

The logo for the Texas Sunset Advisory Commission is a black semi-circle with a white border. Inside the semi-circle, the words "Texas", "Sunset", "Advisory", and "Commission" are stacked vertically in a bold, white, serif font.

**Texas
Sunset
Advisory
Commission**

STAFF EVALUATION

State Depository Board

State Banking Board

Credit Union Commission

*Commission on Law Enforcement Officer
Standards and Education*

A Staff Report
to the
Sunset Advisory Commission



1982

SUNSET ADVISORY COMMISSION

STAFF REPORT

on the

CREDIT UNION COMMISSION

1982

FOREWORD

Over the past several years, there has been a sustained interest among the states in a new concept in legislative review popularly described as sunset. Since 1976, more than half the states have enacted legislation which embodies the primary element of sunset, the automatic termination of an agency unless continued by specific action of the legislature.

The acceptance of this concept has been aided by a general agreement that the normal pressures of the legislative process tend to prevent a systematic review of the efficiency and effectiveness with which governmental programs are carried out. The sunset process is, then, an attempt to institutionalize change and to provide a process by which a review and redefinition of state policy can be accomplished on a regular systematic basis.

The Texas Sunset Act (Article 5429K, V.A.C.S., as amended) was enacted by the 65th Legislature in 1977. Under the provisions of the Act, agencies are automatically terminated according to a specified timetable, unless specifically continued by the legislature.

To assist the legislature in making the determination of whether an agency should be continued and, if continued, whether modifications should be made to its operations and organizational structure, the Act establishes a ten-member Sunset Advisory Commission composed of eight legislative members and two public members. The commission is required to evaluate the performance of the agency in accordance with specific criteria set out in the Act and to recommend necessary changes resulting from the findings of the evaluation.

The process by which the commission arrives at its recommendations moves through three distinct phases beginning with a self-evaluation report made by the agency to the commission. The second phase involves the preparation of a report to the commission by its staff, evaluating the activities of the agency, and proposing suggested changes for commission consideration. The final phase involves public hearings on the need to continue or modify an agency and the development of commission recommendations and legislation, based on the agency self-evaluation, staff report, and public testimony.

The Sunset Commission's findings, recommendations, and proposed legislation are then required to be transmitted to the legislature when it convenes in regular session.

INTRODUCTION AND ORGANIZATION OF AGENCY REVIEWS

The Texas Sunset Act abolishes these agencies on September 1, 1983 unless each is re-established by the 68th Legislature.

The staff reviewed the activities of these agencies according to the criteria set out in the Sunset Act and has based its conclusions on the findings developed under these criteria.

Taken as a whole, these criteria direct the review of an agency to answer four primary questions:

1. Does the state need to perform the function or functions under review?
2. Could the public still be adequately served or protected if the functions were modified?
3. Is the current organizational structure the only practical way for the state to perform the function?
4. If the agency is continued and continues to perform the same functions, can changes be made which will improve the operations of the agency?

The report is structured to present the performance evaluation of each agency separately. The application of the across-the-board recommendations developed by the commission to deal with common problems are presented in a chart at the end of each report and are not dealt with in the text except in one instance. When the review develops a position which opposes the application of a particular recommendation, the rationale for the position is set forth in the text.

SUMMARY OF STAFF FINDINGS AND CONCLUSIONS

SUMMARY

The Credit Union Commission was created in 1969 and is currently active. The agency's major functions include: 1) the chartering of credit unions in Texas; 2) the annual examination of all state-chartered credit unions, and the monitoring of credit unions with deficiencies; and 3) enforcement efforts directed toward violations of the act, or unsafe or fraudulent practices.

The results of the review indicated that the agency is generally operated in an efficient and effective manner. It was determined that sufficient reason exists for the state to continue to regulate the credit union industry in Texas; however, the review showed that an independent board is not the only organizational approach available for performing this function. Consolidation with the Finance Commission was identified as a possible organizational alternative. The review also indicated that if the agency is continued, several modifications should be made which would improve the efficiency and effectiveness of the operations of the agency.

Approaches for Sunset Commission Consideration

I. MAINTAIN THE COMMISSION WITH MODIFICATIONS

- A. Policy-making structure
 - 1. Amend the statute to include the across-the-board recommendations concerning conflicts of interest. (statutory)
- B. Agency operations
 - 1. Overall administration
 - a. Improve internal controls by providing for segregation of duties with respect to both the receipt of funds and the purchase of goods. (management improvement - non-statutory)
 - 2. Evaluation of programs
 - a. Amend the statute to contain adequate chartering criteria, including criteria relating to: the economic viability of the proposed credit union; the character and general fitness of incorporators and proposed directors; and the good faith of applicants. (statutory)

- b. Amend the statute to include provision for public notice and opportunity for prior hearing on request of any protesting party or the incorporators. (statutory)
- c. The board should formally adopt, as rules and regulations, all informal policies and guidelines currently in use. (management improvement -non-statutory)
- d. Amend the statute to include as grounds for administrative sanctions under Section 5.09 of the Act the following: related criminal acts; denial to the department of access to credit union books and records, or concealment or destruction of books and records; and refusal to comply with a final order of the commissioner. (statutory)
- e. The board should define in its rules and regulations the following statutory grounds for cease and desist or removal orders: questionable practice in the conduct of a credit union's business, conducting business in an unsafe or unauthorized manner, and breach of trust or fiduciary duty. (management improvement - non-statutory)
- f. Amend the statute to provide the commissioner with the authority to immediately remove a credit union official or employee whose conduct threatens to cause insolvency of the credit union. (statutory)
- g. Amend the statute to provide a right of appeal to the board of a cease and desist or removal order. (statutory)
- h. Amend the statute to provide that for violations of final cease and desist or removal orders, the commissioner is authorized to impose a fine against offending individuals as well as the credit union, and to seek an injunction to enforce such orders. (statutory)
- i. Amend the statute to provide the commissioner with authority to appoint a conservator, where necessary, to rehabilitate a credit union placed in suspension. (statutory)
- j. Amend the statute to provide criminal penalties for false entries and answers to questions of an examiner, and

destruction and concealment of books and records by credit union officials or employees. (statutory)

- C. Recommendations for other sunset criteria
 - 1. Conflicts of interest
 - a. Amend the statute to include the across-the-board recommendation which would prohibit commission members and department employees from serving either as a salaried or unsalaried officer, employee or paid consultant of a trade association in the credit union industry.

