



# SUNSET ADVISORY COMMISSION

STAFF REPORT WITH COMMISSION DECISIONS

*State Securities Board*

**2018–2019**  
**86TH LEGISLATURE**

# SUNSET ADVISORY COMMISSION

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# **STATE SECURITIES BOARD**

**SUNSET STAFF REPORT WITH COMMISSION DECISIONS  
2018-2019  
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## *HOW TO READ SUNSET REPORTS*

Each Sunset report is issued *three times*, at each of the three key phases of the Sunset process, to compile all recommendations and actions into one, up-to-date document. Only the most recent version is posted to the website. (**The version in bold is the version you are reading.**)

### 1. SUNSET STAFF EVALUATION PHASE

Sunset staff performs extensive research and analysis to evaluate the need for, performance of, and improvements to the agency under review.

**FIRST VERSION:** The *Sunset Staff Report* identifies problem areas and makes specific recommendations for positive change, either to the laws governing an agency or in the form of management directives to agency leadership.

### 2. SUNSET COMMISSION DELIBERATION PHASE

The Sunset Commission conducts a public hearing to take testimony on the staff report and the agency overall. Later, the commission meets again to vote on which changes to recommend to the full Legislature.

**SECOND VERSION:** **The *Sunset Staff Report with Commission Decisions*, issued after the decision meeting, documents the Sunset Commission's decisions on the original staff recommendations and any new issues raised during the hearing, forming the basis of the Sunset bills.**

### 3. LEGISLATIVE ACTION PHASE

The full Legislature considers bills containing the Sunset Commission's recommendations on each agency and makes final determinations.

**THIRD VERSION:** The *Sunset Staff Report with Final Results*, published after the end of the legislative session, documents the ultimate outcome of the Sunset process for each agency, including the actions taken by the Legislature on each Sunset recommendation and any new provisions added to the Sunset bill.

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# — SUNSET COMMISSION DECISIONS



# SUNSET COMMISSION DECISIONS

## Summary

The following material summarizes the Sunset Commission's decisions on the staff recommendations for the State Securities Board, as well as modifications and new recommendations raised during the public hearing.

While the federal Securities and Exchange Commission has overall responsibility for monitoring the securities marketplace in the United States, the State Securities Board plays a critical role in protecting Texas residents from fraudulent or negligent practices by securities professionals and criminal opportunists. Since its last Sunset review in 2000, the agency has responded to volatile market swings and regulatory changes at the national level that have broadened the scope and scale of its regulatory authority and introduced new challenges, like cryptocurrency offerings. The Sunset Commission found the State Securities Board remains a needed agency that effectively carries out its mission to protect investors and ensure a healthy and productive securities market. The Sunset Commission's recommendations continue the agency for 12 years and seek to further streamline the agency's functions and provide tools its staff needs to address evolving demands. Other recommendations apply best practices to improve the agency's enforcement processes, increase transparency to the public and Legislature, and simplify the agency's registration requirements.

## ISSUE 1

### *Key Elements of the State Securities Board's Statute and Procedures Do Not Conform to Common Regulatory Standards.*

**Recommendation 1.1, Adopted** — Clarify statute to authorize the agency to provide prosecutorial assistance and require the agency to develop a process to determine staff resources available to support prosecutions.

**Recommendation 1.2, Adopted as Modified** — Authorize the agency to order refunds for violations of agency statute or rules in both contested and uncontested cases.

**Recommendation 1.3, Adopted** — Remove the requirement that branch offices be registered.

**Recommendation 1.4, Adopted as Modified** — Direct the agency to develop a penalty matrix for both administrative penalties and sanctions recommended for final enforcement actions, and direct the State Securities Board to submit a brief report on the implementation of this recommendation to the Sunset Commission by March 15, 2019. (Management action – nonstatutory)

**Recommendation 1.5, Adopted as Modified** — Direct the board to develop and adopt rules describing all phases of its complaint process and to submit a brief status report on the implementation of this recommendation to the Sunset Commission by March 15, 2019. (Management action – nonstatutory)

**Recommendation 1.6, Adopted as Modified** — Direct the agency to improve its tracking of complaint and case resolution timeframes and to submit a brief status report on the implementation of this recommendation to the Sunset Commission by March 15, 2019. (Management action – nonstatutory)

**Recommendation 1.7, Adopted** — Direct the agency to review its risk-based inspection tool at least every four years. (Management action – nonstatutory)

**Recommendation 1.8, Adopted as Modified** — Direct the agency to accept online submissions of applications and fees. In addition, direct the State Securities Board to develop and present a detailed plan outlining how the agency will complete this recommendation to the Sunset Commission by March 15, 2019. (Management action – nonstatutory)

**Recommendation 1.9, Adopted as Modified** — Direct the agency to remove the notarization requirements on its forms by March 15, 2019. (Management action – nonstatutory)

## ISSUE 2

*The State Has a Continuing Need to Regulate the Securities Industry.*

**Recommendation 2.1, Adopted** — Continue the State Securities Board for 12 years.

**Recommendation 2.2, Adopted as Modified** — Update and apply standard across-the-board recommendations relating to board member training, complaint information, and alternative dispute resolution to the State Securities Board. Also require each State Securities Board member to attest to both receiving and reviewing the training manual.

**Recommendation 2.3, Adopted** — Continue the agency’s statutory reporting requirement.

## Fiscal Implication Summary

Overall, the Sunset Commission’s recommendations would result in an estimated negative annual fiscal impact to the state of about \$425,850. Most of the Sunset Commission’s recommendations would have no fiscal impact or could be accomplished with existing resources and processes, and several recommendations reduce administrative burdens. However, the recommendation to remove the requirement to register branch offices would have an estimated negative impact of \$425,850 to the General Revenue Fund, due to the loss of associated fee revenue. This estimated negative impact is based on the loss of \$25 charged for each of the 11,347 branch offices the agency registered in fiscal year 2017 and each of the 5,687 amendments to branch office certificates in the same year. Removing this requirement would reduce an administrative burden and any efficiencies gained would be used for other agency operations.

### **State Securities Board**

<b>Fiscal Year</b>	<b>Loss to the General Revenue Fund</b>
2020	\$425,850
2021	\$425,850
2022	\$425,850
2023	\$425,850
2024	\$425,850

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**SUMMARY OF SUNSET  
STAFF RECOMMENDATIONS**



# SUMMARY

Graphs, stock tickers, and financial industry jargon pepper the daily news and often obscure the basic importance of securities in powering the economy. The transparency of securities offerings and the competence of securities professionals affect not just those who actively buy or sell securities, but any Texan who plans for retirement or future expenses, like college tuition. While the federal Securities and Exchange Commission has overall responsibility for monitoring the securities marketplace in the United States, the State Securities Board plays a critical role in protecting Texas residents from fraudulent or negligent practices by securities professionals and criminal opportunists.

Since its last Sunset review in 2000, the agency has responded to volatile market swings and regulatory changes at the national level that have broadened the scope and scale of its regulatory authority and introduced new challenges, like cryptocurrency offerings. Sunset staff found the State Securities Board remains a needed agency that effectively carries out its mission to protect investors and ensure a healthy and productive securities market. The agency has few of the problems that can plague other state regulatory agencies, such as licensing backlogs, anticompetitive rulemaking, or lax enforcement. As a result, this review sought to further streamline the agency's functions and provide tools its staff needs to address these evolving demands, including establishing more formal processes and providing opportunities for more transparency. The recommendations apply best practices intended to simplify the agency's registration process, help prioritize its enforcement of a fair market and defense against incompetent or predatory behavior, and increase transparency to the public and the Legislature.

While the board is a well-run agency that contributes \$150 million in excess fee revenue to the state through its regulation, its greatest long-term challenge is one that Sunset cannot address — the loss of the staff's cultivated expertise to higher paying national regulators. The agency is the state's expert on enforcing state and federal securities laws and it cannot easily or quickly replace the expertise of seasoned financial examiners and attorneys. This report contains no recommendation to address this problem, as issues of agency funding and staffing should be addressed through the appropriations process and the agency so far has managed to maintain its high level of performance. However, as the agency's workload increases and criminals constantly create new schemes to defraud the public, the agency and the state could feel the effects of the agency's struggle to retain qualified staff. The following material summarizes Sunset staff recommendations on the State Securities Board.

