

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 white, bold, 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

STATE DEPOSITORY BOARD

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 State Depository Board, created in 1919, is currently active. The board's responsibilities include: 1) selecting banks which serve as depositories for state funds; 2) establishing the allocation of state funds between demand deposits and time deposits; 3) establishing the rate of interest to be paid the state on time deposits; and 4) investing the permanent funds for the Texas School for the Blind, Texas School for the Deaf, the Austin State Hospital and the State Orphans' Home.

The results of the review indicated that the board has been generally effective in carrying out its responsibilities regarding state funds. Based on an analysis of need, it was determined that the need to perform many of the functions of the Depository Board still exist; however, an independent board is not the only organizational approach available. The review also indicated that if the board was continued, several modifications should be made which would improve the efficiency and effectiveness of the board's operations.

Approaches for Sunset Commission Consideration

I. MAINTAIN THE BOARD WITH MODIFICATIONS

A. Policy-making structure

1. The composition of the board should be modified to include the comptroller and two additional public members. (statutory)

B. Agency operations

1. Demand accounts should be limited to banks designated as centrally located depositories. (statutory)
2. The board should adopt a formula for establishing the interest rate on state funds deposited in time-open accounts. (management improvement/non-statutory)
3. The authorized investment alternatives for state funds should be expanded to include U. S. Treasury bills. (statutory)
4. The treasurer should take immediate steps to ensure that all state funds are properly collateralized and that, in the future, funds are not deposited to banks without sufficient approved collateral. (management improvement/non-statutory)
5. The agency should identify all depositories whose account balances exceed the maximum approved amount and request that these banks submit an amended application for approval by the

State Depository Board. (management improvement/non-statutory)

II. ALTERNATIVES

A. Agency reorganization

1. **Abolish the board and transfer the functions to the state treasurer.**

This approach would be consistent with that used in a majority of states. Under this alternative the treasurer would be responsible for determining which banks would be used as state depositories and what interest rate would be paid on state funds. Information developed in the review indicated that the transfer of functions to the treasurer would not result in significant changes in how the statutes governing state depositories are administered; however, the current check and balance process designed to prevent unlimited discretion on the part of the treasurer would be eliminated.

B. Changes in current procedures

1. **Reducing the collateralization requirements.**

Under this approach the collateral rate for state funds would be set at 100 percent of par or market value. This change would be consistent with the collateralization requirements in many states and would reduce the costs of state depositories holding public funds. However, reducing the collateralization requirements would require more frequent re-evaluation of pledged collateral by the treasurer's staff thus increasing the cost to the state.

2. **Bidding on state deposits.**

Adoption of this alternative would permit the State Depository Board to determine rates for time deposits on the basis of competitive bid. A survey of other states indicated that competitive bidding is the most commonly used method of allocating funds to demand or time deposits. The experience of state agencies with funds held outside the treasury and invested on the basis of competitive bid compares favorably with the yield on state funds invested by the treasurer.

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 laws providing a system of state depositories in Texas were enacted in 1905. It was the duty of the state treasurer to designate a banking institution in each senatorial district, on the basis of the highest bid, to act as a state depository. The State Depository Board, consisting of the state treasurer, the attorney general, and the commissioner of insurance and banking was created by the 36th Legislature in 1919. The board was authorized to select a sufficient number of banks, offering the highest rate of interest to keep all state funds, from a list of bids submitted by banks applying to act as a state depository. The board was also responsible for establishing rules and regulations governing the establishment and conduct of state depositories and for approving the securities or bonds offered as collateral for state funds.

In 1923, the state abandoned the procedure of awarding state funds on the basis of the highest bid and established the Texas Rate Making Board, composed of five citizen members, charged with responsibility for meeting once each year to set the rate of interest to be charged for state funds for the succeeding year. The State Depository Board continued to be responsible for selecting the banks to be designated as state depositories and for approving the securities used to collateralize state funds. In 1927 the Texas Rate Making Board was abolished and the rate to be charged state depositories was set in statute. In 1933 the statute was changed authorizing the State Depository Board to establish the interest rate to be paid on state funds. This procedure is currently used by the state. With the exception of a change in the board's composition to substitute a citizen member for the attorney general in 1963, the statutes governing the board have remained relatively unchanged from the 1930's to the present time.