II. ALTERNATIVES

A. Agency reorganization

Consolidation with the Finance Commission was identified as a possible alternative to regulating credit unions through an independent board. The review showed that the benefits from such reorganization depends on the degree of consolidation achieved:

- 1. Transfer the functions to the Finance Commission with no substantive change in its operations. Under this approach the Finance Commission would become the policy-making body for the Credit Union Department and assume all statutory responsibilities currently assigned to the Credit Union Commission. The Finance Commission composition could be modified to include a credit union section with oversight responsibility for the department. Primary benefits from this approach would be more consistent and uniform regulation, and limited savings through elimination of some expenses.
- 2. Transfer the functions to the Finance Commission with some modifications to its current structure. Under this approach, the Finance Commission's structure would be modified so that individual departments currently under the commission, as well as the Credit Union Department, would become divisions under the new agency. The new agency would provide some administrative services such as budgeting, record-keeping and data processing, while each division would retain authority over such functions as chartering and examinations. The benefits include more consistent and uniform regulation, reductions in the costs of administra-

tion achieved through better utilization of existing personnel, equipment, supplies and office space, and access to a greater range of services and level of expertise.

3. Transfer the functions to the Finance Commission with substantial modifications in its current structure. This approach would create a centralized agency organized around the regulatory functions of administration, chartering, examinations and complaints rather than by type of financial institution regulated. A single administrator would be responsible for regulatory decisions on banks, savings and loans, credit unions and consumer finance companies. The greatest consistency in regulation and cost savings would be achieved under this alternative since a single administrator could ensure coordination of policies and the most efficient use of staff.

AGENCY EVALUATION

The review of the current operations of an agency is based on several criteria contained in the Sunset Act. The analysis made under these criteria is intended to give answers to the following basic questions:

1. Does the policy-making structure of the agency fairly reflect the interests served by the agency?
2. Does the agency operate efficiently?
3. Has the agency been effective in meeting its statutory requirements?
4. Do the agency's programs overlap or duplicate programs of other agencies to a degree that presents serious problems?
5. Is the agency carrying out only those programs authorized by the legislature?
6. If the agency is abolished, could the state reasonably expect federal intervention or a substantial loss of federal funds?

BACKGROUND

Organization and Objectives

The first legislation in Texas providing for state regulation of credit unions was enacted in 1913 by the 33rd Legislature. By that time the credit union movement in the United States had grown sufficiently to warrant action by the state to provide for the organization of credit unions in Texas. As the number and volume of business of state credit unions increased, the need for more comprehensive regulation was recognized and subsequent amendments in 1929, 1943, and 1963 provided for increased regulation of credit union practices. In 1969, the 61st Legislature passed the present Credit Union Act completely severing the regulation of credit unions from that of banks and establishing an independent Credit Union Department.

The Credit Union Commission, created in 1969, is currently active. The board is composed of nine members appointed by the Governor with the consent of the senate for overlapping six-year terms. Six members of the commission must be currently serving as director, officer, or committee member of a state chartered credit union, and have at least five years experience in such a position. Three members of the commission are representatives of the general public, and may not be involved in the operation of a financial institution. No two commission members may be residents of the same senatorial district; and no member may be a salaried officer, employee or consultant of a trade association in the credit union industry, or related within the second degree by affinity or consanguinity to such an officer, employee or consultant. The Credit Union Commission is financed primarily from fee income deposited to an operating account outside the state treasury or invested in interest-bearing accounts. For fiscal year 1982, the agency has a staff of 24 with an operating budget of \$940,000.

Regulation of credit unions in Texas takes the general form used by most states. There are currently 500 state chartered and 827 federally chartered credit unions operating in Texas with assets totalling approximately \$2.6 billion and \$3 billion respectively. The Credit Union Department is responsible for the regulation of all state chartered credit unions in Texas and the National Credit Union Administration administers the federal system of credit unions in the state. Both agencies grant charters and conduct periodic examinations of their respective credit unions. Required deposit insurance is provided by the National Credit Union Administration which ensures all federal credit unions and approximately 20

percent of state chartered credit unions. The remaining state chartered credit unions are insured by the Texas Share Guaranty Credit Union (TSGCU). TSGCU, chartered and regulated by the department, provides deposit insurance protection to 404 credit union members. The major areas of responsibility of the Credit Union Department include: 1) the approval of state charter applications; 2) the annual examination of all state chartered credit unions, and the monitoring of credit unions with deficiencies; and 3) enforcement efforts directed toward violations of the Act, or unsafe or fraudulent practices.

Under Texas law, any seven or more adults, a majority of whom are Texas residents and all of whom share a "definable community of interest" or common bond such as common residence or occupation, may act as incorporators of a credit union. Incorporators must file with the commissioner articles of incorporation containing basic information about the proposed credit union, original bylaws or rules for its general operation, and biographical information concerning each of the directors. Once the filing and fee requirements have been satisfied, and if incorporators meet the requirements relating to age, residency and common bond, the commissioner is authorized to approve the charter application and to issue a certificate of incorporation. Texas law also provides for the formation of a credit union through the merger of two existing credit unions, and requires that the agency approve the plan of merger. During the period under review, 97 new charters or mergers were approved by the commissioner.

