payment of operating fees. (Harold E. Feeney, Commissioner – Credit Union Department)

For 3.3

None received.

Against 3.3

None received.

Commission Decision

Adopted Recommendations 3.2 and 3.3.

Legislative Action

House Bill 2735 authorizes the Commissioner to issue cease and desist orders to immediately stop unchartered entities from holding themselves out as credit unions. (Recommendation 3.2)

The bill also authorizes the Department to assess a late fee against a credit union that fails to pay its operating fees on time. (Recommendation 3.3)

Issue 4

The Legislative Advisory Committee Does Not Conform With Statutory Standards for Agency Committees and Is No Longer Needed.

Summary

Key Recommendations

- ◆ Require the Commission to adopt rules for its use of advisory committees, ensuring the committees meet standard structure and operating criteria.
- ◆ The Commission should abolish the Legislative Advisory Committee and seek more effective ways of gaining stakeholder input.

Key Findings

- ◆ The Legislative Advisory Committee does not meet statutory requirements for agency committees.
- ◆ The Legislative Advisory Committee does not add significant value to the Commission's policymaking process.

Conclusion

The Credit Union Commission created the Legislative Advisory Committee (LAC) to provide input on and make recommendations to change agency rules, statutes, and policies. However, this Committee does not meet statutory requirements for the structure and operations of agency committees. The composition of the LAC does not allow credit union members or small credit unions to have equal involvement in the Commission's policymaking process. Further, the LAC provides little added value to the Commission and its work could be done by the Commission, thus saving money on travel costs and staff time. The Sunset review found that requiring the Commission to conform its advisory committees with statutory requirements and directing the Commission to abolish the LAC would ensure more balanced stakeholder input and eliminate duplication of effort.

Support

The Commission established the Legislative Advisory Committee to gather input from stakeholders and make recommendations on rule and statute changes.

- ◆ The Credit Union Commission created the Legislative Advisory Committee (LAC) to assist in its policymaking. The Committee's purpose is to receive public input on changes to statute or rules; recommend changes to existing rules and propose new rules; and propose any legislative changes that may be necessary. In addition to rule and statute changes, the LAC has also discussed major policy changes, such as whether the agency should continue to compile the consolidated IRS information return for all credit unions.
- ◆ The LAC has seven members appointed by the Chair of the Commission. Four of the seven members are members of the Commission. The remaining three members are credit union representatives who are not on the Commission. The LAC meets one month before each Commission meeting to receive input and decide what it will recommend to the full Commission. The LAC then reports to the full Commission at its next meeting. Both bodies meet three times a year.
- ◆ Chapter 2110 of the Texas Government Code lays out the basic structure and duties of state agency advisory committees. The chapter authorizes state agencies to create advisory committees as needed to fulfill their duties. The chapter also creates guidelines for committee membership and reimbursement. State law further requires state agencies to define the purpose of each committee and to annually evaluate committees to determine their continued usefulness. To ensure that committees remain useful, state law creates automatic expiration dates for committees four years from their creation and requires agencies to act, through rulemaking, to continue needed committees.

The LAC consists of four commission members and three credit union representatives.

The Legislative Advisory Committee does not meet statutory requirements for agency committees.

- ◆ Advisory committees represent one means of providing stakeholder input to an agency, thereby broadening its policy perspective and enabling greater representation in policymaking. Advisory committees generally exist to give advice to policy makers, who retain final decisionmaking authority. Typically, board members should not serve on advisory committees as working and voting members, as this prevents the objectivity provided by an independent advisory committee that presents its work to the board. However, the LAC consists of both Commission and non-Commission members. Further, several key elements of the LAC do not meet the requirements of Chapter 2110 of the Government Code, as described in the following material.

Typically, board members do not serve on committees advising the board.

- ◆ Chapter 2110 requires state agencies that establish advisory committees to state in rule the purpose and tasks of the committee.¹ However, the Commission has no rules defining the purpose or duties of the LAC. Instead, the Commission has a policy governing the appointment and use of any advisory committee it chooses to create.² This policy is not specific to the LAC.
- ◆ Chapter 2110 requires state agencies to annually evaluate their advisory committees' work and usefulness and the costs related to the committees' existence, including the cost of agency staff time spent in support of the committees' activities.³ The Commission does not perform an annual evaluation of the LAC. Instead, it simply decides whether to reestablish the LAC every four years, and does not conduct a full evaluation. The Commission reestablished the LAC in June 2007, and before that in October 2004.
- ◆ Chapter 2110 requires advisory committees that advise state agencies regarding an industry regulated by the agency to be composed of a balanced representation of the industry and consumers of that industry.⁴ In contrast, the LAC has a majority of industry representatives and no members specifically representing credit union members. Of the four Commission members on the LAC, three represent the general public and one represents the credit union industry. In total, four of the seven LAC members are industry representatives, as shown in the table, *Legislative Advisory Committee Members*.

Advisory committees should have a balanced representation of both the industry and consumers.

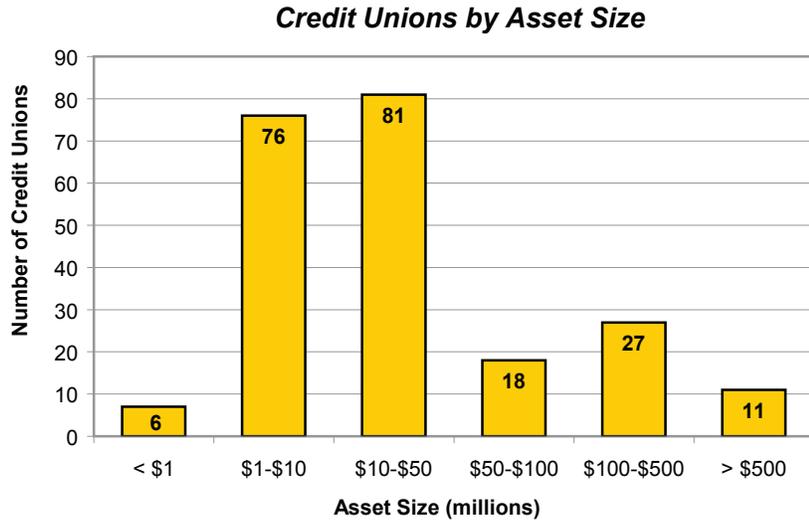
The public members on the LAC may or may not be members of credit unions. The Governor appointed these public members to the Commission to represent the general public, not credit union members specifically. The Commission has not appointed credit union members to the LAC and credit union members rarely attend LAC meetings to provide input.