The State Depository Board, created in 1919, is currently active. The board is composed of three members: the state treasurer; the banking commissioner; and a citizen member appointed by the governor with the consent of the senate for a two-year term. Support services for the board are provided by the staff of the Treasury Department. Travel expenses for the public member are funded by general revenue appropriations to the treasury.

The board's responsibilities include: 1) selecting banks which will serve as depositories for state funds; 2) establishing the allocation of state funds between

demand deposits and time deposits; 3) establishing the rate of interest to be paid the state on time deposits; and 4) investing the permanent funds for the Texas School for the Blind, Texas School for the Deaf, the Austin State Hospital and the State Orphans' Home.

Texas is one of only 17 states which use an appointed board to establish investment policies. In most of the remaining states, investment policies are established by an elected or appointed official, usually the state treasurer.

Currently, more than 1,400 banks have been approved as state depositories. Statutory designation of depositories is for a two-year period beginning in November of each odd-numbered year. The state treasurer is responsible for depositing funds to these depositories on a fair percentage basis. An authorized exception to this rule is the use of centrally located depositories designated by the board as clearing banks. There are currently 18 banks located in Austin, Dallas, Ft. Worth, Houston and San Antonio with this designation. These banks generally hold approximately 50 percent of the state's time deposits and 95 percent of the demand deposits. The demand accounts held in these banks are the basic working accounts of state government. These banks clear all warrants and process state revenues. The remaining funds are allocated to the other state depositories with all banks receiving a \$5,000 demand deposit and most banks holding at least \$100,000 in time deposits. The treasurer attempts to keep as high a percentage as possible of state funds invested in interest bearing time accounts. Recent figures provided by the treasurer indicate that more than 98.6 percent of state funds is invested in time accounts.

Between 1977 and 1982 (the period covered by the review), the board met 19 times; on 16 occasions the interest rate to be paid on state funds was adjusted. The average rate of return achieved on invested funds during this period was 10.52 percent. The interest rate is determined by the board after reviewing a matrix containing factors such as current rates on certificates of deposit, U. S. Treasury bills, the prime rate, the federal funds rate, and the discount rate. The last rate change during the period under review occurred on June 1, 1982, when the rate was set at 12.75 percent.

The board is also responsible for the investment of the permanent funds of certain eleemosynary institutions such as the Texas School for the Blind, the Texas School for the Deaf, the Austin State Hospital and the State Orphans' Home.

These funds, which total \$609,000, have been invested in U. S. Treasury bills and notes at the board's direction.

The review of the State Depository Board indicated that the board has been generally effective in carrying out its responsibilities regarding state funds. However, a number of areas were identified where modifications would increase the efficiency and effectiveness of board activities. 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 fairly reflects 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 affected by the agency's activities; and that the viability of the body is maintained through an effective selection and removal process.

The review of the policy-making structure focused on whether the board has an appropriate representational make-up and size to carry out its role effectively. The primary role of the board is approving all applications of banks designated as state depositories and determining the interest rate to be charged for state funds. Given these responsibilities, the review indicated that the board's current composition could be improved in two ways.

First, the board's current composition includes the treasurer, the banking commissioner, and one public member. Texas is one of a number of states where responsibility for the fiscal concerns of the state is divided between two or more agencies. In Texas the comptroller is the chief fiscal officer of the state. His or her responsibilities include maintaining the fund accounting records of the state; ensuring that all vouchers for payment of warrants are consistent with the authority granted in the State Appropriations Act; issuing warrants against the various state funds; and directing the collection of all monies due the state. The treasurer's responsibilities as custodian for all operating funds and trust and suspense funds deposited to or held by the treasury include: paying all warrants drawn by the comptroller on the treasury; receiving and depositing all state

revenues on warrants of the comptroller; and accounting for all receipts and expenditures of all public funds held by the treasury. Since there are a number of areas where the cooperation of the treasurer's and comptroller's offices enhances the management of state funds, the addition of the comptroller to the board would provide the board with the expertise of both of the officials charged with responsibility for the state's fiscal affairs. In addition, expanding the board to include two additional public members would provide greater public input into decisions which directly affect the taxpayer.

Overall Administration

The evaluation of the overall agency administration 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 cash resources, and which satisfies reporting and management requirements placed on the agency and enforced through other state agencies.

The review of the State Depository Board indicated that there is no overall agency administration in the general sense. Administrative functions are limited to the processing of travel vouchers for the one citizen member and are provided by the staff of the State Treasury Department.

