

**Texas  
Sunset  
Advisory  
Commission**

**STAFF EVALUATION**

*Banking Department*

*Savings and Loan Department*

*Office of Consumer Credit Commissioner*

*Finance Commission*

*Texas Library and Archives Commission*

A Staff Report  
to the  
Sunset Advisory Commission



**BANKING DEPARTMENT**

## SUMMARY

The Banking Department was created in 1923 and is currently active. The agency's major functions include: 1) the annual examination of all state chartered banks and the monitoring of banks with deficiencies; and 2) enforcement efforts directed toward violations of the Act or unsafe or unsound practices. In addition to the supervision of state chartered banks, the Department of Banking also has responsibility for regulating: 1) sellers of prepaid funeral contracts; 2) perpetual care cemeteries; 3) sellers of money orders; and 4) certain mortgage banking institutions.

The results of the review indicated that the agency is generally operated in an efficient and effective manner. It was determined that the need to perform the functions of the agency still exists; however, the review showed that there are other regulatory alternatives which could be considered. The review also indicated that if the department is continued, several modifications should be made to improve its operations.

### Approaches for Sunset Commission Consideration

#### **I. MAINTAIN THE AGENCY WITH MODIFICATIONS**

##### **A. Agency operations**

##### **1. Overall administration**

- a. The department's policy concerning payment for unused sick leave should be modified so that it is consistent with the policies of most state agencies. (management improvement - non-statutory)
- b. The department should take steps to minimize agency funds held in demand accounts. (management improvement - non-statutory)
- c. Access to the department's postage meter should be limited to one or two employees assigned responsibility for ensuring that it is used only for official state mail. (management improvement - non-statutory)
- d. The agency should establish procedures for listing remittances in numerical sequence when the mail is opened to ensure that all checks received are properly accounted for. (management improvement - non-statutory)

- e. The department should determine whether proper reasons exist for establishing and maintaining a petty cash fund, specifically authorize such a fund, and institute appropriate controls over its use. (management improvement - non-statutory)
  - f. The agency should develop a written personnel manual which includes job descriptions and policies regarding vacation and sick leave, overtime, disciplinary and grievance procedures, travel and holidays. (management improvement - non-statutory)
  - g. The department's organizational structure should be modified to limit the scope of duties assigned to the departmental examiner. (management improvement - non-statutory)
2. Evaluation of programs
- a. The agency should initiate the formal adoption, as rules, of all bank examination fees. (management improvement - non-statutory)
  - b. Amend the statute to provide the banking commissioner with a full range of sanctions, including cease and desist and removal authority, and supervision and conservatorship provisions in connection with the regulation of trust companies. (statutory)
3. Evaluation of other sunset criteria
- a. Open Meetings/Open Records
    - 1. Amend the statute to exempt call reports and profit and loss statements from confidentiality requirements. (statutory)
    - 2. Agency policies should be changed to make bylaws and bank correspondence not related to the financial condition of a bank open to the public. (management improvement - non-statutory)
  - b. Conflicts of interest
    - 1. The Banking Code should be amended to require all employees to sign a notarized affidavit that they have

read the general conflict of interest statutes.  
(statutory)

2. All other informal departmental policies concerning conflicts of interest should be reduced to writing and included in a formal personnel manual. (management improvement - non-statutory)

## II. ALTERNATIVES

1. Transfer the regulation of prepaid funeral funds to the State Board of Insurance. Under this approach, the regulation of prepaid funeral funds would be transferred to an agency that already regulates another type of prearranged funeral fund: burial associations. The review indicated that problems have occurred in regulating deceptive advertising and solicitation practices of prearranged funeral funds as a result of the confusion resulting from the division of responsibility between two separate agencies. Transferring the regulation of prepaid funeral funds to the Board of Insurance would consolidate the regulation of prearranged funds within a single agency with the expertise, information, and regulations necessary for the enforcement of the Act.
2. Discontinue the regulation of certain mortgage banking companies.

This approach would eliminate existing regulatory requirements imposed on Texas mortgage banking institutions which have paid-in capital of from \$25,000 to \$100,000 and which are qualified to lend money under provisions of the Federal Housing Act. The review showed that these provisions were enacted in 1969 in order to meet certain federal requirements regarding FHA approved lenders. Because the FHA has substantially revised its standards for approved mortgagees, the agency indicated these provisions no longer serve their original purpose. It is estimated that less than one percent of all mortgage banking companies fall within the capital range specified, and only 15 companies are currently filing with the agency. The department rarely conducts examinations of these companies, routinely refers any complaints received to the Texas Mortgage Banker's Association and has taken no enforcement action against them.