Legislative Advisory Committee Members

Name	Credit Union Commission Member	Representing the Public or a Credit Union	Asset Size of the Credit Union Represented
Thomas Butler Chair	Yes	Public	N/A
Mary Ann Grant Vice Chair	Yes	Public	N/A
Manuel Cavazos	Yes	Public	N/A
Harriet May	No	Credit Union	\$1.4 Billion
Allyson Morrow	Yes	Credit Union	\$47 Million
Lonnie Nicholson	No	Credit Union	\$663 Million
Gary Tuma	No	Credit Union	\$328 Million

- ◆ Small credit unions are also not well-represented on the LAC. The three non-Commission members work for relatively large credit unions with more than \$100 million in assets, as shown in the table, *Legislative Advisory Committee Members*. These three members have been on the LAC since June 2007. Before their appointment, the LAC had two non-Commission members, one representing a credit union with \$1.9 billion and the other from a \$183 million credit union. They were appointed in October 2004. Since the Department does not receive an

appropriation to pay the travel expenses for the LAC’s non-Commission members, only large credit unions can afford to send their staff to meetings in Austin on a regular basis. As shown in the graph, *Credit Unions by Asset Size*, nearly three-quarters of state-chartered credit unions operating in Texas have less than \$50 million in assets.



The Legislative Advisory Committee does not add significant value to the Commission’s policymaking process.

- ◆ The meetings of both the Credit Union Commission and the LAC are short, meaning the business of both bodies could be accomplished in one day. However, the LAC has traditionally met one month before each Commission meeting. Most LAC meetings last from an hour and a half to two hours. Commission meetings generally last one to one and a half hours. Since the LAC and Commission meetings occur separately, the agency must reimburse the Commission members on the LAC for the costs of traveling to six meetings a year. Department staff must also take time away from their other duties to prepare for these meetings.
- ◆ The majority of the LAC’s meeting time consists of hearing recommendations from Department staff and comments from the public to evaluate existing Commission rules. According to general state law, all agencies must review their rules and consider them for re adoption every four years.⁵ The LAC spends a majority of its time reviewing rules to ensure the agency meets this statutory requirement.

Since LAC and Commission meetings occur separately, the agency must pay for members to travel to both.

Before each LAC meeting, Department staff research the rules scheduled for review, talk with affected parties, and develop recommendations for the LAC’s consideration. At LAC meetings, staff present their recommendations and members of the audience, usually a few representatives of credit union associations and individual credit unions, offer their comments. The LAC generally adopts the staff’s recommendations, or makes minor adjustments with little discussion.

One month later, the LAC reports to the Commission, at which time the Commission typically adopts the LAC's recommendations unanimously with little discussion.

- ◆ Department staff, rather than the LAC, have held meetings to gather stakeholder input on controversial issues in recent years, such as conversions to mutual savings banks and suggestions for statutory changes. To develop rules governing conversions to mutual savings banks, agency staff held six informal meetings around the state in 2005, which approximately 50 credit unions attended. Department staff also held two public hearings on the issue, one in Dallas at the offices of the Texas Credit Union League and one at the Department's offices in Austin. A few credit union board members and executives, credit union members, and other credit union representatives attended these public meetings.

In 2007, the agency held five informal meetings around the state to develop a list of suggested statutory changes. Approximately 50 credit unions attended these meetings. Using input gathered at these meetings on both subjects, staff prepared suggestions for rule and statute changes and presented them to the LAC. The LAC discussed the staff's suggestions and forwarded them on to the full Commission with few changes.

Recommendations

Change in Statute

4.1 Require the Commission to adopt rules for its use of advisory committees, ensuring the committees meet standard structure and operating criteria.

The Commission should adopt rules to ensure any advisory committees it chooses to create are in compliance with Chapter 2110 of the Texas Government Code. As a result, the Commission would have to comply with provisions governing balanced industry and consumer representation, setting a committee's purpose and tasks in rule, conducting annual evaluations of the committee's usefulness, and others. To implement the provisions of Chapter 2110, the Commission should adopt rules regarding the purpose, structure, and use of its advisory committees, including:

- ◆ the purpose, role, responsibilities, and goals of each committee;
- ◆ size and quorum requirements of each committee;
- ◆ qualifications of the members, such as experience or geographic location;
- ◆ appointment procedures for the committees;
- ◆ terms of service;
- ◆ training requirements;
- ◆ a process to regularly evaluate the need for each committee;
- ◆ the duration of each committee; and
- ◆ a requirement that committees comply with the Open Meetings Act.

Management Action

4.2 The Commission should abolish the Legislative Advisory Committee and seek more effective ways of gaining stakeholder input.

The Commission should abolish the LAC because it is not necessary as an ongoing presence. The Commission can perform the duties of the LAC at its regular public meetings. If the Commission decides that it needs input on specific topics, it can create advisory committees that comply with the requirements outlined in Recommendation 4.1.

In lieu of the LAC, the Commission should seek input through other, low-cost means, such as through e-mail, the agency's website, or its newsletter. The Department should provide credit unions of all sizes and credit union members with the opportunity for a stronger role in the development of rules, major policy decisions, and recommendations for statutory change. This process could prove more effective in providing input to the Commission than the Legislative Advisory Committee. These recommendations would abolish the LAC, but provide the Commission with a more meaningful process for seeking input on proposed rules, policies, and statutory recommendations.

Fiscal Implication

These recommendations would not have a significant fiscal impact to the State, although they would result in a small cost savings to the Department. The Department does not reimburse non-Commission members of the LAC for their travel costs to attend meetings. However, the agency does pay travel costs for Commission members to attend LAC meetings, totaling \$3,162 in fiscal year 2006 and \$4,917 in fiscal year 2007. Abolishing the LAC would eliminate the expense of paying Commission members to travel to LAC meetings. This recommendation will also allow Department staff to use their time for other agency business, rather than preparing for and attending LAC meetings. The money and time the agency saves could be used to support other forms of stakeholder involvement.

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¹ Texas Government Code, Section 2110.005.

² Credit Union Commission Policies Manual (Revised February 14, 2007), Section IX.

³ Texas Government Code, Section 2110.006.

⁴ Texas Government Code, Section 2110.002.

⁵ Texas Government Code, Section 2001.039.

Responses to Issue 4

Recommendation 4.1

Require the Commission to adopt rules for its use of advisory committees, ensuring the committees meet standard structure and operating criteria.

Agency Response to 4.1

The agency agrees with the recommendation. The agency fully supports the need for all committees to meet standard structure and operating criteria. Should it be the Commission's determination that it needs to establish an advisory committee, it will adopt and implement appropriate rules. (Harold E. Feeney, Commissioner – Credit Union Department)

For 4.1

None received.

Against 4.1

None received.

Recommendation 4.2

The Commission should abolish the Legislative Advisory Committee and seek more effective ways of gaining stakeholder input.