Evaluation of Programs

The State Depository Board was created to provide direction in the management of state funds. Functional responsibilities assigned to the board include approving banks to serve as depositories for state funds; ensuring that funds deposited to these banks are adequately collateralized, establishing the interest rate to be charged for state funds invested in interest-bearing accounts and investing the permanent funds of certain eleemosynary institutions. Since the objectives of any money management program should be to maximize yield while minimizing risk and maximizing liquidity, the review of this agency focused on the degree to which the policies established by the board achieve these objectives.

Maximizing Yield.

The State of Texas maintains its uninvested or idle cash in demand deposit "checking" accounts. The demand accounts serve two purposes in the management of state funds: 1) to reimburse banks for services rendered; and 2) to provide liquidity in state asset management since, unlike time deposits, these funds can be withdrawn without prior notice. Texas currently maintains more than 1,400 demand accounts throughout the state. This policy is in response to the statutory

provision in Article 2532, V.A.C.S., which provides that the treasurer deposit state funds as far as is practical on a fair percentage basis. However, the majority of state funds are currently invested in time-open accounts of varying maturities at most commercial banks approved as state depositories.

Number of Demand Accounts. Texas currently utilizes 1,468 banks as state depositories, and the number continues to grow at approximately three percent annually. All but 52 of these banks have state funds deposited to demand accounts which, except for the 18 designated clearing banks, total \$5,000 each. A survey of the number of demand accounts in selected states, conducted by the Council of State Governments in 1982, (Exhibit 1), indicates that this number is more than four times greater than any other state surveyed. Of the states surveyed, only 12 (29 percent) utilized more than 49 demand accounts.

Analysis of the funds held in more than 1,400 of these state depositories indicated that approximately one percent of all funds was held in demand accounts. Seventy-seven percent (\$23.3 million) of the funds were deposited to demand accounts in the 18 designated clearing banks. The remaining funds in demand accounts were dispersed among 1,398 accounts containing \$5,000 each. An analysis of the activity in these accounts indicated that most had not had any activity in more than 90 days. Although the total amount of state funds invested is currently very high, these small accounts totalling \$7,000,000 represent idle funds which could be invested to maximize the state's investment yield.

Under the current statutes, there are no limits to the number of demand accounts which can be established. The maintenance of 1,400 demand accounts holding \$5,000 each, is inefficient and results in the loss of \$1,000,000 annually at current interest rates. Since the activity in the state's demand accounts is, in practice, limited primarily to the 18 clearing banks, amending the statute to limit demand accounts to banks designated as centrally located depositories would reduce the work associated with the management of such a substantial number of inactive accounts and would maximize interest income to the General Revenue Fund.

Exhibit 1
DEMAND DEPOSIT ACCOUNTS IN SELECTED STATES

<u>State</u>	<u>Number of Banks Used for Demand Deposits</u>
Alabama	319
Arizona	1
Arkansas	15
California	8
Colorado	1
Connecticut	16
Delaware	1
Florida	4
Georgia	50
Hawaii	8
Idaho	26+ branches
Illinois	3
Indiana	15
Iowa	6
Kansas	1
Kentucky	1
Louisiana	1
Maine	3
Maryland	1
Massachusetts	5
Michigan	254
Minnesota	225
Mississippi	6
Missouri	270
Montana	161
Nebraska	49
Nevada	2
New Hampshire	12
New York	145
North Carolina	200
Ohio	3
Oregon	16
Pennsylvania	28
Rhode Island	13
Tennessee	360
Texas	1,406
Utah	165
Vermont	3
Virginia	177
Washington	1
West Virginia	6
Wisconsin	2
Wyoming	1

Source: Council of State Governments, 1982.

Establishing the Interest Rate for State Funds. Since 1933, one of the primary responsibilities of the State Depository Board has been establishing the interest rate charged for state funds invested in interest-bearing accounts. Between fiscal years 1978 and 1981, the board met 19 times and adjusted the interest rate on 16 occasions. The average rate of return achieved on invested funds during this period was 10.52 percent. The interest rate is determined by the board after reviewing a matrix containing factors such as current rates on certificates of deposit, U. S. Treasury bills, the prime rate, the federal funds rate, and the discount rate. Statistical analysis of the factors used to set the rates during the period under review indicates that the average rate on U. S. Treasury bills is the greatest predictor of the rate established by the board under its current procedures.