Each of the 500 credit unions chartered under state law must be examined by the department at least once a year. Major objectives of the examination are to determine a credit union's compliance with the Act, agency rules and regulations, the bylaws, and other laws affecting credit union operations; and to analyze and evaluate the credit union's financial condition. A special focus of exams is loans and lending practices; however, other areas examined include the range of services to members, record-keeping practices, internal controls, investments, and performance of management. After the examination is completed, an exit conference is conducted with the board of directors to discuss the examiner's findings and any recommendations for corrective action. A written exam report, including a general statement of the affairs of the credit union, is prepared and a copy furnished to the board. In addition to the regular annual examination, follow-up or special examinations or remedial contacts may be required in the case of credit unions with high numbers of deficiencies. Agency monitoring of these problem credit unions may also involve review of monthly or quarterly reports required to

be filed with the commissioner. In calendar 1981 the agency conducted a total of 515 regular exams and 47 special or remedial exams. Presently, 95 credit unions are listed on a monitoring roster and subject to special reporting requirements.

Texas law provides the agency with a number of enforcement powers for addressing violations of law or regulations, or unsafe or improper practices. Where problems or abuses are discovered in the course of an examination, and a credit union fails to take recommended corrective action, the commissioner generally issues a letter demanding the practices or violations be discontinued. If problems persist and stronger enforcement action is required, the commissioner may issue a cease and desist order, or an order removing from office or employment either directors or employees. Where necessary, the commissioner is authorized to suspend operations of a credit union and take possession of the assets. Finally, when the interests of credit union members are seriously jeopardized through insolvency or imminent insolvency, involuntary liquidation can be ordered. From 1978 to the present, the commissioner has issued 17 demand letters, and 39 involuntary liquidation orders. Enforcement activities of the agency also include investigating and resolving consumer complaints. The agency has maintained consumer complaint records since 1980, and has received approximately 30 complaints in both 1980 and 1981, all of which were resolved informally.

The review and evaluation of the Credit Union Commission indicated that its regulatory activities generally serve to ensure an adequate level of public protection. However, the review did show that modifications in a number of areas would increase the efficiency and effectiveness of agency operations. Results of the evaluation follow.

REVIEW OF OPERATIONS

The evaluation of the operations of the board is divided into general areas which deal with: 1) a review and analysis of the policy-making body to determine if it is structured so that it is fairly reflective of the interests served by the agency; and 2) a review and analysis of the activities of the agency to determine if there are areas where the efficiency and effectiveness can be improved both in terms of the overall administration of the agency and in the operations of specific agency programs.

Policy-Making Structure

In general, the structure of a policy-making body should have as basic statutory components, specifications regarding the composition of the body and the qualifications, method of selection, and grounds for removal of the members. These should provide executive and legislative control over the organization of the body and should ensure that members are competent to perform required duties, that the composition represents a proper balance of interests impacted by the agency's activities, and that the viability of the body is maintained through an effective selection and removal process.

The Credit Union Commission is composed of nine members appointed by the Governor with consent of the senate for overlapping six-year terms. Six members must be currently active in the operation of a credit union, and three are representatives of the general public. The review showed that the structure of the board is generally appropriate for this type of agency. However, several improvements could be made in the statute relating to the qualifications and grounds for removal of board members.

The Sunset Commission has adopted certain standard recommendations intended to strengthen the policy-making structure. Although a number of these recommended statutory provisions have already been incorporated in the Credit Union Act, the statute should prohibit a registered lobbyist from acting as general counsel to the board or serving as a board member.

Overall Administration

The evaluation of the overall administration of the agency focused on determining whether the operating policies and procedures of the agency provide a framework which is adequate for the internal management of personnel and funds, and which satisfies reporting and management requirements placed on the agency and enforced through other state agencies.

The objectives of the administrative activities of the agency include: 1) directing and supervising the administration of the Credit Union Act; 2) managing agency personnel records, purchasing, inventory, data processing, and deposits and investment of revenue; and 3) budgeting for the agency. The results of the review indicated that the agency is generally administered in an efficient manner; however, one area of concern identified in the review relates to the investment of agency funds. The review showed that the commissioner is authorized to maintain its fee revenues and other income in local bank accounts. Analysis of the agency's investment policies indicated that the yield on investments could be improved by minimizing the funds held in checking or passbook accounts, and investing in time-open accounts or certificates of deposit of \$100,000, whenever surplus balances permit. The agency is currently adjusting its investment strategy wherever possible to maximize the rate of return on agency funds through increased use of such high yield instruments. Although agency revenues are not deposited to the state treasury, and it is not included in the appropriations process, the review indicated that the agency is generally in compliance with the requirements placed on agencies controlled through the appropriations process.

One other area of concern dealing with internal controls was identified during the review where changes in administrative procedures would improve the operations of the agency. Results of the review indicated that the agency's internal controls over the receipt of funds and the purchase of goods are minimal. One employee is responsible for making all bank deposits, drawing checks, and performing bank reconciliations. In addition, the same employee is authorized to issue purchase orders for goods and inventory, verify the receipt of goods, and draw checks for their payment. Providing for segregation of duties with respect to both the receipt of funds and the purchase of goods would improve internal controls over these functions and would bring the agency into conformity with well-established standards of safe business practices.

Evaluation of Programs

The review of the agency's program activities focused on the extent to which these activities achieve the objectives of the Credit Union Act: to protect the public from unlawful and unsafe practices in the credit union industry by chartering and regulating state credit unions. The review also sought to determine if areas exist where the efficiency and effectiveness of the operations could be improved.

Chartering State Credit Unions

The Credit Union Act requires that state credit unions be chartered. Under provisions of the Act, any seven or more adults, a majority of whom are Texas residents, and who possess a "common bond" such as common occupation or place of employment, may act as incorporators of a credit union. Applicants are required to submit articles of incorporation and bylaws, as well as biographical information on each of the proposed directors. Upon completion of the filing requirements and payment of a fee by applicants with the above qualifications, the statute provides the application must be approved.

Review of the chartering activity revealed that it generally functions in an efficient manner; however, one area of concern that was identified relates to the role of the state trade association, the Texas Credit Union League, in the chartering process. Review of chartering practices showed that the League provides interested applicants with standard application forms supplied by the agency, assists in preparing them, and forwards the completed application to the department. As a result of discussions with the agency, the department is currently modifying its chartering procedures to facilitate direct application to the agency without League assistance. The agency plans to provide more complete instructions for processing documents, to supply an application packet directly to interested applicants, and is advising applicants and the League that completed applications should be mailed directly to the agency, rather than through the League. In addition to this concern, the review identified several needed statutory changes which would result in greater protection against credit union failures or provide for increased participation by interested parties in the chartering process.