Agency Response to 4.2

The agency agrees with the recommendation. Although the agency believes the Legislative Advisory Committee has served a useful purpose over the years, we recognize that new and better ways of gaining input may be available. The agency fully supports the concept that all of its activities should be effective and efficient and the recommendations will be implemented. (Harold E. Feeney, Commissioner – Credit Union Department)

For 4.2

None received.

Against 4.2

None received.

Commission Decision

Adopted Recommendations 4.1 and 4.2.

Legislative Action

House Bill 2735 requires the Commission to adopt rules regarding the purpose, structure, and use of advisory committees, ensuring the committees meet standard structure and operating criteria. The bill also requires the Commission to adopt rules to ensure a periodic evaluation of its advisory committees. (Recommendation 4.1)

ACROSS-THE-BOARD RECOMMENDATIONS



Credit Union Department

Recommendations	Across-the-Board Provisions
Already in Statute	1. Require public membership on the agency's policymaking body.
Update	2. Require provisions relating to conflicts of interest.
Update	3. Require unbiased appointments to the agency's policymaking body.
Update	4. Provide that the Governor designate the presiding officer of the policymaking body.
Update	5. Specify grounds for removal of a member of the policymaking body.
Update	6. Require training for members of the policymaking body.
Already in Statute	7. Require separation of policymaking and agency staff functions.
Already in Statute	8. Provide for public testimony at meetings of the policymaking body.
Update	9. Require information to be maintained on complaints.
Apply	10. Require the agency to use technology to increase public access.
Apply	11. Develop and use appropriate alternative rulemaking and dispute resolution procedures.

Commission Decision



Adopted staff recommendations.

Legislative Action



Adopted Commission decision.

AGENCY INFORMATION

(AUGUST 2008)



Agency Information

Agency at a Glance

The Credit Union Department oversees the safety and soundness of state-chartered credit unions in Texas. The Department's mission is to safeguard the public interest, protect the interests of credit union members, and promote public confidence in credit unions. To achieve its mission, the Department carries out the following key activities.

- ◆ Approves new charters, charter conversions, mergers, and other structural or operational changes for state-chartered credit unions.
- ◆ Examines every state-chartered credit union on a regular basis.
- ◆ Oversees out-of-state credit unions operating in Texas.
- ◆ Assists the public by helping to resolve complaints against credit unions and providing informational materials.



Information about the agency's regulation of credit unions is available at www.t cud.state.tx.us.

Key Facts

- ◆ **Funding.** The Department spent about \$2.06 million in fiscal year 2007. It generated revenues totaling \$2.08 million. The Department is revenue-neutral to the State since it relies on fees collected from credit unions to support its operations. The Credit Union Commissioner adjusts fees semi-annually to ensure that revenues approximately equal the agency's appropriation.
- ◆ **Staffing.** In fiscal year 2007, the Department employed 24 staff and had two unfilled positions. Fourteen travel throughout the state examining credit unions, and the other 10 perform administrative and supervisory functions at the agency's office in Austin.
- ◆ **Credit Unions.** The Department supervised 220 state-chartered credit unions, with assets totaling \$19 billion, in fiscal year 2007. Texas also has 375 federally chartered credit unions, with \$33 billion in assets, but the Department does not regulate these institutions.
- ◆ **Applications.** A credit union must apply to the Department to make certain operational or structural changes, such as merging with another credit union or expanding its field of membership. In fiscal year 2007, the Department received 83 applications, and approved 80. Thirty-three of those applications were for field of membership expansions.
- ◆ **Supervision.** The Department conducted 192 regular examinations and 35 remedial exams in fiscal year 2007. The Department performs remedial exams for credit unions that have significant financial or regulatory deficiencies identified during their regular examinations.

Major Events in Agency History

- 1913 The Legislature first allows credit unions to form in rural areas of Texas by passing the Rural Credit Union Act. The Legislature gives the Department of Banking the responsibility of regulating credit unions.
- 1929 The Legislature amends the Rural Credit Union Act to allow credit unions in all parts of the state.
- 1934 The federal government begins chartering credit unions with passage of the Federal Credit Union Act.
- 1969 The Legislature passes the Texas Credit Union Act and creates the Credit Union Department separate from the Department of Banking to oversee state-chartered credit unions.
- 1973 The Legislature requires credit unions to carry deposit insurance. Initially, credit unions in Texas are privately insured.
- 1991 The Department adopts rules requiring all state-chartered credit unions to have federal deposit insurance through the National Credit Union Share Insurance Fund. This new requirement brings Texas chartered credit unions under federal regulation by the National Credit Union Administration, which manages the insurance fund. The Department now allows credit unions to have private deposit insurance, but only one has chosen this option.
- 1998 Due to tightened federal restrictions on field of membership expansions and other business reasons, several federal credit unions in Texas convert to a state charter.
- 2004 Following a limited national trend among credit unions, two of Texas' largest credit unions convert to mutual savings banks due to credit union charter limitations.

Organization

Policy Body

The Credit Union Commission is the nine-member, Governor-appointed policymaking body that oversees the Department. The Commission consists of five public members and four industry representatives, appointed to six-year staggered terms. The Commission's industry representatives must have five years or more of active credit union experience as a director, officer, or committee member. The Governor appoints a member of the Commission to serve as Chair. The table, *Credit Union Commission Members*, shows the Commission's current members. The Commission's primary responsibility is to adopt rules and policies to govern state-chartered credit unions. It also hires and evaluates the Commissioner. The Commission generally meets three times a year in Austin.

The Commission consists of five public members and four credit union representatives.

Credit Union Commission Members

Member	City	Qualification	Term Expires
Gary L. Janacek, Chair	Temple	Industry Representative	2009
Thomas F. Butler, Vice Chair	Deer Park	Public Member	2013
William W. Ballard II	Waxahachie	Public Member	2009
Manuel Cavazos	Austin	Public Member	2011
Mary Ann Grant	Houston	Public Member	2009
Dale E. Kimble	Denton	Industry Representative	2013
Allyson Morrow	San Benito	Industry Representative	2013
Barbara K. Sheffield	Sugar Land	Industry Representative	2011
Henry E. Snow	Texarkana	Public Member	2011

Although the Commission sets overall policy for regulating the industry and is ultimately responsible for agency administration, the Commissioner makes independent decisions on all credit union applications for mergers, consolidations, and conversions, among other changes, and can take administrative actions without consulting the Commission. However, credit unions can appeal the Commissioner's decisions to the Commission.

The Commission has two standing advisory committees. The Legislative Advisory Committee has seven members appointed by the Chair of the Commission. Four of the seven members are members of the Commission. The remaining three members are industry representatives who are not on the Commission. This committee considers changes to statute or rules and makes recommendations to the full Commission regarding proposed changes. The Commissioner Evaluation Committee consists of four Commission members who evaluate the Commissioner's performance and maintain a Commissioner succession plan.