The results of the review indicated that the board is currently considering adoption of one of several formulas for establishing the interest rate. A comparison of the rates that these formulas would have yielded over a 51-month period with the rate actually adopted by the board indicated that in four out of five instances the weighted average rate of return by these formulas exceeded the actual rate by 39 to 93 basis points. With the state's cash balance currently in excess of \$2.5 billion, the use of most of these formulas would have resulted in additional interest income of approximately \$10 to \$23 million annually. The adoption of a formula could be utilized to adjust the interest rate at weekly or monthly intervals by the treasurer's staff, rather than requiring formal meetings of the board, and would provide greater interest rate sensitivity and should result in substantially greater interest income to the General Revenue Fund.

Investment Authority. Texas statutes currently restrict the investment of state funds to interest-bearing accounts in commercial banks. The results of the review indicate that depositories are not always willing to accept state funds. During a recent three-month period, 15 time deposits totalling \$17.7 million were refused by state depositories. Under current law, the only alternative to placing funds in state depositories is holding them in the vault of the treasury. A survey of 35 other states, (shown in exhibit 2), indicated that no other state was as restrictive in its investment authority. Review of the statutes governing city and county depositories indicates that local governments can invest in U. S. government obligations. A study of investment practices of local governments published by the Texas Advisory Council on Intergovernmental Relations indicates that a

number of cities are reported to use repurchase agreements for short-term investments. Expanding the authorized investment alternatives for state funds to include U. S. Treasury bills would provide the treasurer with a risk-free alternative for the investment of state funds when state revenues exceed the approved collateral on deposit or when banks choose not to accept state funds.

Minimizing Risk

Uncollateralized Deposits. In Texas, state funds are required by statute to be collateralized by pledging specified types of securities such as municipal bonds or guaranteed U. S. government bonds or by depositing a surety bond. Currently, most depositories pledge securities as collateral for state funds. Treasury Department records indicate that 47 percent of state deposits are collateralized with municipal bonds, 42 percent with U. S. Treasury, federal agency and state senior college securities, and 11 percent with State of Texas and other securities.

The review of treasury records to determine compliance with the statutory provisions concerning collateralization indicated that on June 9, 1982 more than \$68 million in time and demand deposits in more than 110 state depositories was uncollateralized. Review of the same information on June 24, indicated that more than \$213 million deposited in 42 banks was uncollateralized. The treasury department acknowledged this problem and indicated two possible reasons: 1) there had been a recent revaluation of collateral pledged in May 1982 which had resulted in more than 900 banks being requested to pledge additional securities due to falling bond markets; and 2) the state's average daily cash balances had risen to over \$3 billion during June creating an "emergency" situation under which the normal collateralization requirements were waived.

To further document this problem, a review of the collateralization status of state accounts prior to May 1982 when the revaluation occurred, was made which indicated that all accounts were sufficiently collateralized at that time. Agency staff indicated that these revaluations were not regularly scheduled. The staff would not comment on how long it had been since the last revaluation, despite the fact that the bond markets have been and continue to be unusually volatile. Scheduling quarterly or semi-annual evaluations of securities pledged as collateral could prevent such precipitous drops in the value of securities pledged and provide greater assurance that state funds are fully collateralized.

Exhibit 2

INVESTMENT ALTERNATIVES AVAILABLE
IN SELECTED OTHER STATES

State	CD's/Time Deposits	Treasury Bills	Repurchase Agreements	Guaranteed Federal Agencies	Commercial Paper	Savings and Loans	Other
Alabama	X	X	X				
Arizona	X		X	X			
Arkansas	X		X			X	
California	X	X		X	X	X	X
Colorado	X	X		X	X	X	X
Connecticut	X	X		X	X		X
Florida	X	X					
Georgia	X	X	X	X		X	
Idaho	X	X	X			X	X
Illinois	X	X	X			X	
Indiana	X	X					
Kansas	X		X				
Kentucky	X	X					
Louisiana	X		X				
Maine	X	X	X	X	X	X	X
Maryland	X	X		X			
Massachusetts	X	X		X			X
Minnesota	X	X			X	X	
Mississippi	X		X			X	
Missouri	X	X					
Montana	X	X	X	X	X	X	X
New Mexico	X	X					
New York	X	X	X				
North Carolina	X	X		X			
Ohio	X	X		X			
Oregon	X	X	X	X	X	X	X
Pennsylvania	X	X	X	X	X		
Rhode Island	X	X	X		X		
South Dakota	X	X	X	X	X	X	X
Tennessee	X		X				
Texas	X						
Vermont	X				X		
Virginia	X	X		X	X	X	
Washington	X	X	X	X			
Wisconsin	X	X	X		X		
TOTALS	35	27	19	16	13	13	9