Chartering Requirements. Agency records show that of the 144 credit unions chartered in the last ten years, 49 or approximately 34 percent have failed. Of the 49 that failed, the agency estimated that at least one-third of those failures could be directly related to a field of membership that was too small or lacked sufficient interest to support a credit union. Records show that another common problem among the credit unions that failed was ineffective or unfit management. Currently, the statute contains no basis for screening out those credit unions likely to fail as a result of such problems. In judging whether or not a charter should be granted, the commissioner lacks the authority to deny a charter based on criteria relating to field of membership or fitness of proposed management. In fact, the Act has no specific criteria or substantive standards for use by the commissioner in

making his determination, only the vague requirement that "all statutory requirements and regulations" must be satisfied.

In contrast, Texas laws governing the chartering of banks and savings and loan institutions establishes specific criteria for charter approval, including standards relating to public necessity or need for the institution, fitness of the proposed officials, good faith of applicants, and effect on existing associations. In addition, a survey of laws in other states showed that of the 47 states with state chartered credit unions, statutes in 41 of these impose substantive standards for determining whether a charter should be granted. Those standards most commonly included by other states are criteria involving qualifications of organizers or proposed officials (28 states); general criteria concerning need for the credit union and the probability of success or benefit to members (26 states); and criteria involving size, character or financial stability of the proposed field of membership (16 states).

The Credit Union Act should be amended to contain adequate chartering requirements to protect the public from credit union failures. Based on reasons for past failures, problems identified by the agency, other state acts and the Texas banking and savings and loan statutes, these should include criteria relating to: 1) the economic viability of the proposed credit union; 2) the character and general fitness of incorporators and proposed officials; and 3) the good faith of applicants.

Chartering Procedures. The current procedures for chartering of credit unions make no provision for public notice of pending applications nor for public hearings. The commissioner makes the determination to grant or deny a charter based only upon his review and investigation of the charter application, including the articles of incorporation, bylaws and biographical information on board members. In contrast, both the Banking Code and the Savings and Loan Act provide for notice and public hearing prior to the charter determination. The review identified a need for such procedural safeguards to ensure public participation in the chartering of credit unions as well, and particularly in the case of community credit unions. While many credit unions do not offer their services to the general public but only to a limited membership confined by some common characteristic such as place of employment, an increasing number of credit unions are "public" in that the only restriction on membership is residential. These community credit unions are organized to serve all residents or employees in a defined community or geographical area, and can significantly affect the operations of other financial institutions or credit unions whose membership is drawn

wholly or in part from that community. In these cases, it is especially important to ensure that the interested public is notified and guaranteed an opportunity to be heard.

In addition, the agency indicated that establishing procedures for public notice and hearing would help to ensure that, when necessary, the commissioner is alerted to certain facts which might not otherwise be uncovered in the course of his investigation. Amending the Credit Union Act to include provision for: 1) public notice of pending applications; 2) opportunity for any interested person to file exceptions and request a hearing; and 3) opportunity for incorporators to request a prior hearing would guarantee interested persons the opportunity to be heard and promote a full airing of all relevant facts.

Adoption of Guidelines as Rules. In considering requests for new charters, or plans for merger of existing credit unions, the agency is currently following a set of written policies developed by the staff and sanctioned by the commission which have not been formally adopted as rules. These relate generally to restrictions on credit union membership and provide guidance in interpreting the statutory "common bond" requirement. In addition, the review identified another area where the agency is using guidelines which have not been adopted as rules. In seeking a charter, incorporators are required to file a set of bylaws for the general operation of the credit union. In order to provide guidance to organizers of a new credit union and to ensure uniformity, the agency has issued standard bylaws for adoption by state chartered credit unions. While two sets of standard bylaws have been developed, one for community credit unions and one for all other credit unions, only those for community credit unions have been formally promulgated by the agency as rules and regulations.

The Administrative Procedure Act defines a rule as "...any agency statement of general applicability that implements, interprets or prescribes law or policy or describes the procedure or practice requirements of an agency" and sets out the procedures for adopting such rules. The informal policy statements and standard bylaws described above currently used by the agency seem to clearly fall within this definition. To comply with this requirement the board should initiate the formal adoption as rules of all informal policies and guidelines in order to comply with the requirements of the Administrative Procedure Act, and to afford the public and industry with adequate, equal notice of how the agency interprets and administers the provisions of the Credit Union Act.

Examination and Monitoring

The objective of the examination and monitoring activity of the agency is to protect the public by identifying unsafe or unlawful practices in the credit union industry. The Credit Union Act requires that an annual examination be conducted of each state chartered credit union. The examination assesses a credit union's compliance with laws and regulations and its financial condition. A written exam report, including the examiner's findings and any recommendations for corrective action, is prepared and must be furnished to the board within 30 days after the exam is completed. In addition to the regular exam, special exams may be required in the case of credit unions with high numbers of deficiencies. Agency monitoring of these problem credit unions may also involve review of monthly or quarterly reports required to be filed with the commissioner. In 1981, the agency conducted 515 regular exams, and 47 special or remedial exams.

In assessing the examination activity, the review covered the adequacy of communication between the field and the central office, the degree of supervision and control over examiners in the field, the adequacy of training of new examiners, the adequacy of the exam report, and the manner of conducting follow-up or special exams. Results of the review indicated that generally the agency is performing efficiently and effectively in each of these areas within the limits of available resources. The agency conducts examinations and prepares reports in a thorough and timely manner, meeting its statutory mandate to examine each state chartered credit union annually and to furnish exam reports to the board within 30 days.