*The Commissioner
makes
independent
decisions, which
are appealable to
the Commission.*

Staff

The Department employs 24 staff, fifteen of whom are credit union examiners. Six examiners are based in Houston, eight in Dallas, and one in Austin who supervises the examiners in the field. Examiners based in Houston and Dallas work out of their homes and travel to credit unions throughout the state. The remaining staff work in the Austin headquarters, and include agency management and administrative staff. The Austin staff oversee the examination program, perform off-site credit union monitoring, process credit union applications, and respond to member complaints and inquiries. The Commissioner manages the agency's day-to-day operations and implements policies set by the Commission.

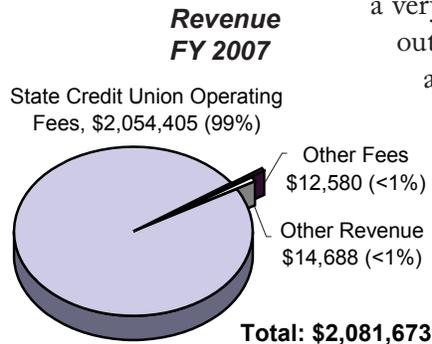
Appendix A compares the agency's workforce composition to the percentage of minorities in the statewide civilian labor force. The agency has exceeded some of the civilian labor force percentages in some categories, but it has

fallen below others. However, the agency is small and has few positions in each job category, making the percentages difficult to meet.

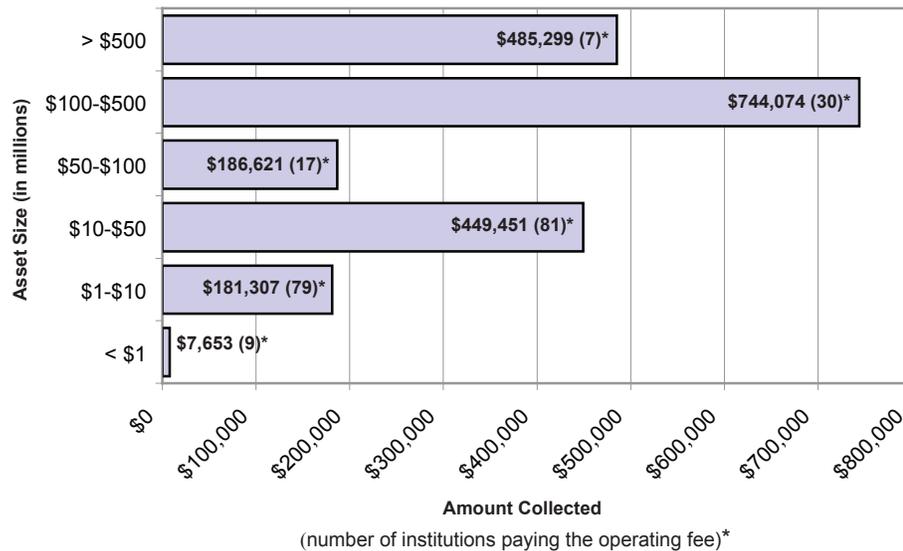
Funding

Revenues

In fiscal year 2007, credit union regulation generated \$2.08 million in revenue. Nearly this entire amount is composed of credit union operating fees, though a very small amount is from penalties, examination fees, and fees from out-of-state credit unions. The Commissioner adjusts operating fees on a semi-annual basis to ensure that the total amount of fees collected will closely match the Department's legislative appropriation plus indirect administration costs. All fees are deposited in the General Revenue Fund. The pie chart, *Revenue*, shows the types and amounts of fees the agency collected from the industry in fiscal year 2007. The graph, *Operating Fees by Size of Credit Union*, shows the amount of fees paid by credit unions according to their asset size.



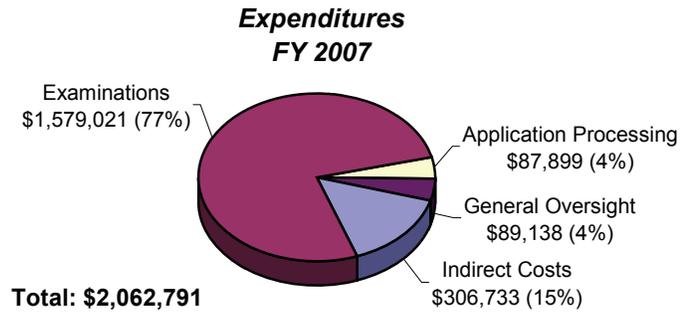
Operating Fees by Size of Credit Union – FY 2007



Expenditures

In fiscal year 2007, the Department spent about \$2.06 million to fund its operations and indirect administration costs, as shown in the pie chart, *Expenditures*. The agency spent about 77 percent of the total agency budget on the examination program. The general oversight category consists of the Commission's activities in overseeing the Department and the industry, including rulemaking and charging fees.

The Department's fee revenue not only pays for the agency's operations, but also for indirect administration costs. The Legislature has directed regulatory agencies that are funded with fees to cover indirect costs for support services provided by other agencies. Examples of these costs include employee benefits paid by the Employee Retirement System and accounting services provided by the Comptroller of Public Accounts. The Department's indirect costs totaled \$306,733 in fiscal year 2007.



Appendix B describes the agency's use of Historically Underutilized Businesses (HUBs) in purchasing goods and services for fiscal years 2004 to 2007. The agency uses HUBs in the categories of special trade, professional services, commodities, and other services. The agency has consistently exceeded the goal for professional services and commodities. The agency exceeded the goal in other services except in fiscal year 2007. The agency has not purchased anything in the special trade category since fiscal year 2004, in which it did not meet the HUB goal.

Credit Unions in Texas

Before describing how the Credit Union Department operates, it is necessary to understand the basic characteristics of a credit union, trends in the credit union industry, and the wider regulatory structure governing credit unions. The material below provides this context, followed by a description of the Department's functions.

State of the Industry

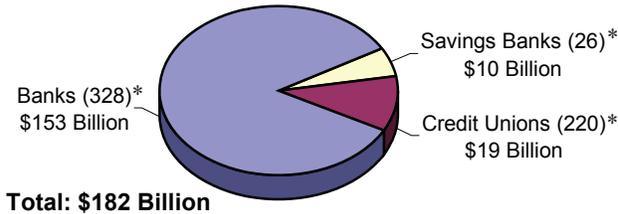
Credit unions are nonprofit financial cooperatives. Credit union members elect a governing board from among themselves. Like other cooperatives, once credit unions pay their normal operating expenses and set aside money for reserves, they return net earnings to their members through dividends, lower fees, interest rebates on loans, new and better services, and other benefits. Credit unions are exempt from federal income tax, but pay other types of federal, state, and local taxes. All credit unions must have member deposit insurance. State-chartered credit unions in Texas may choose federal or private deposit insurance. Most credit unions have federal insurance through the National Credit Union Share Insurance Fund.