The other reason given by the agency for the large amount of uncollateralized funds on the dates reviewed was the "emergency" created by the recent large influx in revenues without a corresponding increase in expenditures. The agency's staff indicated that during these "emergency" periods, funds deposited to state depositories did exceed the market value of the collateral but not the par value. Article 2529 V.A.C.S. states that the amount of all bonds and obligations offered as collateral shall be determined by the board on the basis of either par or market value, whichever is less. A review of the statutes found no authorization for the policy presently used by the treasurer. Although the statutes governing state depositories do provide for situations where the surplus of state funds exceeds the amount applied for by depositories, review of the agency's records indicates that this is not currently the case.

The results of the review indicated that the agency should take immediate steps to ensure that all state funds are properly collateralized and that, in the future, funds are not deposited to banks without sufficient approved collateral.

Deposits in Excess of the Maximum Approved Amount. When a bank applies to the State Depository Board for state funds, it is required to indicate the maximum and minimum amounts in time and/or demand accounts the bank will accept. A list of all banks applying for funds with the minimum and maximum amounts requested is approved by the board in November of every odd-numbered year and made available for public inspection. A review of board minutes indicates that subsequent to that initial approval, the board also approves amendments to these applications to adjust the minimum and maximum amounts requested. However, a comparison of the amount of funds approved by the board and the amounts actually deposited to each bank indicated that during June 1982, the account balances in more than 110 banks exceeded the maximum amounts approved by the board. The amounts in excess ranged from \$3,000 to \$81 million and totalled \$136.3 million. The agency should identify all depositories whose account balances exceed the maximum approved amount and request that these banks submit an amended application for approval by the State Depository Board.

Surety Bond Requirements. The statutes governing state depositories currently permit banks two alternatives to meeting collateralization requirements: 1) depositing a surety bond in an amount at least double the amount of state funds allotted; or 2) pledging with the treasurer specified securities such as municipal bonds, U. S. Treasury and federal agency bonds, and state senior college securities.

Although both collateralization alternatives have been available to banks since the 1930's, until recently, surety bonds have seldom been used. One reason a surety bond may have appeared less attractive is that while banks collateralizing state funds with securities must pledge up to 120 percent of the amount deposited, the statutes required that surety bonds be equal to 200 percent of the state funds on deposit. However, the review indicated that the higher level of interest rates which have resulted in substantial market value losses to bond portfolios have made collateralizing public funds with investment portfolios less attractive in recent years.

The University of Texas System with deposits totalling \$478.3 million in 50 banks has recently amended their depository contract to permit banks to furnish a surety bond equal to 100 percent of the amount on deposit. Currently, at least four large insurance companies appear willing to write surety bonds in Texas. The base rates for these bonds filed with the State Insurance Board are \$4.50 per \$1,000 or \$2.50 per \$1,000 if the bank pledges collateral to the insurance company.

Amending the statute to reduce the bonding requirement from 200 percent to 100 percent of the funds on deposit would not only make the bonding alternative more viable for state depositories, but it would provide greater assurance that state funds were fully collateralized since the value of surety bonds would not be affected by changes in interest rates as is the case with the pledging of securities. In addition, to the extent that surety bonds were used, it would reduce the workload of the treasurer's staff responsible for the verification and revaluation of bonds deposited as collateral for state funds.

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 presented 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

An examination of the agency's compliance with the open meetings statutes determined that the agency files timely notices with the Secretary of State's Office. The agency's minutes reveal no improper use of executive sessions and show general adherence to procedures set out in the Open Meetings Act. Review of the agency's compliance with the Open Records Act indicated that the board has never denied a formal request for information and considers all of its records public.

EEOC/Privacy

A review was made to determine the extent to which the agency has complied with applicable provisions of both the state and federal statutes concerning equal employment and the rights and privacy of individual employees. In general, these requirements affect agencies that employ staff and adopt rules concerning agency activities. Since the State Depository Board has no staff, the agency is not at present affected by the requirements.