**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

Prior to 1905, the banking industry in Texas was dominated by private and national banks because of a constitutional prohibition against incorporated state banks. While national banking had begun to develop very rapidly in Texas in the 1880's, many communities in the state were still without banking facilities and national banks could not always meet the needs of the state's largely rural population due to certain provisions of the national banking laws which excluded real estate as security for loans. In addition, the instability of and lack of control over the many private banks had become a source of growing concern. The first legislation providing for the organization and supervision of state banks was enacted by the 29th Legislature in 1905. The Texas State Bank Law placed responsibility for supervision of state banks with the executive head of the Department of Agriculture, Insurance, Statistics and History. In 1909, the State Banking Board was created and responsibility for the regulation, control and supervision of state banks was delegated to that agency which consisted of the attorney general, the commissioner of banking and insurance, and the state treasurer.

In 1923, legislation was enacted which created a Department of Banking and provided for the appointment of a banking commissioner by the governor. No major revision of the laws governing the state banking system occurred until 1943 when the 48th Legislature enacted the present State Banking Code. One of the most important changes from prior law that occurred at this time was the creation of the Finance Commission to serve as the policy-making body for the Department of Banking with responsibility for appointment of the banking commissioner and for oversight of the department's revenues and expenditures.

Under the code, the banking commissioner is charged with responsibility for administering and enforcing state banking laws, and serving as executive head of the Banking Department. The Banking Department is financed primarily from fee income deposited to an operating account outside the state treasury or invested in interest-bearing accounts. For calendar year 1982, the agency has a staff of 199 and an operating budget of \$6,403,886.

Regulation of the banking industry in Texas takes the general form used by most states. There are currently over 800 state chartered and 700 federally chartered banks operating in Texas with assets of over \$46 billion and \$101 billion,

respectively. The Banking Department is responsible for the regulation of all state chartered banks in Texas, and the U. S. Comptroller of the Currency regulates the system of national banks in the state. Both agencies conduct periodic examinations of their respective banks to determine their safety and soundness. In addition, the state chartered banks are subject to examination by one of two federal regulatory bodies. In its role as insurer of deposit accounts in all state banks in Texas, the Federal Deposit Insurance Corporation examines all state chartered banks which are not members of the Federal Reserve System. The Federal Reserve System examines those 46 state banks which have joined the system.

The major areas of responsibility of the Banking Department in regulating the state banking system include: 1) the annual examination of all state chartered banks and the monitoring of banks with deficiencies; and 2) enforcement efforts directed toward violations of the Act, or unsafe or unsound practices. In addition to the supervision of state chartered banks, the Department of Banking also has responsibility for regulating: 1) sellers of prepaid funeral contracts; 2) perpetual care cemeteries; 3) sellers of money orders; and 4) certain mortgage banking institutions. In contrast to other programs of the agency, revenues generated from fees relating to regulation of sellers of prepaid funeral contracts are deposited to a special fund in the state treasury and constitute the only part of the overall budget of the department subject to the appropriations process. For fiscal year 1982, appropriations to this program totalled \$158,003.

Each of the 835 banks chartered under state law is required to be examined annually by the department. Major objectives of the examination are to determine the bank's compliance with state laws and regulations, and to analyze and evaluate the bank's financial soundness. The examination focuses on such areas as the quality of loans and investments, adequacy of general operations, and performance of management. On conclusion of the exam, an exit conference is generally held with the board of directors of the bank to discuss the examiner's findings. Each examination results in a written report, including the examiner's comments and recommendations, a listing of violations of laws and regulations, and information relating to quality of the bank's assets. As a result of this review, a determination is made concerning the type or frequency of the next exam, and whether special monitoring of the bank is required. Well-run banks with a history of sound management and operation may receive a "limited" examination every other year, involving less in-depth evaluation of bank operations, assets and management. In

addition to the regular annual examination, in cases where serious problems exist, a bank may be subject to a follow-up examination or, more commonly, unannounced "visitations" by examiners to determine if previously identified problems have been corrected. Monitoring activities may also involve placing banks with deficiencies on special reporting status, or holding a conference with the board of directors in Austin. In 1981, the agency conducted a total of 1,047 examinations, approximately 55 percent of which were regular examinations, and 13 visitations. Currently, approximately 90 banks are under special reporting requirements.

The agency's examination program has recently been expanded to include areas in banking not previously addressed. Examination programs separate from the commercial bank examination program have been initiated for trust departments and companies and electronic data processing (EDP) services. Prior to 1980, in examining state banks for safety and soundness, the department did not regularly include operations of trust departments, nor had the commissioner exercised his statutory authority to examine independent trust companies. The objective of the trust examination activity initiated in 1980 is to evaluate the operations of trust departments and companies to determine compliance with applicable laws and, in the case of trust departments, to assess potential bank liability resulting from the trust operations. Also in 1980, the present EDP examination activity was initiated to evaluate a bank's internal controls surrounding the use of EDP services, and to ensure such services are being provided in accordance with applicable industry standards. Amendments to the Banking Code made in 1981 authorized the agency to examine national banks, banking affiliates or any other business that provides EDP services to state banks. In 1981, the agency conducted 37 trust examinations and 73 EDP examinations (including 27 joint examinations with federal authorities). Other amendments in 1981 authorized the department to accept federal examination reports, and made possible agency participation in a divided examination program with the Federal Deposit Insurance Corporation and the Federal Reserve Bank which also examine state banks. This program was started in 1982 and is directed to those banks in good condition without serious problems. It will involve approximately 90 percent of all state banks. Under the plan, half of these banks will be examined by the department and half by the federal examiners, with reports exchanged between the agencies. Those receiving examinations by federal examiners one year would be examined by the department the following year. The

program has significantly reduced the workload of the examination program, with corresponding reductions in examination personnel.