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*The State Securities Board effectively carries out its mission to protect investors and ensure a healthy securities market.*

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## ***Issue 1***

### **Key Elements of the State Securities Board's Statute and Procedures Do Not Conform to Common Regulatory Standards.**

Various agency registration and enforcement processes do not match model standards or common practices observed through Sunset reviews of many regulatory agencies. Specifically, the agency lacks clear authority to provide prosecutorial support and needs direction to evaluate its capacity to assist local prosecutors. The agency also does not have statutory authority to order a registrant to pay a refund to a client, and the agency has not routinely update its risk-based inspection tool to fit its unique needs. Finally, the agency has unneeded requirements to register branch offices and for applicants to submit certain forms in paper format. Updating the agency's statute and practices would help reduce regulatory burdens and ensure the agency can focus its efforts to best protect the public.

#### **Key Recommendations**

- Clarify statute to authorize the agency to provide prosecutorial assistance and require the agency to develop a process to determine staff resources available to support prosecutions.
- Authorize the agency to order refunds for violations of agency statute or rules.

## ***Issue 2***

### **The State Has a Continuing Need to Regulate the Securities Industry.**

The Legislature created the State Securities Board in 1957 to oversee securities regulation and prevent fraud against consumers. Securities are an important tool for businesses, governments, and investors, and regulation by the agency helps protect against fraudulent practices and maintain investors' confidence in the market. In addition, the agency's statute does not reflect standard language typically applied across the board during Sunset reviews, and its sole reporting requirement about its activities and identified needs for future securities regulation remains necessary.

#### **Key Recommendation**

- Continue the State Securities Board for 12 years.

## **Fiscal Implication Summary**

Overall, the recommendations in this report would result in an estimated negative fiscal impact to the state of about \$425,850 to the General Revenue Fund. Most of the recommendations are designed to be accomplished with existing resources and processes or reduce administrative burdens. However, one issue would have a direct negative fiscal impact to the state, as summarized below.

***Issue 1*** — Recommendation 1.3 to remove the requirement to register branch offices would have an estimated negative impact of \$425,850 to the state, due to the loss of branch office registration fee revenue. This estimated negative impact is based on the loss of \$25 charged for each of the 11,347 branch

offices the agency registered in fiscal year 2017 and each of the 5,687 amendments to branch office certificates in the same year. Removing this requirement would reduce an administrative burden and any efficiencies gained would be used for other agency operations. The table shows the overall impact of this recommendation.

**State Securities Board**

<b>Fiscal Year</b>	<b>Loss to the General Revenue Fund</b>
2020	\$425,850
2021	\$425,850
2022	\$425,850
2023	\$425,850
2024	\$425,850



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**AGENCY AT A GLANCE**

**NOVEMBER 2018**



# AGENCY AT A GLANCE

The Legislature established the State Securities Board in 1957 as an independent agency dedicated to the prevention of securities fraud upon the public.<sup>1</sup> At the most basic level, a security represents a financial investment in which a person expects to gain profit derived from the efforts of others. Securities include many types of investments, such as stocks, bonds, interests in oil and gas leases, and other investment contracts. Businesses use securities to grow, and members of the public use securities to accumulate wealth for needs like retirement savings.

The Securities and Exchange Commission (SEC) is the primary overseer and regulator of the securities market in the United States, but states and self-regulatory organizations — such as the Financial Industry Regulatory Authority (FINRA), a nonprofit membership organization that regulates securities dealers — have key responsibilities for regulating specific products and occupations. In Texas, in addition to federal securities law, the State Securities Board enforces state laws that protect investors from criminal securities activity.<sup>2</sup> Appendix A provides more information about the division of oversight between the agency and its other regulatory partners.

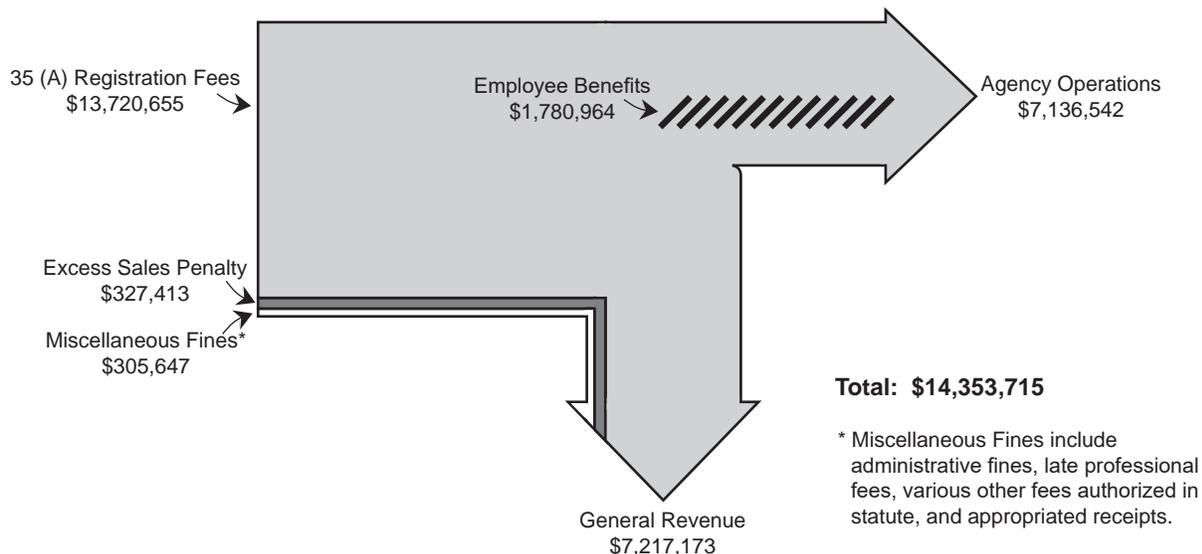
The mission of the State Securities Board is to protect investors and ensure a healthy and productive securities market.<sup>3</sup> To achieve this mission, the agency performs the following major functions:

- Registers dealer and investment adviser entities and their employees involved in securities
- Evaluates securities offerings that must be registered or filed with the agency
- Assists with criminal prosecutions of agency cases in state and federal court
- Inspects investment adviser companies and dealers registered with the agency
- Investigates violations of agency statute and rules, and takes action against registered and unregistered persons when necessary

## Key Facts

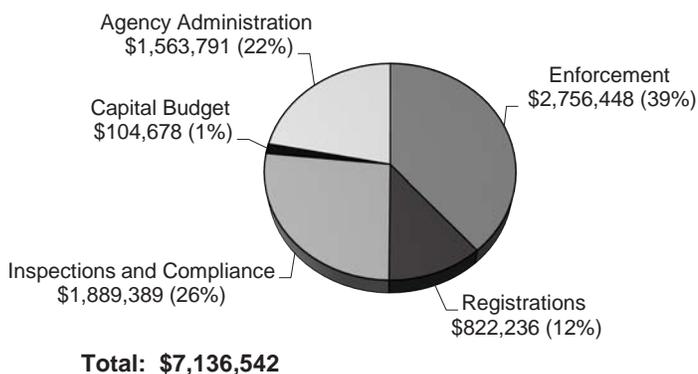
- **Governance.** The State Securities Board consists of five public members who are not involved in the securities industry. The governor appoints the members, with the advice and consent of the Senate, to six-year terms and selects the board's chair.<sup>4</sup> The board appoints the securities commissioner to administer the agency's functions.<sup>5</sup>
- **Funding.** In fiscal year 2017, the agency collected almost \$158 million in revenue and expended approximately \$7 million in general revenue funds and appropriated receipts on its various programs and administration.<sup>6</sup> The chart on the following page, *Flow of State Securities Board Revenues and Expenditures*, illustrates the flow of the agency's revenues and expenditures in more detail but only includes fees collected under Section 35(A) of the Securities Act, which the Legislature can appropriate to support agency activities.<sup>7</sup> The agency sent an additional \$144 million to general revenue from various fees collected under Section 35(B) of the Securities Act in fiscal year 2017.

**Flow of State Securities Board Revenue and Expenditures – FY 2017**



The pie chart, *State Securities Board Expenditures*, details the agency’s expenditures by program, with its enforcement program being the largest expenditure. Appendix B describes the agency’s use of historically underutilized businesses in purchasing goods and services for fiscal years 2015–2017.

**State Securities Board Expenditures – FY 2017**



- **Staffing.** At the end of fiscal year 2017, the agency had 85 staff positions.<sup>8</sup> About 65 percent of the agency’s employees work in Austin, but the agency also maintains field offices in Corpus Christi, Dallas, Houston, and Lubbock. Appendix C provides a comparison of the agency’s workforce composition to the statewide civilian workforce for the past three fiscal years.