Public Participation

The review of agency activities designed to encourage public participation consists of an evaluation of the extent to which an agency has kept those persons which it serves and the general public well informed, and is responsive to changing demands and needs of the public. The evaluation indicated that the board's composition includes the treasurer, a statewide elected official, in addition to a public member appointed by the Governor. Treasury records indicate that meetings of the board are generally attended by members of the press and other agency personnel.

Conflicts of Interest

A review of board member's compliance with statutory standards of conduct and conflict-of-interest provisions showed overall compliance with these requirements. Since the Depository Board is not a "major state agency" as defined by Article 6252-9b, V.A.C.S., the public member of the board is not required to file a financial statement with the Secretary of State's Office.

**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 AND ALTERNATIVES

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.

Need to Continue Agency Functions and Alternatives

The analysis of need is directed toward answers to the following questions: 1) do the conditions which required state actions still exist and are they serious enough to call for continued action on the part of the state; and 2) is the current organizational structure the only way to perform the functions. These two criteria were considered below in relationship to the board's activities.

Selecting State Depositories. This function, assigned by statute, was one of the original functions of the board when it was established in 1919. State law still requires that all state funds be deposited to commercial banks or held in the vault of the treasury so there is still a need to select qualified banks. However, the review showed that although the board has the authority to reject any applicant whose management or other conditions does not warrant the deposit of state funds, all banks are routinely approved. Since the power to approve the applications of banks applying for designation as state depositories could be assigned to the state treasurer, this function of the board cannot be automatically used as justification for its continued existence.

Establishing the allocation of state funds between demand deposits and time deposits. Review of the minutes of the board and records of the treasury indicated that there are no written policies or rules and regulations concerning the allocation of funds. However, the treasurer indicates that his staff attempts to maximize the amount of funds held in interest-bearing accounts. Since the responsibility for determining the allocation of state funds between time and demand deposits could be assigned to the treasurer who is already responsible for maintaining the state's bank accounts, paying all warrants and investing any surplus funds, this function of the board cannot be automatically used as justification for its continued existence.

Investing the permanent funds of certain eleemosynary institutions. Review of the minutes of the board indicates that the funds available for investment during the period under review totalled only \$609,000 and in every instance these funds

were invested in U. S. Treasury bills by the treasurer's staff. Since responsibility for investing these funds could be assigned to the treasurer, whose staff already invests these funds, this function of the board cannot be automatically used as justification for its continued existence.

Adopting rules and regulations for the establishment and conduct of state depositories. Review of the board's minutes and interviews with agency personnel could identify only one rule passed by the board. This function could not be transferred to the treasurer under the current statutes since he does not have the authority to adopt rules and regulations. However, the legislature has given this authority to other elected officials such as the comptroller, and the treasurer could be granted the authority to adopt rules and regulations governing state depositories.

Establishing the rate of interest to be paid on state funds. This statutory responsibility was assigned to the board when the interest rates were removed from the statute in 1933, and is one of the board's primary responsibilities. Although historically the board has met periodically to set an interest rate based on review of a number of factors, the adoption of one of the formulas currently being considered by the board would allow the treasurer to adjust the rate more frequently without the necessity of a meeting with the board. Since the power to set the rate of interest to be paid on state funds or to implement a statutory formula could be assigned to the state treasurer, this function of the board cannot be automatically used as justification for its continued existence.

Based on the analysis of need, it was determined that the need to perform many of the functions assigned to the Depository Board still exist; however, an independent board is not the only organizational approach available for performing these functions. In almost every instance, the review indicated that the responsibilities assigned to the board could be performed by the state treasurer. A review of how other states carry out these functions, (exhibit 3), showed that 27 states assigned these responsibilities to an elected or appointed official such as the state's treasurer, comptroller, or director of finance, while 17 states employed an appointed board to review the policies of the state official assigned responsibility for investing state funds. However, the review showed that in most of these states the primary responsibility of these boards was the investment of state retirement and pension funds rather than only the investment of surplus state funds as is the case in Texas.