When violations of law or regulations, or unsafe or unsound practices are detected by the agency, it has a range of enforcement powers available to correct these practices. In most cases remedial action is recommended to the board of directors and the situation is corrected voluntarily without further action by the agency. Where a bank fails to take recommended corrective action, the commissioner can issue an order demanding the practices or violations be discontinued, and if stronger action is required, issue a formal cease and desist order. If problems persist, the commissioner can place the bank under supervision. If a bank under supervision of the department fails to comply with requirements imposed to correct conditions within a specified time, the commissioner can appoint a conservator. In severe cases, the commissioner can issue an order removing from office or employment an officer, director or employee. Finally, when the interests of depositors are seriously jeopardized through insolvency, involuntary liquidation can be ordered. From 1978 to the present, the commissioner has issued eight notices of determination, 11 cease and desist orders, and placed seven banks under supervision and six under conservatorship. Enforcement activities of the agency also involve investigating and resolving consumer complaints. The agency has maintained consumer complaint files since 1980, and has received approximately 227 complaints in 1980, and 358 complaints in 1981, all of which were resolved informally.

In addition to regulating the system of state chartered banks, the Banking Department has regulatory authority over sellers of prepaid funeral contracts, perpetual care cemeteries, sellers of money orders, and certain mortgage banking institutions. Major responsibilities involved in the regulation of prepaid funeral contracts include: 1) the issuance and annual renewal of permits to organizations desiring to sell prepaid funeral merchandise and services; 2) the annual examination of licensees to determine that funds collected on approved contracts are properly accounted for; and 3) the investigation and resolution of consumer complaints. There are currently 550 licensees regulated by the agency. In fiscal year 1981, the agency conducted 528 examinations of licensees and received approximately 24 complaints from consumers, all of which were resolved informally.

Agency regulation of perpetual care cemeteries involves: 1) the annual examination of perpetual care cemeteries to determine that the minimum deposits

required by statute are made in a perpetual care trust fund and that the net income from the fund is expended to maintain the cemetery property; and 2) enforcement activity, involving primarily the handling of consumer complaints. In 1981, the agency conducted 184 examinations of perpetual care cemeteries and 30 consumer complaints were received, all of which were resolved informally.

The commissioner's major duty in administering and enforcing the Sale of Checks Act is the issuance and annual renewal of licenses to individuals or businesses who desire to issue checks, drafts or money orders for a fee, with certain exceptions including banks and savings and loan associations. There are currently 33 sellers of money orders registered with the agency.

Finally, under current law, the commissioner is designated as the supervisory authority over Texas mortgage banking institutions qualified to lend money under provisions of the Federal Housing Act and which have paid-in capital of from \$25,000 to \$100,000. These institutions must file an annual statement of condition with the department and are required to be examined once a year. Since 1978, the agency has conducted three examinations of mortgage banking institutions. There are currently 15 filing an annual statement with the department.

The review and evaluation of the Banking Department 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 Banking Department 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 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 effective selection and removal process.

The Banking Department operates under the direction of the Finance Commission. The nine-member commission is divided into two sections: a six-member banking section and a three-member savings and loan section. Four members of the banking section must be banking executives and two members are appointed on the basis of recognized business ability. Primary responsibilities of the section include advising the commissioner on the department's operations and promulgating rules and regulations concerning state chartered banks. Recommended changes concerning the banking section are contained in the report on the Finance Commission.

### 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 Banking Code; 2) managing

agency fiscal affairs, data processing, personnel records, purchasing, inventory, and deposits and investments of revenue; and 3) budgeting for the agency. The review indicated that the agency is generally administered in an efficient manner. Although most agency revenues are not deposited to the state treasury, results of the review showed that the department is generally in compliance with the requirements placed on agencies controlled through the appropriations process. One major departure involves the agency's policy regarding payment of sick leave. In approving the 1982 budget, the Finance Commission authorized the department to pay employees with a minimum of five years employment for a percentage of unused sick leave upon termination of employment, with an increased percentage of sick leave subject to payment with added years of employment. Employees of state agencies under the appropriations process are not entitled to any sick leave pay upon termination of employment, except that in the case of the death of an employee, accumulated sick leave may be paid to his or her estate. Modifying the department practice to remove such payment privileges would bring agency policy into line with employment policies required of most state agencies as defined in the General Appropriations Act. In addition, a number of other areas were identified where changes in the agency's administrative procedures would result in more efficient and effective operations.