- **Registration.** The agency registers dealers and investment adviser companies and their employees involved in securities, as shown in the textbox, *Agency Registrants*. The agency also registers securities offerings and receives notice of companies operating in Texas and securities offered in Texas that are regulated by a federal entity.

**Agency Registrants  
FY 2017**

- Dealers: 2,530
  - Agents: 243,753
- Investment advisers: 1,804
  - Investment adviser representatives: 27,782

Dealers, investment advisers, and their employees. Dealers are companies or individuals that sell, offer to sell, take orders for, deliver, or are otherwise involved in transacting securities.<sup>9</sup> The agency registers dealers, as well as investment advisers that manage up to \$100 million in assets. The agency also registers companies and persons who act on investment advisers’ behalf to solicit clients, make analyses, or provide advice in Texas, called representatives, and those who work on a dealer’s behalf, called agents.<sup>10</sup> Most dealers and agents are members of FINRA and use its registration system to

register with the agency. The agency also registers intrastate dealers and agents with limited practices that register directly with the agency instead of joining FINRA.<sup>11</sup> To become registered, applicants must provide certain business and financial information, and professional history for agency review. Individuals must also pass both a national exam and securities law exam.<sup>12</sup>

**Securities offerings.** State law exempts certain securities regulated by other entities from agency registration, including those shown in the textbox, *Examples of Exempt Offerings*. Issuers of non-exempt securities must register with or give notice to the agency before offering securities in Texas.<sup>13</sup> The agency ensures the offerings are “fair, just, and equitable” following guidance from the North American Securities Administrators Association. In fiscal year 2017, the agency processed 64,230 securities applications, amendments, and renewals for securities, 99 percent of which were notifications of securities either registered with the SEC or offerings with an exemption from state securities regulation under federal law.

#### **Examples of Exempt Offerings**

- Public utility, bank, or governmental body securities offerings
- Securities listed on a stock exchange, such as NASDAQ
- Commercial paper with repayment due within nine months
- Religious or charitable organizations’ bonds

- **Criminal enforcement.** The agency investigates unregistered securities, unregistered activities, and securities fraud based on complaints from the public, coordination with law enforcement and regulatory agency counterparts, and proactive monitoring of investment offerings.<sup>14</sup> In fiscal year 2017, the agency opened 396 staff-initiated investigations and complaints received from the public that relate to fraud or unregistered activity. The agency issues cease-and-desist orders to halt fraudulent activity and refers suspected criminal cases to county and district attorneys for prosecution.<sup>15</sup> County and district attorneys can appoint agency staff to assist prosecutors in preparing for and arguing these cases, in addition to serving as witnesses. In fiscal year 2017, the agency referred nine criminal cases to district and county attorneys. In addition, county attorneys obtained indictments covering 600 transactions identified in agency investigations, with agency staff receiving appointments in five cases.
- **Administrative compliance and enforcement.** The agency inspects registrants periodically and investigates complaints to evaluate and take action against violations of agency statute and rules.

**Inspections.** At least once every five years, the agency inspects the offices and work papers of each registered investment adviser and intrastate dealer to ensure compliance with the Securities Act and agency rules.<sup>16</sup> In fiscal year 2017, the agency conducted 365 inspections and found violations ranging from failing to maintain required policies to putting client funds in unsuitable investments.<sup>17</sup>

**Investigations.** In addition to complaints generated through inspections, the agency also conducts investigations based on administrative complaints from the public, other registrants, and its regulatory partners. In fiscal year 2017, the agency received 102 public complaints and opened 384 investigations on administrative violations. The table, *Agency Enforcement Actions*, breaks down the administrative sanctions, civil cases, and criminal referrals against both

#### **Agency Enforcement Actions FY 2017**

Caution Letter	293
Undertaking*	26
Cease-and-desist order (includes emergency orders)	7
Administrative penalty	6
Suspension	5
Referral to other agency	4
Reprimand	3
Revocation	0
<b>Total</b>	<b>344</b>

\* An undertaking imposes certain conditions on a registrant’s operations in Texas.

registrants and unregistered entities. In 2017, the board began responding to reports of potential financial exploitation of vulnerable adults following a new legislative requirement that financial institutions and securities professionals report such concerns.<sup>18</sup> In fiscal year 2018, 61 registrants submitted 130 reports of possible adult financial exploitation to the agency for further review.

1 Section 40, Chapter 269 (S.B. 294), Acts of the 55th Texas Legislature, Regular Session, 1957.

2 “Fast Answers: The Laws That Govern the Securities Industry,” Securities and Exchange Commission, accessed September 18, 2018, <https://www.sec.gov/answers/about-lawsshtml.html>.

3 State Securities Board, *Agency Strategic Plan Fiscal Years 2019 to 2023*, accessed September 23, 2018, <https://www.ssb.texas.gov/sites/default/files/Securities%20Board%20-%20Agency%20312%20-%20Strategic%20Plan%202019%20-%202023.pdf>.

4 All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 581-2, Vernon’s Texas Civil Statutes.

5 Section 581-2-(G), Vernon’s Texas Civil Statutes.

6 State Securities Board, *Operating Budget for Fiscal Year 2018*, accessed August 10, 2018, [https://www.ssb.texas.gov/sites/default/files/agy\\_312\\_op\\_bdgt\\_2018.pdf](https://www.ssb.texas.gov/sites/default/files/agy_312_op_bdgt_2018.pdf).

7 Section 581-35(D), Vernon’s Texas Civil Statutes.

8 State Securities Board, *Supplemental Self-Evaluation Report*, accessed September 23, 2018, [https://www.ssb.texas.gov/sites/default/files/Self\\_eval\\_supplemental\\_Sunset\\_TSSB.pdf](https://www.ssb.texas.gov/sites/default/files/Self_eval_supplemental_Sunset_TSSB.pdf).

9 Section 581-4 (C), Vernon’s Texas Civil Statutes.

10 Sections 581-4(N), 581-4(P), and 581-12, Vernon’s Texas Civil Statutes.

11 7 T.A.C. Section 115.2(a) and (e); “Technology,” Financial Industry Regulatory Authority, accessed September 5, 2018, <https://www.finra.org/about/technology>.

12 7 T.A.C. Sections 115.1–115.3 and 116.1–116.3.

13 Sections 581-5(K)–(M), 581-6, and 581-7, Vernon’s Texas Civil Statutes.

14 Sections 581-4(F) and 581-23, Vernon’s Texas Civil Statutes.

15 Section 581-3, 581-23, and 581-29, Vernon’s Texas Civil Statutes.

16 Sections 581-13-1 and 581-28, Vernon’s Texas Civil Statutes.

17 “Enforcement Actions: Administrative,” State Securities Board, accessed September 19, 2018, <https://www.ssb.texas.gov/news-publications/enforcement-actions-administrative?page=1>.

18 Chapter 280 (H.B. 3921), Acts of the 85th Texas Legislature, Regular Session, 2017.

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**ISSUES**



# ISSUE 1

## *Key Elements of the State Securities Board's Statute and Procedures Do Not Conform to Common Regulatory Standards.*

### Background

The State Securities Board registers, regulates, and enforces state laws governing the offer and sale of securities; dealers and agents that sell securities in Texas or to Texas clients; and investment advisers that manage up to \$100 million in assets and their representatives. Most dealers and agents are also registered with the Financial Industry Regulatory Authority (FINRA), which enforces securities laws and rules for its members on behalf of the Securities and Exchange Commission (SEC). The table, *Agency Registrants*, lists the numbers of individuals, companies, and securities registered with the agency at the end of fiscal year 2017.

The agency's primary role is to regulate persons and entities that do not have to register federally, though states have overlapping authority to provide oversight of federally registered individuals. The agency enforces state laws against registered and unregistered individuals, and in fiscal year 2017, the agency conducted 365 inspections, took 344 disciplinary actions, as shown in the *Agency Enforcement Actions* table, and referred nine cases for criminal prosecution.

The Sunset Advisory Commission has a long history of evaluating licensing and regulatory agencies, as the increase of occupational regulation served as an impetus behind the creation of the commission in 1977. Since then, the Sunset Commission has completed numerous reviews of licensing and regulatory agencies, documenting standards to guide future reviews. While these standards provide guidance for evaluating a regulatory agency's structure and functions, they are not intended for blanket application. Sunset staff continues to refine and develop standards to reflect additional experience and changing needs, circumstances, or practices. The following material highlights areas where the agency's statute and rules differ from these model standards and describes potential benefits of conforming to standard practices.