Exhibit 3

**RESPONSIBILITY FOR THE INVESTMENT OF
STATE FUNDS IN SELECTED STATES**

<u>State</u>	<u>Responsibility for State's Investment Policy</u>	<u>Responsibility for Investment of State Funds</u>
Alabama	State Treasurer	State Treasurer's Office
Arizona	State Treasurer	State Treasurer's Office
Arkansas	State Board of Finance	State Treasurer's Office
California	Money Investment Board	State Treasurer's Office
Colorado	State Treasurer	State Treasurer's Office
Connecticut	State Treasurer	State Treasurer's Office
Delaware	Cash Management Policy Board	State Treasurer's Office
Florida	Statute	State Treasurer's Office
Georgia	State Depository Board	Dept. of Administrative Services
Hawaii	Director of Finance	Dept. of Budget and Finance
Idaho	State Treasurer	State Treasurer's Office
Illinois	State Treasurer	State Treasurer's Office
Indiana	State Treasurer	State Treasurer's Office
Iowa	State Treasurer	State Treasurer's Office
Kansas	Money Investment Board	Money Investment Board
Kentucky	State Investment Commission	State Treasurer's Office
Louisiana	State Treasurer	State Treasurer's Office
Maine	Deputy State Treasurer	State Treasurer's Office
Maryland	State Treasurer	State Treasurer's Office
Massachusetts	State Treasurer	State Treasurer's Office
Michigan	State Treasurer	State Treasurer's Office
Minnesota	State Board of Investment	State Board of Investment
Mississippi	State Depository Commission and State Treasurer	State Depository Commission and State Treasurer
Missouri	State Treasurer	State Treasurer
Montana	Board of Investments	Board of Investments
Nebraska	Investment Council	Investment Council
Nevada	State Treasurer	State Treasurer's Office
New Hampshire	State Treasurer	State Treasurer's Office

**Responsibility For the Investment of
State Funds in Selected States**
(Continued)

<u>State</u>	<u>Responsibility for State's Investment Policy</u>	<u>Responsibility for Investment of State Funds</u>
New York	Comptroller	Comptroller
North Carolina	State Treasurer	State Treasurer's Office
North Dakota	State Investment Board	State Treasurer's Office
Ohio	State Board of Deposit	State Treasurer's Office
Oregon	Investment Council	State Treasurer's Office
Pennsylvania	State Treasurer	State Treasurer's Office
Rhode Island	Investment Commission	State Treasurer's Office
South Carolina	State Treasurer	State Treasurer's Office
South Dakota	Investment Office	State Treasurer's Office
Tennessee	State Treasurer	State Treasurer's Office
Utah	State Treasurer	State Treasurer's Office
Vermont	State Treasurer	State Treasurer's Office
Virginia	State Treasurer	State Treasurer's Office
Washington	State Treasurer	State Treasurer's Office
West Virginia	State Board of Investments	State Treasurer's Office
Wisconsin	Investment Board	Investment Board
Wyoming	State Treasurer	State Treasurer's Office

Source: Council of State Governments, 1982

ALTERNATIVES

Agency Reorganization

Abolish the board and transfer the functions to the state treasurer. This approach would be consistent with that used in a majority of states. The treasurer, currently responsible for maintaining the state's bank accounts, paying all warrants and investing surplus funds, would also be given the authority to determine the banks to be used as state depositories and the interest rate to be paid on state funds. Many of the other functions of the board such as supervising the collateralization of state funds, investing the permanent funds of certain eleemosynary institutions, and determining the allocation of funds between time and demand deposits is already administered by the treasurer. The results of the review indicated the responsibilities currently assigned to the board, could be transferred to the state treasurer's office without significant changes in the way the statutes governing state depositories are currently administered, and would provide the treasurer with greater flexibility in dealing with the day to day management of the state's cash balances. However, if the board were abolished, the current check and balance process designed to prevent total discretion on the part of the treasurer in determining depositories and interest rates would be eliminated.

Changes in Current Procedures

Reducing the collateralization requirements. The collateralization alternative currently used by most state depositories requires a bank to pledge specified securities such as municipal bonds, U. S. Treasury and federal agency bonds, and state senior college securities as collateral for state funds. U. S. government securities are valued at 95 percent of their par or market value whichever is less and municipals are valued at 80 percent of their par or market value. Review of the pledging ratios for state funds in 40 other states show Texas requirements to be more restrictive than other states. Of the states requiring collateral in excess of 100 percent, Texas was the only state to require more than 110 percent collateralization. Sixteen other states required 100 percent collateralization, nine states required less than 100 percent and in six states the collateralization requirement was discretionary. At least three of the states surveyed required collateral of less than 10 percent of the balances on hand. In the event of a bank default in these states each depository is assessed a proportional share of the losses based on the ratio that its public deposits bear to the statewide total.