Investment Policies. The Banking Code authorizes the agency to maintain its fee revenues and other income in local bank accounts outside the state treasury. Revenues are deposited to demand accounts for the purpose of covering current operating expenses or invested in interest-bearing accounts. The review showed that the percentage of total funds held in demand accounts is excessive, resulting in a loss of interest earnings estimated at \$78,000 annually. A comparison of investment policies of the Banking Department with those of the Savings and Loan Department showed that while the rates of return on invested funds for the two departments were roughly comparable, the effective interest earnings when all funds are considered is substantially less for the Banking Department because of the large amounts held in non-interest-bearing accounts. By adjusting agency money management practices to minimize the funds held in demand accounts and investing an increased percentage of funds in high yield certificates, agency interest revenues would be significantly increased.

Internal Controls. The review identified inadequate internal controls as a problem in a number of areas of agency administration. One area of concern

involves the use of a postage meter in the Austin office. Currently, the meter can be used by all employees for the purpose of mailing official state mail. By limiting access to the meter to one or two employees assigned responsibility for ensuring that it is used only for official state mail, the agency could protect against possible misuse. A second area of concern relates to controls over the receipt of checks or remittances. Presently, when the mail is opened and sorted, some of the checks received are sent to various divisions for processing and then returned to the Chief Clerk's Office for deposit. In order to ensure that all checks received are properly accounted for and can be traced to final disposition, the agency should establish procedures for listing remittances in numerical sequence when the mail is opened. A final concern relates to procedures for purchasing stamps for field examiners and the agency's use of a petty cash or stamp fund. There are no policies concerning the maximum amount of cash that can be held in this fund and the review indicated that approximately \$500 in cash or stamps is generally maintained. The stated purpose of this fund is to purchase stamps which are supplied to field examiners upon request; however, the review indicated that stamps are also sold to agency employees for personal use and the fund is used to cash personal checks of employees. The agency indicated that no record of transactions is maintained. The review showed that the absence of written documentation of expenditures from this fund and the practice of purchasing stamps with cash from the fund are inconsistent with standards established for other state agencies by provisions of the General Appropriations Act. In order for the agency to comply with sound business practices and standards for the operation of state agencies regarding cash funds, the department should determine whether proper reasons exist for establishing and maintaining a petty cash fund, specifically authorize such a fund, and institute appropriate controls over its use, including proper documentation of all expenditures.

Personnel Manual. The review showed that the agency has no written personnel manual. Although written job descriptions for some positions have been developed, these are not available for all positions and have not been compiled in a formal manual endorsed by the commissioner. To ensure responsibilities are not neglected and that duties of each position are clearly defined and do not overlap, a formal manual with complete job descriptions should be developed. Adequate personnel procedures should also be included, such as policies regarding vacation and sick leave, overtime, disciplinary and grievance procedures, travel, holidays,

and conflicts of interest. Although general provisions of the annual departmental budget include certain employment policies, a number of important personnel procedures are not included and have not been reduced to writing.

Organizational Structure. Another area of concern identified in the review involves the agency's organizational structure, and more specifically, the scope of responsibilities assigned to the departmental examiner, one of four top management positions along with those of commissioner, deputy commissioner, and general counsel. Under the current structure, the departmental examiner is charged not only with responsibility for all facets of the examination function, including management, supervision and training of the field examination force, oversight of activities of assistant departmental examiners in Austin and the regional examiners in Houston and Dallas, review and quality control of all exam reports, and supervision and monitoring of problem banks; but this employee also has a number of responsibilities related to the supervision of administrative and support functions in the Austin office. These responsibilities include involvement in recruiting, resolving disciplinary problems, evaluating employees and administering the salary plan. In addition, he is responsible for decisions on the investment of agency funds, approves major purchases such as the acquisition of a computer, and authorizes major changes in accounting or bookkeeping procedures. Under the current organizational structure, a total of twelve staff members report directly to the departmental examiner, including the personnel director, the chief clerk and the accountant, as well as the four assistant departmental examiners, two regional examiners, the director of trust examination, and the director of EDP examinations. Possible disadvantages of the present organizational structure include difficulties in administering such a diverse range of activities, in becoming knowledgeable in all areas, and in balancing responsibilities for unrelated, complex functions. Modification of the organizational structure of the department to limit the scope of duties assigned to the departmental examiner and to separate the responsibility for supervision of administrative and support functions from responsibility for supervision of the examination functions would help to avoid such difficulties, and ensure efficient and effective administration and supervision of these agency activities.