#### **Agency Registrants – FY 2017**

Agents	243,753
Dealers	2,530
Investment advisers	1,804
Investment adviser representatives	27,782
Securities offerings applications, amendments, and renewals	64,230

#### **Agency Enforcement Actions FY 2017**

Caution Letter	293
Undertaking*	26
Cease-and-desist order (includes emergency orders)	7
Administrative penalty	6
Suspension	5
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Reprimand	3
Revocation	0
<b>Total</b>	<b>344</b>

\* An undertaking imposes certain conditions on a registrant's operations in Texas.

## Findings

### Nonstandard statutory requirements and enforcement procedures limit the agency's ability to protect investors and the public.

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*The agency lacks clear authority to provide ongoing assistance to local prosecutors.*

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- **Unclear prosecutorial support authority.** An agency should have clear statutory authority for its operations. Statute charges the agency with preventing and detecting violations of the Securities Act, including securities-related fraud.<sup>1</sup> Statute also requires the agency to refer criminal cases to county and district attorneys, who have the primary authority to pursue these cases in court.<sup>2</sup> Agency staff have unique expertise in securities law, resulting in prosecuting attorneys frequently asking agency attorneys and financial examiners to assist as special prosecutors and witnesses in criminal cases, a service the agency provides at no cost to the prosecuting authority. During fiscal year 2017, agency staff supported 28 new or ongoing cases in county and district courts.

County and district attorneys have clear authority to appoint agency attorneys as special prosecutors, making each appointment on a case-by-case basis determined by the individual considerations of each case. However, case-by-case appointment authority is separate and distinct from a recurring relationship, in which a state agency repeatedly commits state resources to help prosecute local criminal cases. Statute does not provide clear authority for the agency to provide such ongoing services to local prosecutors' offices at no cost. While assisting local prosecutors helps fill a critical experience gap, resulting in a nearly spotless conviction rate, statute does not clearly authorize it or direct the agency to evaluate its capacity and determine whether to assist local prosecutors.

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*Most state financial regulators can order refunds for people harmed by a licensee's misconduct.*

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- **No refund authority.** Some regulatory agencies can order refunds instead of or in addition to imposing an administrative penalty or other sanction on licensees. Refunds can be granted when a consumer has been defrauded or subjected to a loss that can be quantified, such as investing a client's funds contrary to the client's preference. Currently, the agency does not have statutory authority to order a registrant to pay a refund to a client, even though it receives complaints that involve financial disputes between clients and registrants regarding overcharged fees or misallocated funds. In these instances, the ability to grant a refund would give the agency an additional enforcement tool to help consumers recoup their losses from registrants' errors or deceptive practices. Other agencies, including most of the state's financial regulators, have the authority to order refunds to cancel out the harm that results from a licensee's misconduct.<sup>3</sup> Including refund authority as an additional enforcement tool would enable the agency to help consumers harmed by registrants.
- **Lack of a penalty matrix.** Agencies should establish a schedule or guidelines for the use of sanctions to help ensure that disciplinary action relates appropriately to the nature and seriousness of the offense. These guidelines,

often called a penalty matrix, should also inform the determination of administrative penalty levels. Currently, agency rules provide guidelines for assessing administrative fines, but the agency does not provide any specific guidance as to which sanctions, like reprimands or suspensions, are appropriate for which violations.<sup>4</sup> Creating a penalty matrix that clearly guides the agency's application of sanctions promotes transparency and helps ensure the agency's sanctions against registrants are consistent and deliberate.

- **No rules for complaint investigations.** Regulatory agencies should have rules or procedures that clearly lay out policies for all phases of investigating and taking action on a complaint. While the agency's internal manuals detail the steps of an investigation against registered and unregistered persons, the agency provides little public information regarding its investigations process.<sup>5</sup> Providing information to the public and registrants about case resolution procedures, particularly those that precede contested cases at the State Office of Administrative Hearings (SOAH), would improve understanding of the whole process. Clear, accessible information about investigation and complaint resolution procedures available to all parties may also improve the efficiency of investigations.
- **No tracking of complaint duration.** An agency should ensure that investigations are completed in a reasonable amount of time. The agency prescribes timelines for completing its inspections based on their complexity. However, it does not track the number of days that complaints or staff investigations against registered and unregistered persons take from open to close, or the average number of days taken to resolve its complaints and investigations overall. Setting guidelines and tracking the duration of each complaint or investigation would better enable the board and the Legislature to monitor its workload and identify areas for improvement.
- **Lack of a regular review for risk-based inspection tool.** An agency should have clear procedures, rules, and statutory authority for conducting inspections, including focusing resources on the highest risk areas to the public. At least once every five years, the agency inspects the approximately 1,400 agency-registered investment advisers that do not get an SEC inspection and the dealers that only register in Texas. In 2010, the agency helped develop and began using a risk assessment tool from the North American Securities Administrators Association to determine its inspections schedule, but the agency has not routinely updated this tool to fit the agency's unique needs. For example, the agency inspects the 167 dealers that operate only in Texas at the same frequency as other registrants, even though these dealers operate in limited circumstances and rarely receive an agency sanction. During its review, Sunset staff received multiple suggestions that certain securities products or registrants may be higher risk, but the agency lacks a formal process to review and update its risk-based inspection tool to fully account for such risks. Periodically updating

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*The agency does not track complaint resolution timeframes.*

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*The agency lacks a formal process to review and update its risk-based inspection tool.*

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its risk assessment tool would allow the agency to apply its expertise and experience to better focus its investigative resources on the riskiest areas to have the most impact.

**Nonstandard and unnecessary licensure requirements present hurdles to applicants and reduce the agency’s efficiency and transparency.**

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*The registration of branch offices does not serve a significant public interest.*

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- **Unneeded registration of branch offices.** Regulation should be implemented at the minimum level necessary to protect the public. Statute requires dealers and investment advisers to register all of their Texas branch offices.<sup>6</sup> In fiscal year 2017, the agency registered 11,347 branch offices. However, the agency takes no meaningful enforcement action against branch offices, as they are ultimately the responsibility of a designated supervisor who must be registered with the agency.<sup>7</sup> The registration of branch offices does not serve a significant public interest and essentially consists of collecting a \$25 fee to register each office and produce a registration certificate. The agency separately requires dealers and investment advisers provide the location and supervisor of each branch office as part of their registration, making the formal registration of branch offices duplicative.<sup>8</sup>
- **No electronic submission of forms.** An agency should accept applications and fees online to maximize administrative efficiencies. Board rules require all registrants to submit certain forms in paper format to be considered for registration in Texas, such as the registrants’ bylaws, balance sheet, and articles of incorporation or partnership.<sup>9</sup> In addition, the 418 dealers and agents who register exclusively with the agency must submit both applications and fees to the agency by mail. Accepting applications and fees online reduces hurdles for applicants without compromising the agency’s ability to determine applicants’ eligibility for registration and, once implemented, would eventually be a simpler, more efficient process for agency staff.
- **Unnecessary licensing application requirements.** Regulatory provisions should not create a significant burden for applicants unless there is a clear nexus between the requirements and protecting the public. The statute requires sworn applications to register with the agency, but the agency also requires notarization for a number of its other forms, even though state law already prohibits a person from knowingly making a false statement on an official government record.<sup>10</sup> Notarization is meant to establish one’s identity, not to establish the truth of underlying information. Requiring notarized forms is redundant with general state law, adds no value to the regulation of securities dealers and investment advisers, and is burdensome to applicants.