Enforcement

The objective of agency enforcement activities is to prevent or halt violations of law or regulations, and unsafe or improper practices. Where problems or abuses are discovered in the course of an examination, the credit union is notified of the violations and, when appropriate, allowed an opportunity to correct the problems. Where problems persist, or if a credit union fails to take recommended corrective action, the commissioner may respond by issuing a letter demanding the practices or violations be discontinued. If stronger enforcement action is required, he may issue a cease and desist order, or an order of removal from office or employment of the offending individual. Criminal violations can be referred to local district attorneys for prosecution. Where necessary, the commissioner is authorized to suspend operations of a credit union and take possession of the assets. Should the interests of credit union members be seriously

jeopardized through insolvency or imminent insolvency, involuntary liquidation can be ordered. The review indicated that agency enforcement efforts generally serve to ensure an adequate level of public protection; however, a number of statutory changes were identified which would strengthen the enforcement efforts.

Grounds for Administrative Sanctions. Section 5.09 of the Act lists a number of grounds for applying administrative sanctions against credit union officers or employees, or the credit union itself. The review showed that these provisions fail to include certain types of misconduct which have seriously interfered with agency examination or enforcement efforts in the past, and involve a significant degree of potential harm to credit union members. These include: criminal acts by officials or employees; actions aimed at concealing information from the agency or falsifying data; or refusals to comply with an order of the commissioner.

H.B. 247, enacted by the 67th Legislature, authorizes occupational licensing agencies to impose sanctions against licensees on the basis of misdemeanor convictions relating to responsibilities of the licensed occupation. It further requires that upon a licensee's conviction of a felony offense, his or her license shall be revoked. In view of the close parallel between occupational licensees and officials or employees who operate or control state chartered credit unions, and whose conduct also involves potential harm to the public, the authority to administer sanctions based on related criminal acts should be available to the commissioner. Adding criminal acts as a ground for sanctions would bring the Credit Union Act into line with this legislative enactment and increase protection against unfit management.

Another area where the present law could be strengthened relates to misconduct by credit union officials during an examination. The agency identified a number of instances where actions by officials or employees, aimed at concealing or falsifying information, have seriously hindered agency examination efforts. Where this occurred, completion of the exam has been delayed at added expense to the credit union, and existing financial difficulties have increased. In at least one case, denial of access to records was one of a number of problems resulting in liquidation of the credit union. Providing the ability to respond with strong sanctions against this type of misconduct would protect against serious interference with the examination function.

A final concern relates to the agency's ability to effectively enforce final orders of the commissioner without the necessity for court action. Making refusal to comply with a final order the basis for stronger administrative action would

strengthen enforcement efforts and may prevent the need for court action. To strengthen the agency's enforcement efforts, the Act should be amended to include as grounds for administrative sanctions: 1) criminal acts relating to official duties; 2) refusal to permit or authorize examination of credit union books or records; 3) destruction, removal or falsification of books or records; and 4) refusal to comply with a final order of the commissioner.

Definition of Questionable Practice. The need for specific standards concerning business practices in the credit union industry is especially important in light of the fact that credit union officials perform functions involving custody and control of large amounts of customer assets, which often constitute the life savings of credit union members. Although "questionable practice in the conduct of the credit union's business," conducting business in an "unsafe, or unauthorized manner," and "breach of trust or fiduciary duty" are bases for issuing cease and desist or removal orders, what constitutes such practices has never been defined by the board in agency rules and regulations applicable to all credit unions. The agency indicated it is currently using a written set of standards of conduct in defining questionable practices, and agency rules promulgated for community credit unions outline to some extent what may constitute breaches of fiduciary duty, questionable and unsafe or unauthorized practices. The fact that these practices have not been defined in agency rules governing all credit unions, creates uncertainty and confusion, and increases the potential for successful challenge by an unscrupulous official to agency attempts to sanction conduct based on one of these grounds. The promulgation of rules and regulations defining questionable and unsafe or unauthorized practices, and breach of fiduciary duty would provide adequate notice to credit union officials and employees, as well as the general public concerning how the Act is interpreted and administered by the agency, and would assist in the enforcement of the Act.

Removal Authority. The review showed that mismanagement is a major problem in credit unions experiencing severe financial difficulties. In the event the conduct of a credit union official or employee threatens to cause insolvency of the credit union or other immediate and irreparable harm to the public, quick corrective action is needed against the offending individual to prevent further deterioration of the credit union's condition. Included among the enforcement powers of the commissioner is the authority to remove an official or employee from his or her position in the credit union in the event certain specified violations or improper practices are found. The Act provides, however, that the commissioner may not

issue a removal order unless he finds that a previously issued notice and demand for discontinuance is continuing to be violated. In situations where immediate harm is threatened, the delay involved in the requirement of first issuing a demand letter and finding continuing violations of that order before ordering actual removal can result in such a decline in the credit union's condition that rehabilitation is no longer possible.

The Savings and Loan Act provides precedent for giving the commissioner removal power which is exercisable without waiting for a demand for discontinuance to be defied. Expanding the statutory provisions governing removal orders to provide for immediate removal authority would strengthen the commissioner's ability to protect the public from conduct that threatens immediate and irreparable harm.

Appeal to the Board. Another area of concern noted during the review concerns procedures for review of a removal or cease and desist order of the commissioner. Basic principles of due process require that any determination of legal rights and principles be rendered by an impartial decision-maker removed from investigation of the case. Review of the current procedure for appealing an order of removal or cease and desist order issued by the commissioner identified the potential for abuse of this principle. Under the current process, on the basis of information derived from examinations or other contacts with the credit union, the commissioner determines whether credible and sufficient evidence of an unlawful or improper practice exists and whether a formal order will be issued. The Act provides for appeal of such orders; however, because the statute requires that appeal be made to the commissioner, the process results in an aggrieved party appealing the commissioner's decision to the commissioner. Amending the Act to provide a right of appeal to the board would guarantee a party aggrieved by a cease and desist or removal order of the commissioner a review by an impartial body clearly removed from the original decision. This guarantee currently exists under the Banking Code which provides for appeal from a cease and desist or removal order of the commissioner to the banking section of the Finance Commission.