### Evaluation of Programs

The review of the agency's program activities focused on the extent to which these activities achieve the objectives of the Banking Code: to protect the public

from unlawful and unsafe practices in the banking industry by examining and supervising state chartered banks. The review also sought to determine the extent of protection afforded the public by agency activities in regulating perpetual care cemeteries, sellers of prepaid funeral contracts, certain mortgage banking companies and sellers of money orders. Finally, the review assessed whether areas exist where additional efficiencies in operation could be achieved.

#### 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 banking industry. The Banking Code requires that an annual examination be conducted of each state chartered bank. The examination evaluates a bank's compliance with laws and regulations and its financial condition. Each examination results in a written report which is reviewed by headquarters personnel and a copy furnished to the board of directors of the bank. The agency may alternate the regular exam every other year with a "limited" examination, involving less extensive review and evaluation, in cases of well-run banks with a history of sound management and operation.

Agency monitoring of banks with problems involves a number of activities. In addition to the regular annual examination, a bank experiencing serious difficulties may be subject to a "follow-up" examination, or more commonly, to an unannounced "visitation" by examiners seeking to determine the progress made in correcting previously identified problems. In some cases, a meeting may be held with the board of directors in Austin to discuss problems and recommended action. Monitoring activities may also involve placing banks with deficiencies on a list of reporting banks, those required to periodically submit special reports to the commissioner, and possibly also on a list of "problem" banks, those classified as having severe or critical problems. In 1981, the agency conducted a total of 1,060 examinations and visitations. Currently, approximately 11 percent of all state banks have been placed on reporting status, and approximately one percent are classified as "problem" banks.

The agency's examination program has recently been expanded to include trust and electronic data processing examinations. The objective of the trust examination activity is to evaluate the operations of trust departments of banks and independent trust companies to determine compliance with applicable laws and in the case of trust departments, to assess potential bank liability resulting from

the trust operations. The EDP examination was initiated for the purpose of evaluating a bank's internal controls surrounding the use of EDP services, and to ensure such services are being provided in accordance with applicable industry standards. In 1981, the agency conducted 37 trust examinations and 73 EDP examinations.

In assessing the efficiency and effectiveness of the examination function, the review covered a number of areas including: the distribution of duties among examination personnel, the division of workload among the examination field force, the method of scheduling exams, the degree of supervision and control over examiners in the field, the system of communication between the field and the central office, examination procedures and documentation of procedures, format and quality control of the examination report, the method of establishing examination fees, and procedures for follow-up action on discovery of violations or abuses. Results of the review indicated that the agency is generally performing adequately in each of these areas. However, concerns were noted in two areas where the effectiveness of the agency's operations could be improved.

Examination Fees. The Banking Code charges the commissioner with responsibility for assessing and collecting a fee in connection with each state bank examination. In implementing this duty, the commissioner, on the basis of current cost studies, periodically sets fees to be charged all state banks. In September 1981, a graduated fee structure based on asset size was established. During 1981, examination fee revenues collected by the commissioner totalled \$5,216,548. The review indicated that examination fees are not adopted as rules and none of the procedural safeguards involved in formal rule-making are provided. The commissioner does not give public notice or limited notice to state banks of proposed fee changes, makes no provision for public or industry input, and beyond informing department examiners of changes, makes no publication of the revised schedule.

The Administrative Procedure Act defines a rule as "...any agency statement of general applicability that implements...law or policy" and sets out the procedures for adopting such rules. Examination fees to be applied to all state banks set by the commissioner in implementing his statutory duty to "assess and collect a fee in connection with each examination" clearly seem to fall within this definition. The agency should initiate the formal adoption as rules of all bank examination fees in order to comply with requirements of the Administrative Procedure Act, and in order to afford the general public and the banking industry with the

opportunity for comment on proposed changes, and full, adequate notice of current fees.

Trust Examinations. The present trust examination program was initiated by the department in 1980 with the objective of examining trust operations of banks and independent trust companies. Trust examination procedures have been developed and a staff of three examiners, headed by the director of the program, have been assigned responsibility for conducting these examinations. There are presently 15 active trust companies and 135 banks with trust departments in Texas. The statutory provision dealing with examinations of trust companies by the department authorizes, but does not require, the commissioner to examine each company annually and provides a penalty for refusal to submit to examination. The review indicated that the number and size of trust operations are growing rapidly in Texas, and with this growth, increased supervision of trust companies, including annual examinations, will be necessary. Potential harm to the public can result from such abuses as the failure to institute adequate procedures to protect assets of the trusts, and to discharge fiduciary responsibilities. Although the agency is not currently examining all trust operations annually, it indicated that plans are to examine every major trust operation by 1983, and in addition, to train commercial bank examiners in certain aspects of trust operations so that these can be covered in the course of the regular bank examination.