However, the problems currently experienced by the treasury in keeping state funds adequately collateralized indicates that the present collateralization requirements do provide an additional margin of safety for state funds when interest rates rise and bond values decline. If the collateralization requirements are decreased to 100 percent, it is anticipated that the treasurer's office will need additional funds to provide staff to revalue pledged collateral on a much more frequent basis than presently occurs.

Bidding on state deposits. Prior to the establishment of the State Depository Board, state depositories were selected from each senatorial district on the basis of the highest bid. Since 1923, the interest rate charged on state funds has either been established in statute or set by the Depository Board. A survey of other states, (Exhibit 4), indicated that competitive bid is the most commonly used method of allocating funds to demand or time deposits. Texas laws governing depository selection for cities and counties also authorizes selection of a depository on the basis of bidding. In addition, a review of investment practices of state agencies with funds held outside the treasury indicates that in most instances these agencies place their funds on the basis of bids solicited on a state-wide basis. A comparison of yields on funds placed by bid by other state agencies with the yield received by funds in the treasury during fiscal year 1982, showed that the yield achieved by these agencies compares favorably with the yield on funds invested by the treasurer.

State Depository Rate	12.80%
Department of Corrections	15.34%
Savings and Loan Department	14.55%
University of Texas System	13.24%
Texas A & M University System	13.70%

Agencies which use bidding indicate that the spread between bids can be substantial depending upon the availability of securities for collateralization and the amount of other public funds on deposit.

Exhibit 4

METHOD OF DETERMINING RATE OF INTEREST ON TIME DEPOSITS

<u>STATE</u>	<u>METHOD</u>
Alabama	Average of 91 day T-Bill auction rate for 4-week period preceeding each quarter.
Arizona	Competitive bid.
Arkansas	Rates for time deposits determined by T-Bill rate. Rates for repurchase agreements by bid.
Colorado	Rates for certificates of time deposit determined by competitive bid.
Connecticut	Rates negotiated on CD's; bids must meet or exceed rates available on national money market.
Florida	All new time deposits placed on basis of competitive bids.
Georgia	Time deposits under 90 days negotiated, with time deposits over 90 days placed on basis of competitive bids.
Idaho	Rates for certificates of deposit determined by treasurer by applying formula set by law.
Illinois	Time deposits are placed by competitive bids solicited twice each year and short-term investments rates are negotiated.
Indiana	Rates for certificates of deposit set by State Board of Finance.
Iowa	Interest rates set monthly by state treasurer, state insurance commissioner and state banking superintendent.
Louisiana	Rates for certificates of deposit determined by average weekly treasury bill sales of same maturity.
Maine	Rates for certificates of deposit based on competitive bid.
Massachusetts	Rates are determined for certificates of deposit by competitive bid.
Mississippi	Rates for certificates of deposit set by statute.
Missouri	Rates determined for CD's based on average rate of U. S. Treasury obligations of same maturity of previous week.
New Jersey	Rates on certificates of deposit determined by competitive bid.

Method Of Determining Rate Of Interest On Time Deposits
(Continued)

STATE	METHOD
New Mexico	At least once each quarter the State Board of Finance sets the rate of interest upon all time deposits of state funds.
New York	Rates determined by competitive bid.
North Carolina	Rates for certificates of time deposits cannot be less than U. S. Treasury obligations of comparable maturity.
Rhode Island	Rates are determined by obtaining competitive bids from all Rhode Island banks which are analyzed and compared to national rates.
Tennessee	Rates are determined primarily by analysis of competitive rates of Tennessee banks; however, these rates are compared to national rate to insure the in-state rate is competitive.
Vermont	Rates for certificates of deposit are negotiated.
Virginia	Rates for \$100,000 CD's determined by market survey. Larger amounts distributed by competitive bid.
Washington	The placement and rate of daily investments are determined by competitive bid.
Wisconsin	Certificates of deposit are purchased on a competitive basis.

ACROSS-THE-BOARD RECOMMENDATIONS

STATE DEPOSITORY BOARD

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.

State Depository Board
(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.