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*Accepting applications and fees online reduces hurdles for applicants.*

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## Recommendations

### *Change in Statute*

#### **1.1 Clarify statute to authorize the agency to provide prosecutorial assistance and require the agency to develop a process to determine staff resources available to support prosecutions.**

This recommendation would clearly authorize the agency, upon request, to provide ongoing prosecutorial assistance. Under this recommendation, the county and district attorneys would continue to maintain ultimate authority over a case, and the agency's appointed staff would continue to be responsible for the day-to-day prosecution of the case. In addition, the agency would be required to adopt guidelines to govern the use of agency staff to support a prosecution. This recommendation would require the board to create a process in rule to determine the potential resource requirements of each case, and the resources the agency can offer to assist in the prosecution of the case before referring it to a prosecuting attorney. In response to a county or district attorney's request for support on a referred case, the agency would then be allowed to offer the resources identified in that analysis. At a minimum, the agency's analysis should include the following:

- The availability of agency staff, in light of ongoing agency investigations and other cases
- An estimate of the anticipated resources needed to assist in the prosecution of a given case
- The seriousness of the alleged violations in the case, including the harm and number of victims
- The state's interest in assisting the prosecution and the availability of other methods of redress, like a civil suit

This recommendation would also modify the agency's current statutory reporting requirement to include key performance information regarding this use of staff resources. In addition to the report's current requirements, the agency would provide the following:

- A breakdown of the number of cases each of the county and district attorneys began, continued, or completed prosecution of in the most recent fiscal year
- The amount of the agency's budget used to assist in the prosecution of cases that fiscal year

To evaluate whether the agency's commitment of resources is both needed and effective, this recommendation would also require the office of the attorney general, who also is statutorily charged with enforcing the Securities Act, to biennially review a sample of the instances where the agency referred a case and a prosecutor requested assistance, including the agency's analysis of available resources in each case.<sup>11</sup> The office of the attorney general would be authorized to report any concerns with the agency's activities to the appropriate legislative committees. This recommendation would ensure the agency continues to use its appropriated resources in a responsible manner that supports prosecution of securities crimes while being mindful of its other statutory responsibilities. The recommendation would also require the board to adopt all necessary procedures and rules to implement this recommendation by March 1, 2020.

#### **1.2 Authorize the agency to order refunds for violations of agency statute or rules.**

Under this recommendation, the agency would be allowed to include refunds as a part of its agreed orders to resolve enforcement matters. This refund would be limited to the amount the consumer paid for services or the actual amount a registrant lost or stole from a consumer, and would not include an

estimation of other damages or harm. The refund may be in lieu of or in addition to other sanctions against an agency registrant. This recommendation would also require the agency to track the amounts of refunds ordered and received for each case.

### **1.3 Remove the requirement that branch offices be registered.**

This recommendation would remove the branch office registration fee from statute, which is the only clear requirement for branch office registration. The agency would continue to require location information about branch offices provided as part of the main offices' registration and require the designation of a supervisor for each branch office who is responsible for the branch office's activities.<sup>12</sup> Instead of developing registration certificates for each branch office, the agency would allow branch offices to use and post the registration certificate of their main office so consumers know who is responsible for the office's conduct. The agency would continue to be authorized to inspect a branch office and take action if needed. This recommendation would require the board to update rules necessary to implement this recommendation by March 1, 2020.

## ***Management Action***

### **1.4 Direct the agency to develop a penalty matrix.**

This recommendation would require the agency to develop a penalty matrix covering the range of possible violations by registrants and the administrative penalties and sanctions that can be levied against a registrant, such as revocation and suspension. A penalty matrix is a guideline with both mitigating and aggravating factors that is designed to inform but not dictate an agency's enforcement actions. The agency should ensure the matrix relates the appropriate fines and sanctions to different violations based on their severity, and provide for increased penalties for repeat violations. This recommendation would ensure that the agency can consistently and fairly apply its wide range of sanctions to registrants for violations of state laws and rules. The agency should develop this penalty matrix by September 1, 2019.

### **1.5 Direct the board to develop and adopt rules describing all phases of its complaint process.**

Under this recommendation, the board would be required to develop and adopt rules to clearly lay out the agency's complaint process, including the steps that precede contested cases at SOAH, so that they are available to the public. These steps include complaint receipt, investigation, resulting sanctions, interactions with the agency, and disclosure to the public. The board would retain the ability to ensure its complaints process is both fair and timely for those under investigation. The board should adopt these rules by September 1, 2019.

### **1.6 Direct the agency to improve its tracking of complaint and case resolution timeframes.**

This recommendation would direct the agency to track the number of days each complaint or staff investigation takes from opening to close, as well as the average number of days to resolve its complaints from beginning to end overall. Tracking complaints and investigation timelines would allow the agency to objectively review the efficiency of its enforcement processes and determine if and where the agency can improve its processes. The agency should track complaint timelines by September 1, 2019.

### **1.7 Direct the agency to review its risk-based inspection tool at least every four years.**

This recommendation would direct the agency to review and update its risk-based inspection criteria as needed at least every four years — the same frequency it reviews its administrative rules — to account

for identified risk factors and other changes in the securities industry, including a review of the weights for criteria in the tool. Additionally, the recommendation would direct the agency to consider other methods by which it could evaluate relevant risk factors, including:

- Securities or investment products that are higher-risk or have higher rates of violations
- Registrant types that experience higher rates of agency sanction
- State law or rules, such as the requirement to revoke licenses or registrations of those with a felony conviction
- Relevant economic conditions in the state

This recommendation would ensure the agency continues to take a strategic approach to conducting its regular inspections of investment advisers and dealers not registered with another entity. The agency should evaluate and update its current risk-based inspection criteria by September 1, 2020, and at least every four years thereafter.

### **1.8 Direct the agency to accept online submissions of applications and fees.**

This recommendation would direct the agency to enable electronic receipt of application materials and fees for all registrants. While applicants can already submit certain forms to the agency using the registration portals at FINRA, this recommendation would allow them to submit any additional items required for registration electronically rather than by mail. This recommendation would reduce the burden on applicants by eliminating the requirement to obtain and submit hard copy application forms and mail in checks, while also reducing the administrative burden on agency staff to manually process paperwork and payments.

### **1.9 Direct the agency to remove the notarization requirements on its forms.**

This recommendation would direct the agency to remove any requirements on its forms for applicants and registrants to submit notarized documents. Provisions within the Securities Act that require sworn applications in certain cases and penalize knowingly false statements would continue to apply.<sup>13</sup> Rather than submitting certain required information on a notarized form, applicants could submit the same information online using an electronic signature, certifying that the information provided is true and correct. This recommendation would ensure the agency can access needed information without being unnecessarily burdensome.

## **Fiscal Implication**

Overall, these recommendations would have a negative fiscal impact to the state of approximately \$425,850. The loss to general revenue would result from removing the requirement to register every branch office and its associated fee. Requiring the office of the attorney general to biennially review the agency's prosecutorial support to county and district attorneys and report to the Legislature could be done with existing resources, as could updating the agency's risk assessment approach, a standard agency best practice. Incorporating online submission of forms and fees is likely to have a fiscal cost, but may yield administrative efficiencies. However, neither of these fiscal impacts can be estimated at this time.

Recommendation 1.3 to eliminate the branch office registration would result in an estimated loss of \$425,850 to general revenue. In fiscal year 2017, the agency registered 11,347 branch offices and amended 5,687 branch registrations at a cost of \$25 per registration and amendment. Not having to

devote staff time and resources to processing these registrations and branch certificates would result in some administrative savings the agency could use for its other, more critical functions. However, these savings cannot be estimated at this time.

**State Securities Board**

<b>Fiscal Year</b>	<b>Loss to the General Revenue Fund</b>
2020	\$425,850
2021	\$425,850
2022	\$425,850
2023	\$425,850
2024	\$425,850

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- <sup>1</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Sections 581-3 and 581-29, Vernon’s Texas Civil Statutes.
- <sup>2</sup> Sections 581-3 and 581-28, Vernon’s Texas Civil Statutes.
- <sup>3</sup> Section 901.6015, Texas Occupations Code; Sections 14.251(b), 35.002(b-1) and 156.305, Texas Finance Code.
- <sup>4</sup> 7 T.A.C. Section 106.1.
- <sup>5</sup> “Filing a Complaint,” State Securities Board, accessed September 19, 2018, <https://www.ssb.texas.gov/securities-professionals/inspections-compliance/filing-complaint>.
- <sup>6</sup> Section 581-35(B)(1), Vernon’s Texas Civil Statutes.
- <sup>7</sup> 7 T.A.C. Sections 115.2(c) and 116.2(c).
- <sup>8</sup> Sections 581-7(A)(1)(b) and 581-13(A)(2), Vernon’s Texas Civil Statutes; “Form BD,” Securities and Exchange Commission, accessed September 23, 2018, <https://www.sec.gov/about/forms/formbd.pdf>.
- <sup>9</sup> 7 T.A.C. Sections 115.2(c)(1) and 116.2(a)(2).
- <sup>10</sup> “Texas Forms,” State Securities Board, accessed September 27, 2018, <https://www.ssb.texas.gov/texas-securities-act-board-rules/texas-forms>; Sections 581-7(A), 581-13(A), 581-18, and 581-29(E), Vernon’s Texas Civil Statutes, and Section 37.10, Texas Penal Code.
- <sup>11</sup> Section 581-3, Vernon’s Texas Civil Statutes.
- <sup>12</sup> Section 581-13(A)(2), Vernon’s Texas Civil Statutes; 7 T.A.C. 115.2(c) and 116.2(c).
- <sup>13</sup> Sections 581-7(A), 581-13(A), 581-18, and 581-29(E), Vernon’s Texas Civil Statutes; Section 37.10, Texas Penal Code.