#### Enforcement

The objective of agency enforcement activities is to prevent or halt violations of law or regulations, and unsafe or unsound practices. Where problems or abuses are discovered in the course of an examination, the bank is notified of the violations, and generally allowed an opportunity to correct the problems. The agency employs a number of means of monitoring the progress of banks with problems, including requiring special reports from the bank or making unannounced visitations. Where a bank fails to take recommended corrective action, the commissioner is empowered to require that such corrective action be taken. The commissioner can issue a letter demanding the practices or violations be discontinued and if stronger enforcement action is required, issue a formal cease and desist order. In cases where serious problems exist, another sanction used by the commissioner is to place the bank under supervision. If a bank under supervision of the department fails to comply with requirements imposed to correct conditions within a specified time, the commissioner can appoint a conservator. In severe

cases, the commissioner can issue an order removing from office or employment an officer, director or employee. Finally, when the interests of depositors are seriously jeopardized through insolvency or imminent insolvency, involuntary liquidation can be ordered. From 1978 to the present, the commissioner has issued eight demands for discontinuance, 11 cease and desist orders, and placed seven banks under supervision and six under conservatorship. Enforcement activities of the agency also involve investigating and resolving consumer complaints. The agency has maintained consumer complaint records since 1980, received approximately 227 complaints in 1980, and 358 complaints in 1981, all of which were resolved informally. The review indicated that agency enforcement efforts generally serve to ensure an adequate level of public protection; however, one change was identified that would strengthen enforcement efforts involving independent trust companies.

Under Texas law, the banking commissioner is charged with responsibility for supervision of trust companies. The current system of regulation provides the commissioner with authority to examine these companies annually and to require the filing each year of a financial statement; however, it fails to provide the commissioner with authority to require corrective action or to apply formal sanctions to halt or prevent violations or unsafe, unsound practices which are discovered in the course of an examination. The lack of authorized sanctions available to the commissioner in supervising trust companies contrasts sharply with the wide range of sanctions available to him in regulating trust departments of banks, as provided under the Banking Code. Thus, although the activities of trust departments of banks and independent trust companies are the same, the two are subject to inconsistent systems of regulation. The review showed that the types of deficiencies and abuses identified in trust operations by department examiners include: 1) inadequate controls over trust operations by directors and/or senior trust committees; 2) violations of the Texas Trust Act; and 3) inadequate internal controls. To ensure the commissioner can adequately address such problems or abuses discovered in trust companies, the statute should be amended to provide a full range of sanctions, including cease and desist, and removal authority, and supervision and conservatorship provisions, comparable to those provided under the Banking Code and applicable to trust operations of banks.

### Non-bank Regulation

In addition to regulating the system of state banks, the Banking Department has regulatory authority over sellers of prepaid funeral contracts, perpetual care cemeteries, sellers of money orders, and certain mortgage banking institutions. Activities of the non-bank regulation program include: 1) the issuance and annual renewal of permits to funeral homes offering pre-arranged funeral contracts and to sellers of money orders; 2) examinations of perpetual care cemetery funds, prepaid funeral service funds, and certain mortgage banking companies; 3) approval of withdrawals from prepaid funeral service funds; and 4) enforcement activities, involving primarily the handling of consumer complaints. There are currently 550 sellers of prepaid funeral contracts and 33 sellers of money orders registered with the agency. There are also 201 perpetual care cemeteries and 15 mortgage banking companies regulated by the agency. The division responsible for non-bank regulation receives approximately 60 complaints from consumers annually, involving primarily perpetual care cemeteries and sellers of prepaid funeral contracts. These are generally resolved informally.

The review showed that non-bank regulatory activities of the agency are generally conducted in an efficient and effective manner; however, improvements can be made in the division's procedures for handling complaints. The agency generally requests that all complaints be made in writing, and keeps the written complaints and related correspondence in the division's regular correspondence files. Complaints are not logged in and separate files are not maintained for all complaints. The Sunset Commission has developed an across-the-board recommendation for the handling of complaints which directs an agency to keep an information file concerning each written complaint received. The agency has indicated the division would take steps to implement this procedure and to maintain a log of all complaints.



**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 dealing with persons affected by the agency and that the agency deals with its employees in a fair and impartial manner.

### Open Meetings/Open Records

Review of the agency's compliance with the Open Meetings Act indicates that the agency has made timely filings with the Secretary of State's Texas Register Division providing appropriate notice of its meetings. An area of concern identified in reviewing the agency's compliance with the Open Records Act involves three types of bank records which under current agency policy are considered confidential: 1) bylaws; 2) call reports and profit and loss statements; and 3) bank correspondence files. The Open Records Act specifies that agency records are generally open to the public, but lists a number of specific exceptions to that rule. Included among the list are particular exceptions for information contained in or related to bank examination, operating or condition reports, and a general exception for information deemed confidential by a specific statute. The Banking Code makes confidential "all information obtained by the department relative to the financial condition of state banks." Since the bylaws or rules for the general operation of a bank are not relative to the financial condition of a bank and thus not exempted by provisions of the Code or the Open Records Act, and no reason was identified for requiring they be withheld, these should be made available to the public. Second, although call reports and profit and loss statements specifically relate to the bank's financial condition, the information contained in these reports is available from the federal bank regulatory authorities and often from the bank itself. Since this information is in effect already public, the statute should be amended so that call reports and profit and loss statements are exempted from confidentiality requirements. Finally, under existing agency policy, all bank correspondence files are considered closed even though some items in the files may not relate to the financial condition of the bank, and are not required to be closed by provisions of the Banking Code. No reason was identified as to why these should be considered confidential by the department. In order to

comply with the Open Records Act, the agency should maintain separate correspondence files, with only those items directly related to the financial condition of the bank made confidential.