Penalties for Violation of Final Orders. The penalty for violation of a final cease and desist or removal order of the commissioner is a civil fine assessed against the credit union. Upon failure to pay the fine assessed, the commissioner may institute a suit for collection. The review indicated that the penalty provision fails to adequately protect against continuing violations of final orders. Although instances of failure to comply with final cease and desist or removal orders have

occurred in the past, the agency has been reluctant to impose a fine which will be assessed against the credit union as a whole, when only a few individuals are responsible for continuing violations, and the credit union is in no condition to bear an additional financial burden.

Similar penalty provisions in the Banking Code and Savings and Loan Act dealing with violations of final cease and desist or removal orders provide authority to bring a suit to enjoin further violations and to impose fines on individuals. This same authority would be appropriate in the case of credit unions and the Act should be amended to authorize the commissioner to seek an injunction and provide that offending individuals in addition to the credit union may be subject to a fine.

Conservation. Under current statutory provisions, the commissioner is authorized to take possession and suspend operations of a credit union on the basis of certain findings, generally involving severe financial or other problems. In the event a credit union is placed in suspension, existing law provides only two options: the commissioner may approve the credit union's "plan to continue operations," or place the credit union in involuntary liquidation. The review showed that in practice a middle ground has been used by the agency in a number of instances. In these cases the credit union has been allowed to continue operations pursuant to a plan which provides for supervision of the credit union's activities by a conservator, appointed by the commissioner and subject to his control. The only statutory basis for the appointment is the commissioner's authority to approve a plan to continue operations. Since it is unclear whether or not that statutory authority properly extends to appointment of a conservator, in order to ensure that conservation efforts can be continued, a specific provision authorizing the appointment of a conservator is needed.

Without specific authority to appoint a conservator, attempts to improve the condition of failing credit unions cannot be consistently undertaken. In situations where the officers of a credit union resist outside supervision, conservation cannot be attempted over their disagreement. Experience has shown that conservation can be an effective method of preventing liquidation, and possibly could have prevented a number of liquidations occurring in the past, had a conservator been appointed at an early stage.

Precedent for this type of authority exists in other financial institution regulatory acts in Texas. For example, the Banking and Insurance Codes include conservation provisions which establish a means for rehabilitation of state chartered banks and insurance companies. Amending the statute to allow the

commissioner the option of appointing a conservator where necessary to rehabilitate a credit union that has been placed in suspension would provide increased protection against credit union failures.

Destruction of Records. The penal provisions of the Credit Union Act define criminal penalties for certain types of intentional misconduct by credit union officers, directors or employees which involve an especially grave threat of harm to the credit union and its members. These include the receipt by such individuals of commissions on loans, making loans to non-members or other loans in violation of the Act, agency rules or the bylaws. The review showed that in failing to provide criminal penalties for knowingly giving a false answer to an examiner, making false entries in books or records, and destruction or concealment of books and records for the purpose of concealing information from the department, the Act does not adequately protect against a common type of deception with potentially severe consequences and is out of line with the penal provisions of other financial institution regulatory statutes.

A review of the penal sections of the Banking Code and Savings and Loan Act showed that both these statutes include criminal remedies for false entries, and destruction of books and records. In addition, 19 other states criminally sanction one or both of these types of offenses. Precedent also exists in the Federal Credit Union Act which provides that the making of any false entry with intent to deceive is punishable by a \$10,000 fine and five years imprisonment.

The agency indicated that false entries and answers, and destruction of records are frequently encountered problems, sometimes with serious and far-reaching consequences both in terms of damaging the stability and soundness of the credit union and in hindering the agency's ability to conduct an effective examination. By including this type of misconduct in the penal provisions of the Act, another means of addressing these abuses would be available. Additional protection to credit union members might also be afforded as a result of the possible deterrent effect of criminal sanctions.

EVALUATION OF OTHER SUNSET CRITERIA

The review of the agency's efforts to comply with overall state policies concerning the manner in which the public is able to participate in the decisions of the agency and whether the agency is fair and impartial in dealing with its employees and the general public is based on criteria contained in the Sunset Act.

The analysis made under these criteria is intended to give answers to the following questions:

1. Does the agency have and use reasonable procedures to inform the public of its activities?
2. Has the agency complied with applicable requirements of both state and federal law concerning equal employment and the rights and privacy of individuals?
3. Has the agency and its officers complied with the regulations regarding conflict of interest?
4. Has the agency complied with the provisions of the Open Meetings and Open Records Act?

EVALUATION OF OTHER SUNSET CRITERIA

The material in this section evaluates the agency's efforts to comply with the general state policies developed to ensure: 1) the awareness and understanding necessary to have effective participation by all persons affected by the activities of the agency; and 2) that agency personnel are fair and impartial in their dealings with persons affected by the agency, and that the agency deals with its employees in a fair and impartial manner.

Open Meetings/Open Records

Meetings and activities conducted by the Credit Union Commission show general compliance with the requirements of the Open Meetings Act and the Open Records Act. The results of the review indicate that the Credit Union Act makes statements concerning the financial condition of a credit union confidential. A review of statutes of other state financial regulatory agencies indicates this provision is consistent with those Acts and should be retained.

EEOC/Privacy

A review was made to determine the extent of compliance with applicable provisions of both state and federal statutes concerning affirmative action and the rights and privacy of individual employees. The Credit Union Commission is operating under a current affirmative action plan which includes formal grievance procedures and personnel selection policies. The results of the review indicated that the agency performs adequately in this area.

Public Participation

In general, the review of public participation consists of an evaluation of the extent to which persons served by the programs and the general public have been kept informed of program activities, and the extent to which the program is responsive to the changing demands and needs of the public. The review indicated that adequate efforts have been made to inform the public and credit unions through the commissioner's monthly newsletter which goes to all state chartered credit unions and other interested parties. Recently, three public members were added to the Credit Union Commission to ensure the board is more receptive to public concerns.

Conflicts of Interest

Under state law, appointed state officers are subject to statutory standards of conduct and conflict of interest provisions. This includes, in certain circum-

stances, the filing of financial disclosure statements with the Office of Secretary of State. A review of the documents filed with the Secretary of State indicates that all commission members and the Credit Union Commissioner have filed adequate financial statements.