# ISSUE 2

## *The State Has a Continuing Need to Regulate the Securities Industry.*

### Background

The Legislature created the State Securities Board in 1957 to oversee securities regulation and prevent fraud against consumers.<sup>1</sup> The agency regulates securities — stocks, bonds, notes, and other products that entitle the holder to a stake of a venture’s capital or earnings — and also persons who buy and sell securities or advise clients about them. State oversight occurs alongside federal regulation by the Securities and Exchange Commission (SEC) and self-regulatory organizations under the SEC’s oversight, primarily the Financial Industry Regulatory Authority (FINRA), a nonprofit organization for securities dealers and agents authorized to regulate its members directly on behalf of the SEC.<sup>2</sup>

The agency’s mission is to protect investors and ensure fair and reliable capital markets.<sup>3</sup> In fiscal year 2017, the agency expended \$7.14 million and processed 64,230 applications and renewals for securities offerings valued at more than \$298 billion. The agency also registered 345,484 investment adviser companies, dealers, and employees involved in the securities industry. The agency conducted 365 inspections and took 353 enforcement actions. County and district attorneys obtained 213 convictions on transactions the agency investigated for securities violations, representing about \$18.9 million in lost funds.<sup>4</sup>

### Findings

#### **Texas has a continuing interest in maintaining a safe securities market for investors.**

Securities are an important tool for businesses, governments, and investors. By offering investors a stake in future profits or agreeing to repay an investment with interest, businesses and governments can access needed funds today to expand their operations or services for the future, which promotes business activity and job creation in the state. Securities, in turn, provide income for Texas investors to build wealth for present and future needs, such as retirement plans or investment accounts for college. A fair and effective securities market, however, requires full disclosure of material information to reduce the risk of bad investments, or outright theft or scams. In addition, the state has an interest in ensuring those involved in buying or selling securities, or advising Texans about securities, understand the market and how potential investments work, and can evaluate an investment’s suitability for their clients. Regulation by the agency helps protect against fraudulent practices and maintain investors’ confidence in the market.

To protect the public, the agency requires securities dealer and investment adviser professionals to demonstrate competence by successfully passing national securities examinations and an exam on securities law, and screening for relevant criminal history or professional misconduct.<sup>5</sup> Dealers and investment advisers must also register their offices, provide information about their companies and locations, and are subject to inspection by the agency, the SEC, or FINRA.

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*The agency helps protect against fraudulent practices and maintain investors’ confidence in the market.*

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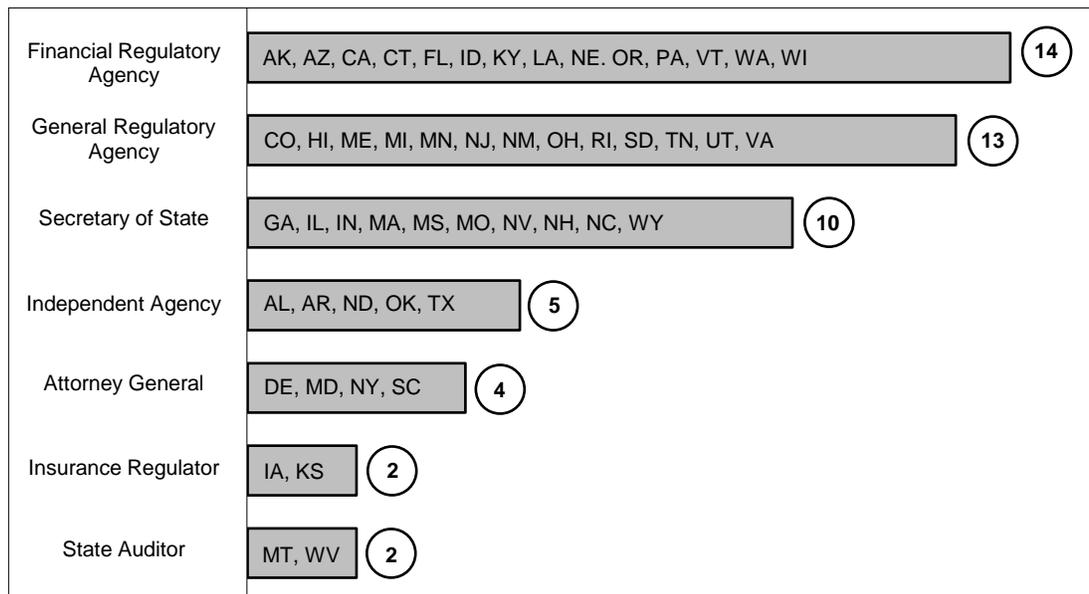
The agency ensures registrants abide by state and federal securities law by inspecting their offices and records and investigating complaints to identify and address violations. The agency also investigates unregistered persons and products in the securities market and refers egregious cases, like suspected fraud, to county and federal prosecutors.

**While most states regulate the securities industry through an umbrella agency structure, no substantial benefits would result from transferring the agency’s functions to another agency.**

All 50 states regulate securities offerings and professionals alongside the SEC and organizations like FINRA. The states’ primary role is to regulate persons and entities that do not have to register federally, though the states have overlapping authority to provide oversight of federally registered individuals. In addition, states enforce their own securities laws against registered and unregistered individuals. As shown in the graph, *Regulation of Securities in the United States*, the majority of states regulate securities within a financial or general regulatory agency or a state official’s office, such as an attorney general. However, Texas and four other states regulate securities with an independent agency.

*All 50 states regulate securities offerings and professionals.*

**Regulation of Securities in the United States**



While many states house their securities regulators with those that regulate banks and other financial entities, Sunset staff did not find that transfer to the Texas Finance Commission would result in efficiencies that outweigh the likely costs of transfer. The agencies within the Texas Finance Commission license financial institutions and businesses, perform inspections, and take enforcement actions, which generally aligns with the functions of the agency. However, the agency’s evaluation of securities offerings and practitioners is discrete from regulations that focus on physical institutions, like banks, that are custodians of consumers’ funds. Securities regulation generally focuses on transparency

in the industry and ensuring the disclosure of material information to clients, not on the safekeeping and sound management of funds.

Furthermore, the agency lacks the performance or management problems, such as licensure delays or ineffective enforcement, found in agencies that Sunset staff normally recommend for transfer. Any efficiencies that could be gained from a transfer to the Finance Commission likely would be offset by the need to retain a separate securities regulator under the Finance Commission for securities industry expertise, along with the costs to transfer technology, staff, and infrastructure to another agency.

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*No efficiencies would be gained from a transfer to the Finance Commission.*

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

The Sunset Commission has developed a set of standard recommendations that it applies to all state agencies reviewed unless an overwhelming reason exists not to do so. These across-the-board recommendations reflect the Legislature's effort to place policy directives on agencies to prevent problems from occurring, instead of reacting to problems after the fact. The provisions reflect review criteria contained in the Sunset Act designed to ensure open, responsive, and effective government.

- **Board member training.** The agency's statute requires training for all board members but does not require agency staff to create a training manual for all board members, or specify that the training must include a discussion of the scope of, and limitations on, the agency's rulemaking authority.<sup>6</sup> Though the agency currently provides both board member training and a manual, updating this language would ensure the agency continues to provide training and a manual members can reference that includes information necessary to protect the public.
- **Complaint information system.** Statute requires the agency to maintain files on complaints received.<sup>7</sup> However, statute does not require the agency to maintain a system to promptly and efficiently act on complaints. Although the agency generally tracks complaints and takes action, updating this requirement would ensure the agency continues to both track and take timely action on complaints.
- **Alternative rulemaking and dispute resolution.** The agency's statute does not include a standard provision relating to alternative rulemaking and dispute resolution that the Sunset Commission routinely applies to agencies under review. Without this provision, the agency could miss opportunities to improve how it makes rules and resolves disputes through more open, inclusive, and conciliatory processes designed to solve problems by building consensus rather than through contested proceedings.