### 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 individuals. The Banking Department is operating under a current affirmative action plan. The review indicated that although a formal grievance procedure has been developed, the commissioner has not acted upon it. This policy needs to be approved and included in a personnel manual along with other personnel policies and made available to all departmental employees. The review also indicated that the agency has experienced extremely high employee turnover during the period under review. Between 1976 and 1981 the turnover rate increased from 17.6 percent to 39.1 percent. Most of this turnover is concentrated among the examination staff and the reasons for the high rates include: 1) the tendency of banks and other financial institutions to hire bank examiners, particularly minorities and women at substantially higher salaries; 2) with growth of the banking industry, the increased demand for bank management personnel; 3) the amount of travel required; and 4) the amount of overtime or night work required. Steps being taken to reduce this turnover include efforts to improve working conditions, for example by spreading the travel burden more evenly among the field force; providing an extensive training program, including the opportunity to attend graduate banking schools; and efforts to improve communications between the field force and headquarters staff.

### Public Participation

In general, the review of public participation consists of an evaluation of the extent to which persons served by the department and the general public have been informed of agency activities and the extent to which the agency is responsive to the changing demands and needs of the public. The review showed that public information efforts are generally directed to the persons served by the agency and include: 1) seminars held by the commissioner to inform bankers concerning the activities of the agency and changes in the banking statutes, and to answer questions; and 2) publication of a list of all amendments to the articles of association of state banks and the annual consolidation report of bank operations in

the Texas Bankers Record which is circulated to members of the Texas Bankers Association.

### Conflict of Interest

Under state law, appointed state officers are subject to statutory standards of conduct and conflict of interest provisions. This includes, in certain circumstances, 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 the Banking Commissioner has filed adequate financial statements. The review also showed that the agency has procedures for making employees aware of their responsibilities under general conflict of interest statutes. Although new employees receive copies of these standards, there is no requirement that the employees sign an affidavit that they have read these statutes. Because of the importance of proper notification to new employees, the agency's statute should be amended to require all employees to sign a notarized affidavit that they have read these conflict of interest statutes.

The review indicated that department employees are also subject to conflict of interest provisions contained in the Banking Code which provides that any employee who becomes indebted to or financially interested in any state bank, directly or indirectly, commits a misdemeanor offense. In interpreting this provision, the agency follows an unwritten policy that prohibits an employee or his or her spouse, from any ownership of or indebtedness to a state bank, and prevents the spouse of an employee from working in a state bank. Agency policy relating to conflicts of interest also precludes sending an examiner into a state bank in which the examiner had recently worked or in which any family member has an interest. In addition, the agency indicated it presently follows some unwritten rules on accepting gifts and favors from bank officials or employees, but recognizes the need to further define these rules and to address existing "gray areas." A personnel advisory committee composed of staff members has been charged with further development and clarification of agency policy with respect to conflicts of interest. To ensure that all examiners are fully informed of what is considered appropriate conduct in this regard and to provide maximum protection against potential abuses in this area, policies developed should be reduced to writing and included in a formal personnel manual.



**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 banking industry in Texas. The reasons for this determination are summarized in the material set out below.

Danger to the Public Sufficient to Warrant Regulation. In determining the need for regulation of the banking industry in Texas, an analysis was made of 1) whether the conditions that led to regulation of the industry in 1905 still exist and 2) the possible harm to the public in the absence of regulation.

Although a state banking system was not established in Texas prior to 1905 due to a constitutional prohibition, private and national banks did exist prior to that time. The establishment and regulation of state banks was initiated in 1905 because the existing banks did not meet the needs of the state's citizens and the state could not control abuses which occurred in the unregulated banking industry. This long history of regulation of banks as well as other financial institutions in this state reflects the quasi-public nature of these institutions. Since state chartered banks in Texas hold deposits totalling more than \$38 billion, assuring the soundness of these institutions through close regulation and supervision has long been in the public interest. As the number and volume of business of state banks has increased, the need for more comprehensive regulation has continued to be recognized by subsequent amendments to the original Act. These amendments created a separate regulatory agency and extended the supervisory powers of the commissioner in order to provide increased scrutiny of banking institutions.