The results of the review indicated that the 67th Legislature amended the Credit Union Act to prohibit membership as a "salaried" officer, employee or paid consultant of a trade association. It was noted, however, that this provision does not prohibit two current commission members from serving as elected officials, without pay, to the Credit Union League, an association active in promoting the establishment and operation of credit unions in Texas. While no problems resulting from this overlapping membership were identified in this review, serving on the policy-making boards of both the regulatory body and the industry association creates the potential for undue bias towards the regulated industry. Amending this provision to include the Sunset Commission's across-the-board language which would prohibit commission members and department employees from serving either as a salaried or unsalaried officer, employee or paid consultant of a trade association in the credit union industry would eliminate any potential for conflicts of interest.

**NEED TO CONTINUE AGENCY FUNCTIONS
AND
ALTERNATIVES**

The analysis of the need to continue the functions of the agency and whether there are practical alternatives to either the functions or the organizational structure are based on criteria contained in the Sunset Act.

The analysis of need is directed toward the answers to the following questions:

1. Do the conditions which required state action still exist and are they serious enough to call for continued action on the part of the state?
2. Is the current organizational structure the only way to perform the functions?

The analysis of alternatives is directed toward the answers to the following questions:

1. Are there other suitable ways to perform the functions which are less restrictive or which can deliver the same type of service?
2. Are there other practical organizational approaches available through consolidation or reorganization?

NEED

The analysis of need and alternatives is divided into: 1) a general discussion of whether there is a continuing need for the functions performed and the organizational setting used to perform the functions; and 2) specific discussion of practical alternatives to the present method of performing the functions or the present organizational structure.

Function

After reviewing the basic sunset questions relating to need for a function, it was determined that sufficient reason exists for the state to regulate the credit union industry in Texas. The reasons for this determination are summarized in the material set out below.

Danger to the Public is Sufficient to Warrant Regulation. In determining the need for regulation of the credit union industry in Texas, an analysis was made of 1) whether the conditions that led to regulation of the industry in 1913 still exist; and 2) the possible harm to the public in the absence of regulation.

The first legislation in Texas providing for state regulation of credit unions was enacted in 1913 by the 33rd Legislature. This long history of regulation of credit unions as well as other financial institutions in this state reflects the quasi-public nature of these institutions. Since state chartered credit unions in Texas hold deposits totalling more than \$2.6 billion and serve more than 1.3 million members, assuring the soundness of these institutions through close regulation and supervision has long been considered in the public interest. The need for more comprehensive regulation as the number and volume of business of credit unions increased has continued to be recognized by subsequent amendments to the original Act which have provided for increased scrutiny of credit union practices.

In assessing the current need to continue to regulate the credit union industry, presently encompassing 500 institutions and over 1.3 million members, a number of factors were examined. A survey of other states revealed that 46 out of 50 states have state chartered credit unions. Credit unions in the remaining four states are chartered and regulated by the National Credit Union Administration, a federal agency. Since every state which charters credit unions also regulates them, it was not possible to compare regulated states to unregulated ones. An assessment of the continuing need and the potential harm to the public if there were no regulation of the industry was made, however, by examining the recent

history of credit union failures in Texas and other evidence of abuses which the current activities of the agency prevent or address.

Agency records show that over one-third of the 144 credit unions chartered in Texas within the last ten years have closed. Of the 49 that closed the majority failed to develop sufficiently to remain in business or suffered from severe financial or managerial problems. Fifteen of those that closed were merged with stronger credit unions, frequently at the recommendation of the agency. Thirty-four credit unions were placed in liquidation. The high failure rate indicates the severity of financial and other problems that significant numbers of credit unions can experience and suggests that considerable potential for harm to the public still exists.

In assessing the types and magnitude of abuses in the industry which can occur, a review was also made of the agency's monitoring list, consisting primarily of weak or problem credit unions that are subject to special monthly or quarterly reporting requirements. A review of the list showed that almost 100 credit unions are currently subject to such special monitoring, and of these almost one-half are also subject to dividend restrictions. Common deficiencies among such problem credit unions include: excessive delinquent loans, inadequate collection efforts, excessive loan losses, ineffective or questionable management, excessive expenses, poor lending and loan documentation practices, weak reserves and inadequate record-keeping.

Another possible indication of potential harm is the types of complaints received from the public. Agency records show that over the last four years from 25-37 complaints have been received annually. The agency's staff investigates complaints of such problems as improper denial of loan applications; miscalculated loan payments; improper closing of accounts; improper third-party withdrawals from accounts; and errors in crediting accounts.

The history of credit union failures and other evidence of current problems demonstrates that considerable potential for harm to the public still exists. In the absence of regulation of the industry, it is unlikely the possible harm would diminish; and in fact, it would likely increase without the deterrent effect of regulation, and in view of the increase in competitive pressures, the expansion of credit union services, the growing complexity of financial transactions and the increasingly volatile economic climate.

Based on the analysis of need it was determined that the need to perform many of the functions assigned to the Credit Union Commission still exists;

however, an independent board is not the only organizational approach available for performing these functions. Information available concerning the kinds of organizational structures created to regulate credit unions, banks, savings and loan associations and consumer finance companies in other states indicates numerous organizational approaches to regulating financial institutions. Texas is only one of three states with four separate departments to regulate each of the four types of financial institutions. In 30 other states all of the regulatory responsibilities for financial institutions have been consolidated in one agency and in 17 other states two or three agencies are responsible for financial regulation. The review also showed that the number of boards responsible for policy-making decisions and oversight of financial institutions regulation varied with 14 states having no policy-making boards, 18 states with one board, 11 states having two boards, and seven states, including Texas, having three to four boards. Texas is one of only 13 states with a council or board solely responsible for the regulation of credit unions.