### **The agency's sole reporting requirement remains necessary.**

The Sunset Act establishes a process for state agencies to provide information to the Sunset Commission about reporting requirements imposed on them by law and requires the commission, in conducting reviews of state agencies, to consider if each reporting requirement needs to be continued or abolished.<sup>8</sup> The Sunset Commission has interpreted these provisions as applying to reports that are specific to the agency and not general reporting requirements that extend well beyond the scope of the agency under review. Reporting requirements with deadlines or that have expiration dates are also not included, nor are routine notifications or notices, or posting requirements.

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*The agency's annual report conveys needed changes in securities regulation to decision makers.*

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The agency has one statutory requirement to annually report to the governor, lieutenant governor, and speaker about the agency's activities, revenues and expenditures, and any identified needs for future securities regulation.<sup>9</sup> Sunset staff recommends continuing this report to ensure the agency retains a formal vehicle to convey needed changes in securities regulation to lawmakers and the governor. In recent years, the agency has largely repeated itself in these reports, focusing on its turnover challenges, instead of identifying potential statutory changes, such as those in the agency's self-evaluation report submitted to Sunset in September 2017.<sup>10</sup> The agency should use its annual report to proactively discuss changes needed to better protect investors so its regulatory authority and ability keep pace with an evolving industry.

### **The agency should continue to implement state cybersecurity requirements and industry best practices.**

The 85th Legislature tasked the Sunset Commission with assessing cybersecurity practices for agencies under review.<sup>11</sup> The assessment of the agency's cybersecurity practices focused on identifying whether the agency complied with state requirements and industry cybersecurity best practices for its information systems. Sunset staff did not perform technical assessments or testing due to lack of technical expertise, but worked closely with the Department of Information Resources to gather a thorough understanding of the agency's technical infrastructure. Sunset staff found no issues relating to the agency's cybersecurity practices that require action by the Sunset Commission or the Legislature, and communicated the results of this assessment directly to the agency.

## **Recommendations**

### ***Change in Statute***

#### **2.1 Continue the State Securities Board for 12 years.**

This recommendation would continue the State Securities Board until 2031 as an independent agency, ensuring the state has the experience and authority necessary to protect investors and detect and pursue securities-related fraud. This recommendation would ensure that investors in Texas have access to important information about securities and that those who buy, sell, or give advice about securities and regulated investments are competent and suitable to participate in the securities market.

## 2.2 Update and apply standard across-the-board recommendations to the State Securities Board.

- **Board member training.** This recommendation would update existing statutory requirements for the agency to provide board member training by requiring the agency to develop a training manual that each member attests to receiving annually. The existing board member training would be required to include information and guidance about the scope of the agency's rulemaking authority, to address concerns of potentially anticompetitive behavior.
- **Complaint information.** This recommendation would update the statutory requirement for the agency to maintain a system to act promptly and efficiently on all complaints.
- **Alternative dispute resolution.** This recommendation would ensure the agency develops and implements a policy to encourage alternative procedures for rulemaking and dispute resolution that conforms, to the extent possible, to the State Office of Administrative Hearings' model guidelines. The agency would provide training as needed and collect data concerning the effectiveness of these procedures.

## 2.3 Continue the agency's statutory reporting requirement.

This recommendation would continue the agency's sole statutory requirement to report annually on future needs for securities regulation and the agency's revenues and expenditures. Continuing this requirement would ensure that the governor and Legislature are aware of the agency's activities and would provide the agency an opportunity to proactively identify needed changes to the Securities Act to better protect investors.

## Fiscal Implication

These recommendations would not result in a fiscal impact to the state. If the State Securities Board is continued, the agency's annual appropriation of \$7,014,450 would continue to be needed.

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<sup>1</sup> Section 40, Chapter 269 (S.B. 294), Acts of the 55th Texas Legislature, Regular Session, 1957; State Securities Board, *Self-Evaluation Report* (Austin: State Securities Board, 2017), 1 and 9.

<sup>2</sup> “Fast Answers: The Laws That Govern the Securities Industry,” Securities and Exchange Commission, accessed September 18, 2018, <https://www.sec.gov/answers/about-lawsshtml.html>.

<sup>3</sup> State Securities Board, *Agency Strategic Plan Fiscal Years 2019 to 2023*, accessed September 23, 2018, <https://www.ssb.texas.gov/sites/default/files/Strat%20Plan%20Combined%20Final%20Sgnd.pdf>, 1.

<sup>4</sup> State Securities Board, *Supplemental Self-Evaluation Report*, accessed September 12, 2018, [https://www.ssb.texas.gov/sites/default/files/Self\\_eval\\_supplemental\\_Sunset\\_TSSB.pdf](https://www.ssb.texas.gov/sites/default/files/Self_eval_supplemental_Sunset_TSSB.pdf), 13, 17, and 23.

<sup>5</sup> 7 T.A.C. Sections 115.2 and 116.2.

<sup>6</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 581-2-3, Vernon’s Texas Civil Statutes.

<sup>7</sup> Section 581-2-6, Vernon’s Texas Civil Statutes.

<sup>8</sup> Section 325.012(a)(4), Texas Government Code.

<sup>9</sup> Section 581-2(J), Vernon’s Texas Civil Statutes.

<sup>10</sup> State Securities Board, *Self-Evaluation Report*, 60–70.

<sup>11</sup> Section 325.011(14), Texas Government Code.

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# APPENDICES



# APPENDIX A

## ***Securities Regulation in the United States***

Federal and state entities play a joint role in regulating persons, companies, and offerings in the securities market. The federal government ultimately regulates the securities industry, and the State Securities Board fills in the gaps for certain areas of the industry not covered under federal jurisdiction or where regulation is shared among state and federal entities.

### **Federal Regulatory Entities**

- **Securities and Exchange Commission (SEC).** The primary regulator of securities in the United States tasked with monitoring, inspecting, and overseeing national securities exchanges, securities brokers and dealers, investment companies and large investment advisers, and non-exempt securities.
- **Financial Industry Regulatory Authority (FINRA).** A nonprofit membership organization that primarily registers and enforces rules against dealers and their agents on behalf of the SEC.<sup>1</sup> Almost all dealers and agents in Texas are members of FINRA, which allows them to engage in trading outside of a registered exchange.<sup>2</sup> FINRA maintains a central registration database that allows securities professionals to manage their registrations nationwide.<sup>3</sup>

### ***Regulation of Securities Professionals and Offerings***

	<b>State Securities Board</b>	<b>FINRA</b>	<b>SEC</b>
Investment Advisers	Registers and inspects all investment advisers with less than \$100 million AUM; requires notice of SEC-registered investment advisers <sup>4</sup>	Provides a registration system for investment advisers	Registers all investment advisers with more than \$100 million assets under management (AUM); subject to inspection
Investment Adviser Representatives	Registers all investment adviser representatives based in Texas; requires notice of investment adviser representatives based outside of Texas who operate in Texas <sup>5</sup>	Provides a registration system for investment adviser representatives	N/A
Dealers	Registers FINRA-member dealers in Texas; registers and inspects dealers exclusively engaged in intrastate commerce	Registers all dealers engaged in interstate commerce; subject to inspection at least every four years	Oversees and inspects FINRA and national securities exchanges
Dealer Agents	Registers FINRA dealer agents in Texas and dealer agents exclusively engaged in intrastate commerce	Registers all agents engaged in interstate commerce; subject to inspection at least every four years	Oversees and inspects FINRA and national securities exchanges
Securities Offerings	Registers all securities not registered with the SEC or otherwise exempt under state law; requires notice of SEC-registered securities offered in the state <sup>6</sup>	N/A	Registers all non-exempt securities that are bought or sold using interstate commerce communications <sup>7</sup>

## *Appendix A*

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<sup>1</sup> Securities Exchange Act of 1934 (15 U.S.C. Section 78a et seq.); “Fast Answers: Broker Dealer Registration: Where to File,” Securities Exchange Commission, <https://www.sec.gov/fast-answers/answersbrkrdr.htm>, accessed September 26, 2018.

<sup>2</sup> “Self regulatory organization,” Legal Information Institute, [https://www.law.cornell.edu/wex/self\\_regulatory\\_organization](https://www.law.cornell.edu/wex/self_regulatory_organization), accessed September 26, 2018.