*All credit unions
must have
member deposit
insurance.*

Originally, people formed credit unions with membership based on a single "common bond" through a profession, association, or employer. However, to remain financially viable, diversify risk, and compete more effectively with other financial institutions, credit unions have expanded their fields of membership to include multiple groups with common bonds or persons living or working within a certain geographic area. By expanding fields of membership to entire communities, credit unions compete with other credit

unions as well as other types of financial institutions. In this industry climate, organizing and building the necessary capital to successfully operate a new credit union is difficult. In fact, the Department has granted only eight new charters since 1994, and of those, only four are still operating today.

Comparison of State-Chartered Financial Institutions by Asset Size

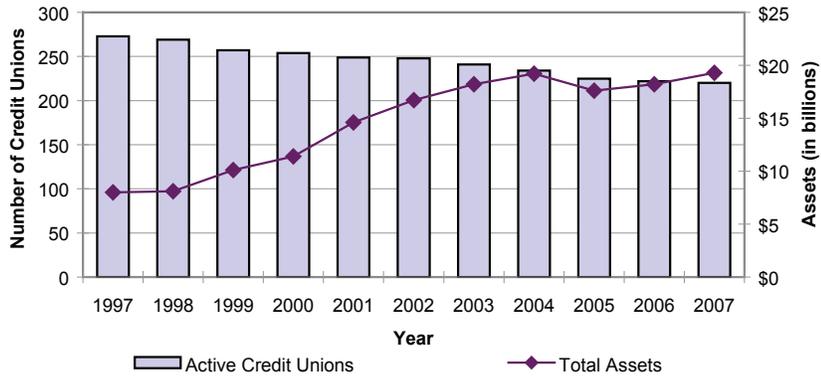


* Number in parentheses indicates number of institutions.

As another strategy to become more efficient and remain competitive, credit unions have been merging into larger institutions. In Texas, the number of state-chartered credit unions has declined from 269 in 1998 to 220 in 2007, mostly due to industry consolidation. Though the number of credit unions declined, the total assets of the remaining credit unions increased from about \$8 billion in 1998 to about \$19 billion in 2007, as shown in the graph, *Texas Credit Union Industry Trends*. The pie chart,

Comparison of State-Chartered Financial Institutions by Asset Size, shows how assets held in credit unions compare to those held in other Texas financial institutions.

Texas Credit Union Industry Trends, 1997 – 2007



Regulatory Structure

In Texas, as in 46 other states, credit unions can choose to apply for a federal charter or a state charter. Nationally, approximately 40 percent of credit unions have a state charter, while the other 60 percent have a federal charter. This dual chartering system is similar to the regulatory structure of other types of financial institutions, such as banks. Federal and state credit unions are similar in the way they operate, with some differences in tax liabilities and regulation. For some credit unions, the federal charter provides advantages, while others may see greater benefits in having a state charter. The table on the following page, *State and Federal Credit Unions in Texas*, compares the general characteristics of state and federal credit unions operating in Texas.

Credit unions in Texas can choose to apply for a federal or state charter.

State and Federal Credit Unions in Texas

	State Credit Unions	Federal Credit Unions
Number	220	375
Total Assets	\$19.3 billion	\$33.4 billion
Number of Members	3 million	4 million
Tax Requirements	<ul style="list-style-type: none"> ◆ Must pay state sales tax ◆ Must pay property tax ◆ Must pay federal employment taxes ◆ Exempt from federal income tax ◆ Exempt from state franchise tax ◆ Must pay tax on unrelated business income ◆ Must report financial information to IRS 	<ul style="list-style-type: none"> ◆ Exempt from state sales tax ◆ Must pay property tax ◆ Must pay federal employment taxes ◆ Exempt from federal income tax ◆ Exempt from state franchise tax ◆ Exempt from tax on unrelated business income ◆ Not required to report financial data to IRS
Regulator	◆ Credit Union Department	◆ National Credit Union Administration
Member Deposit Insurance	<ul style="list-style-type: none"> ◆ National Credit Union Share Insurance Fund ◆ American Mutual Share Insurance Corporation 	◆ National Credit Union Share Insurance Fund

The National Credit Union Administration (NCUA) is the federal agency that regulates credit unions with federal charters. In addition to regulating federal credit unions, NCUA also administers the National Credit Union Share Insurance Fund, described in the textbox, *What is the Federal Share Insurance Fund?*

Since all but one state-chartered credit union are federally insured and NCUA has an interest in minimizing risk to the share insurance fund, NCUA has a collaborative oversight role with the Department and all other state

regulators. The Department and NCUA conduct 30 to 40 joint examinations per year. NCUA can decide what examinations it wants to participate in based on a number of factors, but it usually participates in examinations of credit unions with known problems that may pose risks to the share insurance fund. NCUA also assists the Department by offering training for the Department's examination staff and some technical assistance, such as computer programs and other tools to assist with the examination process.

What is the Federal Share Insurance Fund?

- ◆ Protects credit union member deposits up to \$100,000, with additional coverage of up to \$250,000 for certain retirement accounts.
- ◆ Funded with credit union deposits and premiums credit unions pay.
- ◆ Backed by the full faith and credit of the U.S. government.
- ◆ Similar in structure and function to the Federal Deposit Insurance Corporation, which insures bank deposits.
- ◆ Of 3,231 state-chartered credit unions in the U.S., 95 percent are federally insured.

Agency Operations

To ensure the safety and soundness of state-chartered credit unions, the Credit Union Department performs several key activities. These activities include approving applications for structural or operational changes, setting standard business practices, examining and supervising credit unions, and responding to complaints.

◆

A credit union must apply for approval from the Department to merge with another credit union.

Applications

Before starting a credit union or making changes to an existing credit union's structure or operations, state-chartered credit unions must either apply for approval from or provide notice to the Department, depending on the nature of the change. The Commissioner has independent authority to approve or deny applications, but all decisions are subject to appeal to the Credit Union Commission. The Commissioner evaluates applications based on financial feasibility and regulatory compliance.

A credit union must go through the application process to obtain a new state charter, to make any changes to its bylaws or articles of incorporation, merge with another credit union, or convert from a state to federal charter or from a federal to state charter, among other changes. Credit unions chartered in other states must apply to the Commissioner for permission to operate a branch in Texas. Examples of changes that only require a credit union to notify the Department include opening a new office and offering online transaction services to members.

Number of Applications by Type FY 2007	
Field of Membership Expansions.....	33
Other Bylaw/Article Amendments	27
Mergers	9
Conversions	2
Regulatory Waivers.....	12

The most common application, as shown in the textbox, *Number of Applications by Type*, is field of membership expansions. Credit unions may diversify membership to minimize risk and improve economic viability. For example, credit unions that serve employees of a certain company might apply to also serve anyone living within a 10-mile radius of the credit union.