In assessing the current need to continue to regulate the banking industry, which includes 835 institutions, a number of factors were examined. Because every state regulates its banking industry, the review could not compare regulated states with non-regulated 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 evidence of abuses which the current activities of the agency prevent or address. The review indicated that common problems identified during the examination process include low liquidity levels, excessive delinquent loans, deficient loans, improper loans such as those in excess of legal loan limits, insufficient levels of equity capital, improper accounting procedures, and deficiencies in management.

Another indication of potential harm is the types of complaints received from the public. Agency records show the department received 358 complaints in 1981. The agency staff investigates and informally resolves complaints in such areas as loan defaults and repossession charges or procedures, overdue loan payments, improper service charges, and discrepancies or delays in crediting accounts.

The evidence of current problems addressed by the agency's program of examination and supervision demonstrates that considerable potential for harm to the public still exists. In the absence of regulation of the industry, it is unlikely that 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 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 Banking Department still exists; however, alternatives to the agency's current procedures in two areas have been identified. Alternatives to the current agency structure are discussed in detail in the report on the Finance Commission.

## ALTERNATIVES

### Changes in the Method of Regulation

Discontinue the Regulation of Certain Mortgage Banking Companies. Under current law the banking commissioner is designated as the supervisory authority over certain Texas mortgage banking institutions. The Act provides: "Any Texas mortgage banking institution that has actually paid in capital of not less than \$25,000 and up to but not including \$100,000 and is qualified to lend money under provisions of the Federal Housing Act is subject to inspection and supervision by the Banking Commissioner of Texas." These companies must file an annual statement of condition with the commissioner and are required to be examined by the department once a year.

The review showed that these provisions were enacted by the 61st Legislature in 1969 in order to meet certain federal requirements regarding FHA approved lenders and were never intended to establish a system of regulation over the mortgage banking industry as a whole. From information available, at that time FHA requirements for approved lenders mandated this type of governmental supervision of mortgagees with paid-in capital of less than \$100,000. Because the FHA has substantially revised its standards for approved mortgagees, the agency indicated these provisions no longer serve their original purpose. Under the current FHA requirements all classes of approved lenders must have a net worth of at least \$100,000.

Within the mortgage banking industry, it is estimated that less than one percent of all companies fall within the \$25,000 to \$100,000 capital range specified. Only 15 mortgage banking institutions of this type are currently filing with the agency. The department rarely conducts examinations of these companies, routinely refers any complaints received to the Texas Mortgage Bankers Association and has taken no enforcement action against them. In addition to self-regulation by the state Mortgage Bankers Association, the industry itself is highly supervised at the federal level, and must comply with regulations of such agencies as the FHA and VA. The review also indicated that most mortgage banking companies are heavily bonded.

Transfer the regulation of prepaid funeral funds to the State Board of Insurance. Under the Banking Code, sellers of prepaid funeral contracts, who accept payments from purchasers for funeral services or merchandise to be

delivered at a future date, are required to handle the funds collected in accordance with certain requirements. The Banking Commissioner is charged with responsibility for issuing permits to the sellers of prepaid funeral contracts and examining the funds collected under the contracts to ensure they are being handled as prescribed by statute. The review showed that the Board of Insurance is also currently involved in the regulation of the prepaid funeral service industry through the regulation of burial associations which provide burial or funeral benefits of not more than \$150 payable in merchandise and services. The Board of Insurance approves the policies issued by these associations, adopts a schedule of rate charges, examines financial statements and audits association records. The board, in its self-evaluation report to the Sunset Commission, indicated that problems have occurred in regulating deceptive advertising and solicitation practices for prearranged funeral funds as a result of the confusion resulting from the division of responsibility between two separate agencies. Transferring the regulation of prepaid funeral funds to the Board of Insurance would consolidate the regulation of prearranged funeral funds within a single agency with the expertise, information and regulations necessary for the enforcement of this Act.

## **ACROSS-THE-BOARD RECOMMENDATIONS**



## BANKING DEPARTMENT

Applied	Modified	Not Applied	Across-the-Board Recommendations
<b>A. ADMINISTRATION</b>			
X		X	1. Require public membership on boards and commissions.
			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.
			9. The board shall make annual written reports to the governor and the legislature accounting for all receipts and disbursements made under its statute.
X			10. Require the board to establish skill oriented career ladders.
X			11. Require a system of merit pay based on documented employee performance.
X*			12. The state auditor shall audit the financial transactions of the board during each fiscal period.
X			13. Provide for notification and information to the public concerning board activities.
X			14. Require the legislative review of agency expenditures through the appropriation process.

\*Already in statute.

**Banking Department**  
(Continued)

Applied	Modified	Not Applied	Across-the-Board Recommendations
			<b>B. LICENSING</b>
		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.
		X	(b) Provide for licensing by reciprocity rather than endorsement.
		X	7. Authorize the staggered renewal of licenses.
			<b>C. ENFORCEMENT</b>
		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.
			<b>D. PRACTICE</b>
		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.