ALTERNATIVES

Agency Reorganization

Based on the range of financial regulatory structures in other states and the current organization of financial regulation in Texas, consolidation with the Finance Commission was identified as a possible alternative to regulating credit unions through an independent board. To assess the advantages and disadvantages of this organizational alternative, the review sought to determine if consolidation or transfer of functions would provide a significant number of the following benefits: 1) regulation would be more consistent and uniform; 2) the costs of administration of the function would be reduced; 3) utilization of existing personnel, equipment, supplies and office space would be improved; 4) regulation would be simplified by a reduction in the number of agencies serving a similar population; 5) access to a greater range of services and level of expertise would be provided; and 6) increased accountability would result. The review determined that the benefits to be derived from the transfer of regulatory functions to the Finance Commission would depend on the degree of consolidation achieved by any of the following alternatives:

Transfer the functions to the Finance Commission with no substantive change in the commission's operations. Under this approach, the least comprehensive alternative for consolidation, the Credit Union Department's operations would be essentially unchanged, except that the Finance Commission would become the policy-making body and assume all statutory responsibilities currently assigned to the Credit Union Commission. Although the Finance Commission does not currently contain representatives of the credit union industry, the commission's composition could be changed to create a credit union section with oversight responsibility for the department. The primary benefit to be derived from this approach would be more consistent and uniform regulation. Some limited savings would probably be achieved by eliminating expenses associated with the present board.

Transfer the functions to the Finance Commission with some modifications to the commission's current structure. Under this approach, the Finance Commission's operations would be modified to create an agency that provides some administrative services, including budgeting, record-keeping, data processing, and personnel services. The individual departments under the Finance Commission as well as the Credit Union Department, would become divisions of the new agency,

retaining their authority in such matters as chartering, examinations and handling of complaints. Benefits to be derived from this approach would include more consistent and uniform regulation, reductions in the costs of administration achieved through better utilization of existing personnel, equipment, supplies and office space, and access to a greater range of services and level of expertise.

Transfer the functions to the Finance Commission with substantial modifications in the Commission's current structure. The third and most comprehensive organizational alternative would create a centralized agency that performs all regulatory functions and administrative duties. Under this approach the agency would be organized around the regulatory functions of administration, chartering, examinations and complaints rather than by type of financial institution regulated. A single administrator, appointed by the Finance Commission would be responsible for regulatory decisions on banks, savings and loan associations, credit unions and consumer finance companies. The greatest consistency in regulation and cost savings would be achieved under this alternative since a single administrator could ensure coordination of policies and the most efficient use of staff. In addition, the number of agencies the public would have to deal with would be minimized.

A survey of partially or fully consolidated financial regulatory agencies in 43 states conducted by the Kansas Legislative Post Audit Committee indicated that many of the potential benefits mentioned above were achieved with better use of staff, cost savings, more consistent and uniform regulation, greater efficiency of operations and exchange of information about different financial institutions cited most often. Frequently cited disadvantages of consolidated regulation included difficulties in balancing responsibilities in several areas and administering various operations within one agency, and the difficulty in one agency becoming knowledgeable in all areas of financial regulation. While this study confirms that improvements in efficiency and policy coordination resulting from consolidation may be at least partially offset by increased problems in coordination of operations, the fact that 30 states consolidate regulatory activities in a single agency suggests that the difficulties can be overcome. However, the extent of benefits that can be achieved through adoption of any of these organizational alternatives is dependent on the degree of consolidation chosen.

ACROSS-THE-BOARD RECOMMENDATIONS

CREDIT UNION COMMISSION

| Applied | Modified | Not Applied | Across-the-Board Recommendations |
|---------|----------|-------------|---|
| | | | A. ADMINISTRATION |
| X* | | | 1. Require public membership on boards and commissions. |
| X | | | 2. Require specific provisions relating to conflicts of interest. |
| X | | | 3. A person registered as a lobbyist under Article 6252-9c, V.A.C.S., may not act as general counsel to the board or serve as a member of the board. |
| X* | | | 4. Appointment to the board shall be made without regard to race, creed, sex, religion, or national origin of the appointee. |
| X | | | 5. Per diem to be set by legislative appropriation. |
| X* | | | 6. Specification of grounds for removal of a board member. |
| X* | | | 7. Board members shall attend at least one-half of the agency board meetings or it may be grounds for removal from the board. |
| X* | | | 8. The agency shall comply with the Open Meetings Act, and the Administrative Procedure and Texas Register Act. |
| X | | | 9. Review of rules by appropriate standing committees. |
| X* | | | 10. The board shall make annual written reports to the governor and the legislature accounting for all receipts and disbursements made under its statute. |
| X | | | 11. Require the board to establish skill oriented career ladders. |
| X | | | 12. Require a system of merit pay based on documented employee performance. |
| X | | | 13. The state auditor shall audit the financial transactions of the board during each fiscal period. |
| X | | | 14. Provide for notification and information to the public concerning board activities. |
| X | | | 15. Require the legislative review of agency expenditures through the appropriation process. |

*Already in statute.

Credit Union Commission
(Continued)

| Applied | Modified | Not Applied | Across-the-Board Recommendations |
|---------|----------|-------------|---|
| | | | B. LICENSING |
| | | X | 1. Require standard time frames for licensees who are delinquent in renewal of licenses. |
| | | X | 2. A person taking an examination shall be notified of the results of the examination within a reasonable time of the testing date. |
| | | X | 3. Provide an analysis, on request, to individuals failing the examination. |
| X* | | | 4. (a) Authorize agencies to set fees. (b) Authorize agencies to set fees up to a certain limit. |
| | | X | 5. Require licensing disqualifications to be: 1) easily determined, and 2) currently existing conditions. |
| | X | | 6. (a) Provide for licensing by endorsement rather than reciprocity. (b) Provide for licensing by reciprocity rather than endorsement. |
| | | X | 7. Authorize the staggered renewal of licenses. |
| | | | C. ENFORCEMENT |
| | | X | 1. Authorize agencies to use a full range of penalties. |
| X* | | | 2. Require files to be maintained on complaints. |
| X* | | | 3. Require that all parties to formal complaints be periodically informed in writing as to the status of the complaint. |
| | | X | 4. Specification of board hearing requirements. |
| | | | D. PRACTICE |
| | | X | 1. Revise restrictive rules or statutes to allow advertising and competitive bidding practices which are not deceptive or misleading. |
| | | X | 2. The board shall adopt a system of voluntary continuing education. |

*Already in statute.