When credit unions apply for certain types of changes, such as a field of membership expansion, the Department publishes a notice of receipt in the Texas Register to allow for public comments and protests. In addition, credit unions inform members at their annual meetings about bylaw or articles of incorporation changes. Members must vote to approve a merger, a voluntary liquidation, or a charter conversion.

Business Practices

Agency rules govern the operations of credit unions by setting requirements for their administrative and financial practices. These standards help ensure credit unions manage their business in a sound manner, and cover a range of topics from establishing a credit union to maintaining a certain level of capital reserves and administering member loans and deposit accounts.

The operational requirements generally fall into the categories shown in the textbox, *Business Practices Governed by the Credit Union Department*.

Examinations

The Department primarily assesses the safety and soundness of credit unions through examinations. Examinations not only allow the Department to determine the financial health of a credit union, but also to determine a credit union's compliance with laws and regulations. Examiners develop corrective measures, recommendations, and instructions to help a credit union improve its performance. Information generated through the process also helps NCUA protect the financial integrity of the deposit insurance fund.

The Department examines all 220 Texas-chartered credit unions, as well as credit unions chartered in other states that have offices in Texas. The agency's rules require it to examine each credit union at least once every 18 months; however, the Department averages 15 months between examinations.

On-Site Evaluation

The Department's examiners conduct a majority of the exam on-site at the credit union. Examiners spend several days reviewing a credit union's general ledger, financial transactions, loan documents, procedures, board meeting minutes, and other materials. Examiners use a standard evaluation and rating system used by other states and the federal government in their examinations of credit unions. The rating system is similar to that used for banks and other financial institutions. This system rates institutions from one (best) to five (worst) and is described in the textbox, *CAMEL Rating System*.

Business Practices Governed by the Credit Union Department

Business Administration

- ◆ Articles of incorporation and bylaws
- ◆ Mergers with another credit union or conversions to another type of financial institution
- ◆ Purchase, lease, and sale of credit union property
- ◆ Records retention
- ◆ Qualifications of credit union board members
- ◆ Bonding and insurance
- ◆ Confidentiality for credit union member records

Financial Practices

- ◆ Financial reporting, audits, and accounts verification
- ◆ Credit union investments
- ◆ Use of credit union service organizations
- ◆ Capital reserves
- ◆ Deposit insurance

Consumer Services

- ◆ Share and deposit accounts
- ◆ Safe deposit box facilities
- ◆ Loans
- ◆ Trusts

CAMEL Rating System

The term CAMEL is an acronym for the following components on which credit unions are rated.

- ◆ Capital adequacy
- ◆ Asset quality
- ◆ Management
- ◆ Earnings
- ◆ Liquidity

For each component, examiners assign a rating of one to five, with one indicating the best performance. Examiners then give a credit union a composite CAMEL rating based on its performance in each of the components. Credit unions with a composite CAMEL code of three, four, or five are considered higher risk institutions that require additional supervisory attention. Most credit unions in Texas have a composite CAMEL rating of one or two, with only 28 credit unions having a three or four rating and none having a five rating in fiscal year 2007.



Through the examination process, the Department works to achieve informal resolution of problems.

Once examiners complete their on-site evaluation, they meet with the credit union's executive management and board of directors. Examiners present their findings and discuss a plan for resolving any areas of concern. Examiners then submit their reports to the Department's office in Austin for review. The Department sends the final, approved version of the exam report to the credit union within 20 days of the examination. The National Credit Union Administration also receives a copy of the final report. In fiscal year 2007, the Department conducted 192 examinations, including 34 joint examinations with NCUA.

Examination Findings

If an examination uncovers significant deficiencies, the Department schedules on-site follow-up contacts, or remedial examinations, on a quarterly or semi-annual basis, depending on the severity of the problems. Examiners primarily conduct remedial exams at credit unions with a composite CAMEL code of three or worse. The Department performed 35 remedial examinations in fiscal year 2007.

Through the examination process, the Department works to achieve informal resolution of problems. However, if a credit union refuses to work with the agency or is not making adequate progress, it has several options for pursuing administrative action. These options, from least to most severe, include

Common Examination Findings

Common problems found during examinations include the following.

- ◆ Failure to comply with provisions of the federal Bank Secrecy Act
- ◆ Weak earnings
- ◆ High loan delinquency or losses
- ◆ Declining net worth position
- ◆ Information incorrectly reported on call reports

entering into a voluntary written agreement or issuing a determination letter, cease and desist order, removal order to remove specific employees or board members of the credit union, conservatorship order, or liquidation order. In the past five fiscal years, the agency has entered into two written agreements, and issued three determination letters, two cease and desist orders, and one conservatorship order. The textbox, *Common Examination Findings*, lists the five problems found most often during examinations.

Off-Site Monitoring

Between examinations, the Department monitors each credit union's performance by reviewing financial and statistical reports known as call reports. The Department requires credit unions to submit call reports on a quarterly basis. The Department downloads data from the call reports into a computer system that identifies information outside the norm and alerts the Department's examiners. NCUA's examiners also have access to this information and review it for risk areas. When the Department or NCUA identifies adverse operating trends in the call report data, examiners may schedule an exam or follow up contact sooner than planned to assess the situation.

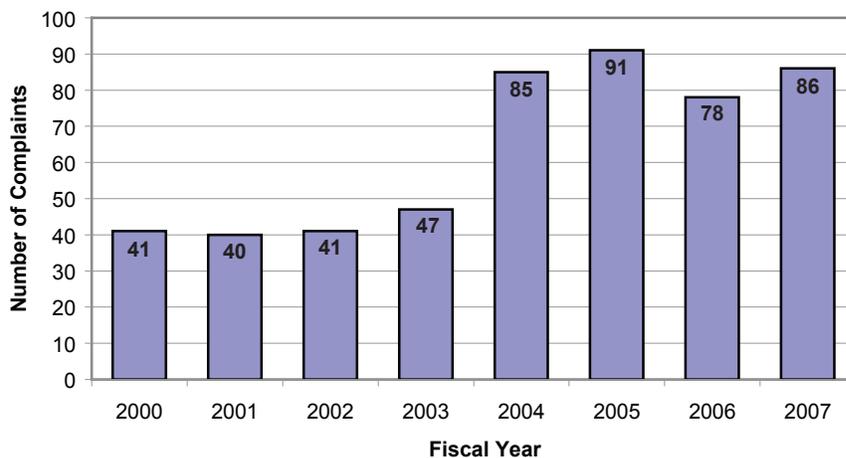
Complaints

The Department responds to complaints from the public and acts as a mediator to ensure people receive fair and timely resolution of their complaints against credit unions. The Department receives written complaints, as well as phone calls. The Department requires a response from the credit union named in a complaint before deciding what action to take. The most common areas of complaints against credit unions relate to:

- ◆ repossessions and collections of delinquent accounts;
- ◆ non-sufficient funds and overdraft fees;
- ◆ fraud and check scams; and
- ◆ loan procedures.

In fiscal year 2007, the agency received 86 written complaints and numerous phone inquiries. The graph, *Written Complaints Received by the Department*, shows the number of complaints the agency has received over the past eight fiscal years. The number of complaints doubled starting in 2004. The Department indicates that this increase could be due to increased awareness of the agency's website and the ease of filing complaints by e-mail.

**Written Complaints Received by the Department
FYs 2000 – 2007**



APPENDICES

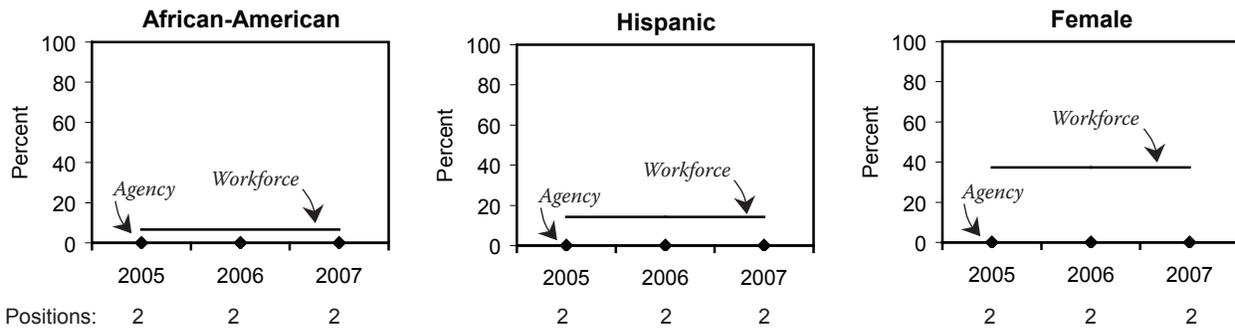


Appendix A

Equal Employment Opportunity Statistics 2005 to 2007

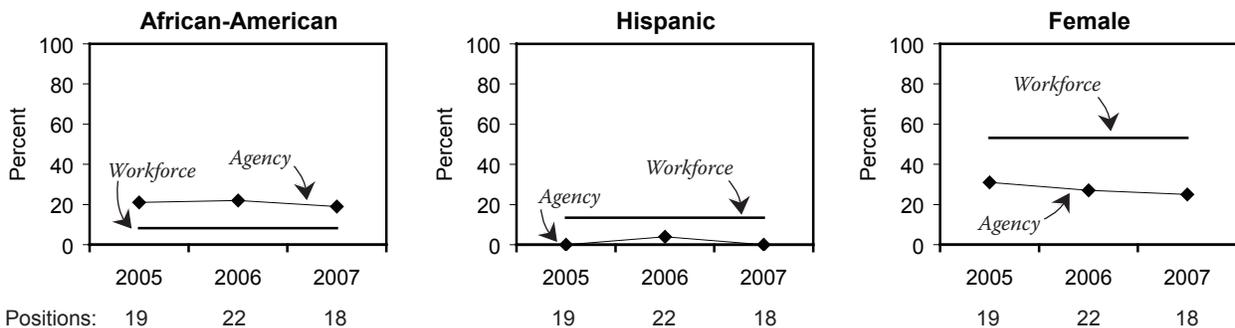
In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the Credit Union Department.¹ The agency maintains and reports this information under guidelines established by the Texas Workforce Commission.² In the charts, the flat lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the agency's actual employment percentages in each job category from 2005 to 2007. The agency has had difficulty meeting the statewide civilian workforce percentages in some categories due to its small staff size. Also, the agency does not employ persons in the technical and skilled craft categories. The agency has an Equal Employment Opportunity and Workforce Diversity Policy.

Administration



The agency has consistently fallen below the civilian workforce percentages for African-American, Hispanic, and female employment in administration, but it only has two employees in this category.

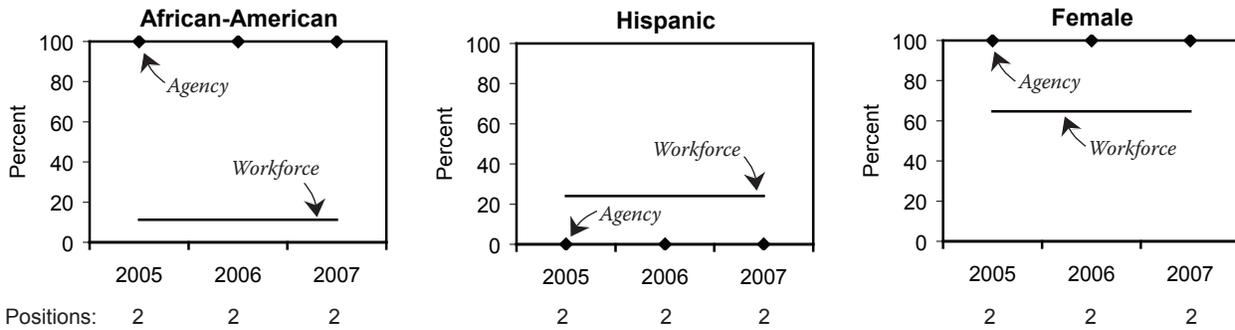
Professional



The agency exceeded the civilian workforce percentages for African-Americans, but fell short for Hispanic and female employment in professional positions.

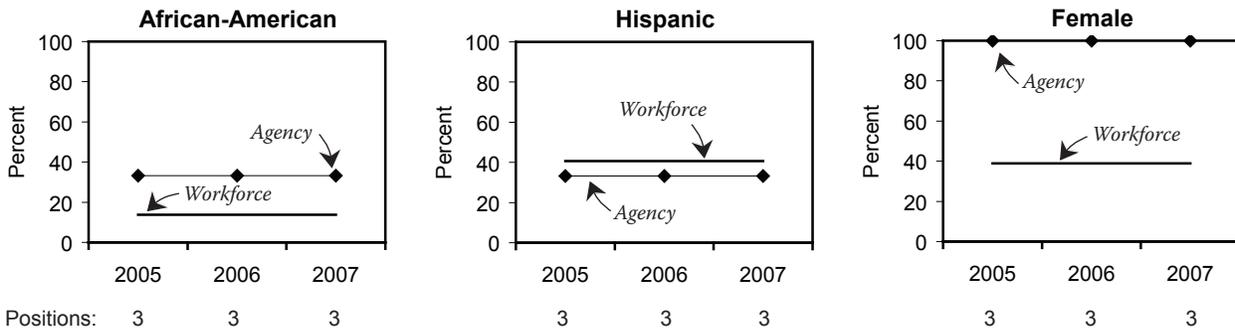
Appendix A

Administrative Support



The agency did not meet the civilian workforce percentages for Hispanics, but significantly exceeded the percentages for African-Americans and females.

Service/Maintenance³



The agency did not meet the civilian workforce percentages for Hispanics, but exceeded the percentages for African-Americans and females.

¹ Texas Government Code, sec. 325.011(9)(A).

² Texas Labor Code, sec. 21.501.

³ The Service/Maintenance category includes three distinct occupational categories: Service/Maintenance, Para-Professionals, and Protective Services. Protective Service Workers and Para-Professionals used to be reported as separate groups.

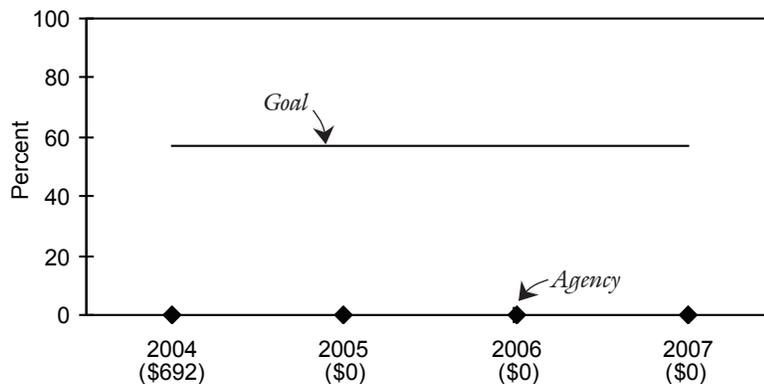
Appendix B

Historically Underutilized Businesses Statistics 2004 to 2007

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 agency maintains and reports this information under guidelines in statute.² In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Comptroller's Office. The diamond lines represent the percentage of agency spending with HUBs in each purchasing category from 2004 to 2007. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category. The Credit Union Department generally exceeds the State's HUB purchasing goals and has established a HUB policy in rule.

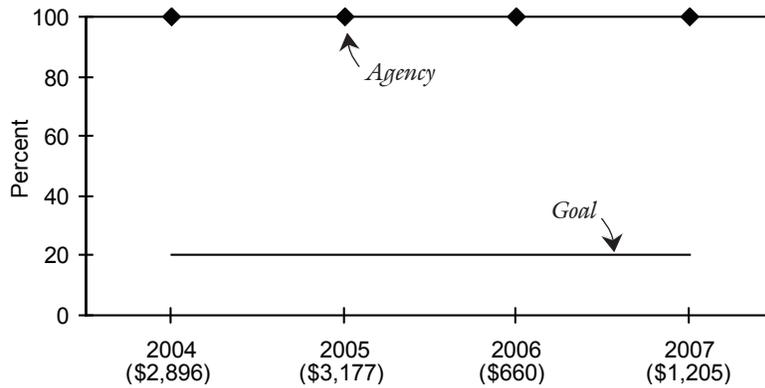
Special Trade



In 2004, the agency spent a small amount in this category, but made no HUB purchases. The agency spent no money in this category in the past three years.

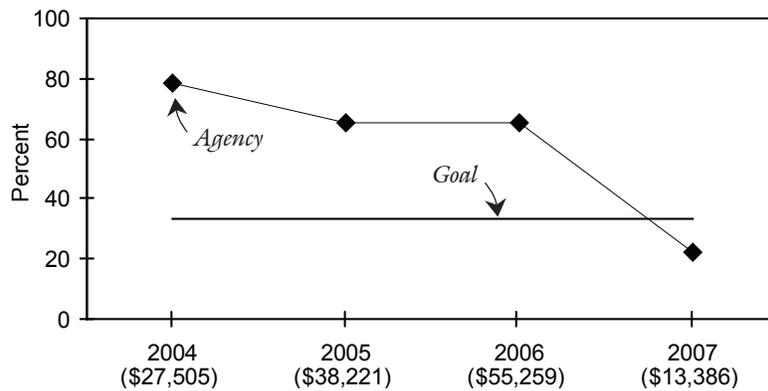
Appendix B

Professional Services



The agency has consistently exceeded the goal for spending on professional services.

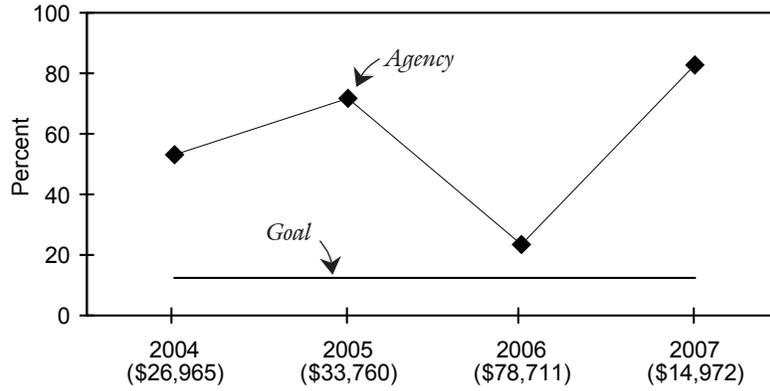
Other Services



The agency exceeded the goal in this category from 2004 to 2006, but fell short in 2007. However, in 2007, the agency spent less money on other services than in years past.

Appendix B

Commodities



The agency has consistently exceeded the goal for spending on commodities.

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¹ Texas Government Code, sec. 325.011(9)(B).

² Texas Government Code, ch. 2161.

Appendix C

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 agency personnel; spoke with staff from key legislative offices; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research using the Internet.

In addition, Sunset staff also performed the following activities unique to this agency.

- ◆ Attended meetings, reviewed meeting minutes, and interviewed members of the Credit Union Commission and Legislative Advisory Committee.
- ◆ Interviewed staff from the Texas Department of Banking and National Credit Union Administration.
- ◆ Observed an examination of a credit union by Department staff.
- ◆ Met with staff and managers of credit unions, the Texas Credit Union League, and Texas Credit Union Legislative Coalition.
- ◆ Talked with staff of the National Association of State Credit Union Supervisors.

NEW ISSUES



New Issues

None received.

PROVISIONS ADDED BY LEGISLATURE



Provisions Added by Legislature

None added.

SUNSET STAFF REVIEW OF THE CREDIT UNION DEPARTMENT



REPORT PREPARED BY:

Karen Latta, Project Manager

Amy Tripp

Janet Wood

Ginny McKay, Project Supervisor

Joey Longley

Director

Sunset Advisory Commission
PO Box 13066
Austin, TX 78711

Robert E. Johnson Bldg., 6th Floor
1501 North Congress Avenue
Austin, TX 78701

512-463-1300 Fax 512-463-0705

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