<sup>3</sup> Securities Exchange Act of 1934 (15 U.S.C. Section 78a et seq.); “Fast Answers: Broker Dealer Registration: Where to File,” Securities Exchange Commission; Investment Adviser Registration Depository, “What is IARD?” <https://www.iard.com/whatsiard>, accessed October 16, 2018.

<sup>4</sup> State Securities Board, Self-Evaluation Report, accessed October 29, 2018, <https://www.sunset.texas.gov/public/uploads/files/reports/State%20Securities%20Board%20Self-Evaluation%20Report.pdf>; All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Sections 581-12 and 581-12-1, Vernon’s Texas Civil Statutes.

<sup>5</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 581-12 (B), Vernon’s Texas Civil Statutes; 7 T.A.C. Section 116.1(b).

<sup>6</sup> Sections 581-5–581-7, Vernon’s Texas Civil Statutes.

<sup>7</sup> 15. U.S.C. Sections 77e, 77r, and 77z-3.

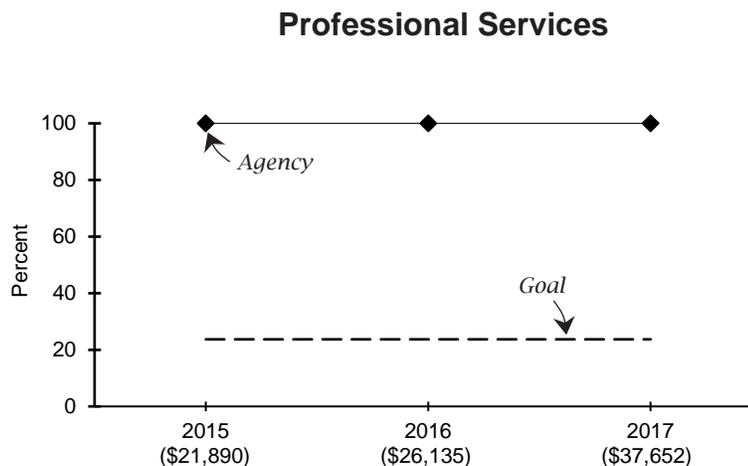
# APPENDIX B

## *Historically Underutilized Businesses Statistics 2015 to 2017*

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

The following material shows trend information for the State Securities Board's use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in statute.<sup>2</sup> In the charts, the dashed lines represent the goal for HUB purchasing in each category, as established by the comptroller's office. The diamond lines represent the percentage of agency spending with HUBs in each purchasing category from 2015 to 2017. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

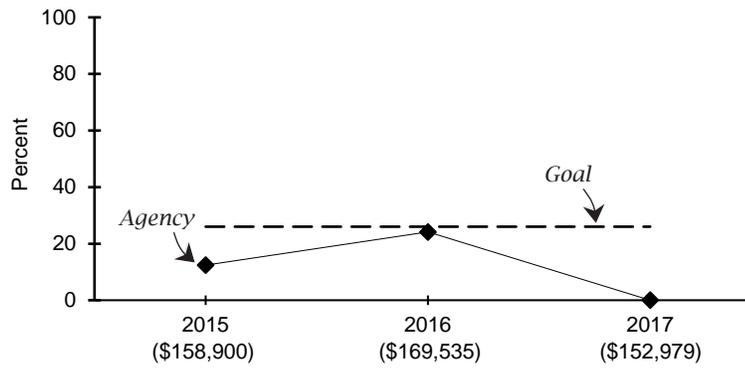
In fiscal years 2015 to 2017, the agency's purchases consistently exceeded the statewide purchasing goal for professional services and commodities but failed to meet the goal for other services in those same years.



The agency far exceeded the state goal in this category for all three of the last fiscal years.

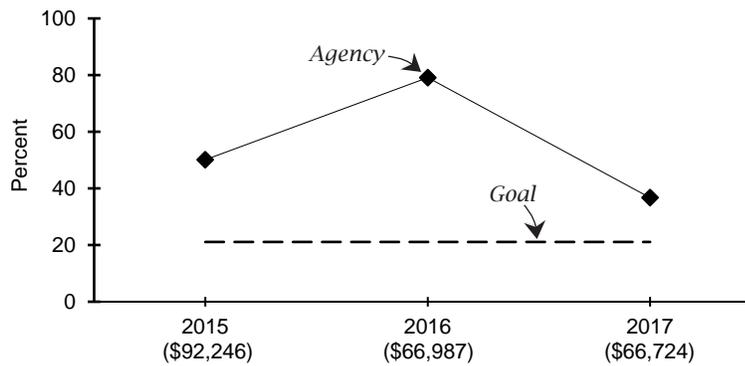
## Appendix B

### Other Services



The agency did not meet the state’s purchasing goal for other services in each of the last three fiscal years.

### Commodities



The agency exceeded the state goal in this category for all three of the last fiscal years.

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

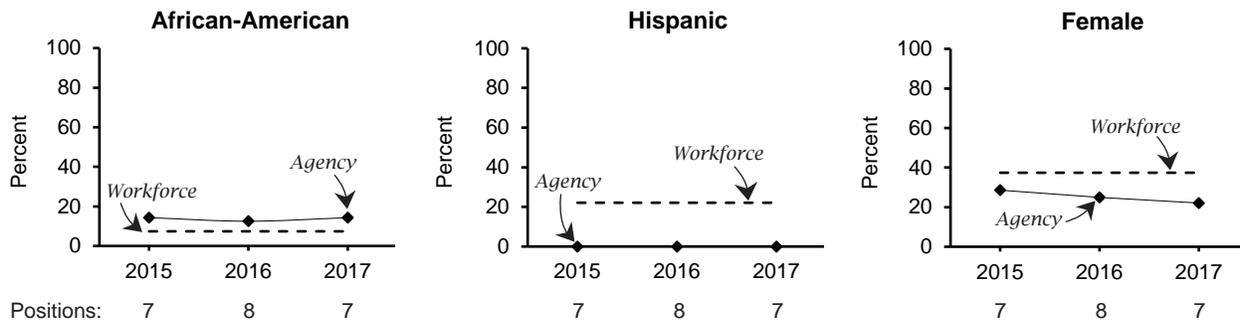
<sup>2</sup> Chapter 2161, Texas Government Code.

# APPENDIX C

## Equal Employment Opportunity Statistics 2015 to 2017

In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the State Securities Board.<sup>1</sup> The agency maintains and reports this information under guidelines established by the Texas Workforce Commission.<sup>2</sup> In the charts, the dashed lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category.<sup>3</sup> These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the agency's actual employment percentages. In fiscal years 2015 to 2017, the State Securities Board consistently exceeded civilian workforce percentages for African-Americans employees but fell below civilian workforce percentages for Hispanic employees. The agency had mixed success meeting the civilian workforce percentages for female employees in the same time period. The technical category had too few employees to conduct a meaningful comparison to the overall civilian workforce.

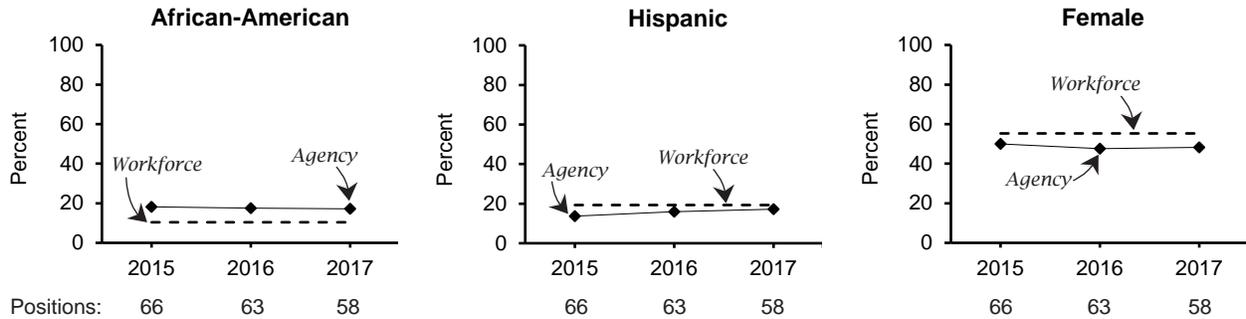
### Administration



The agency exceeded the civilian workforce percentages for African-Americans but fell below the civilian workforce percentages for Hispanics and females in this category for the last three fiscal years. However, the board employed few staff in this category.

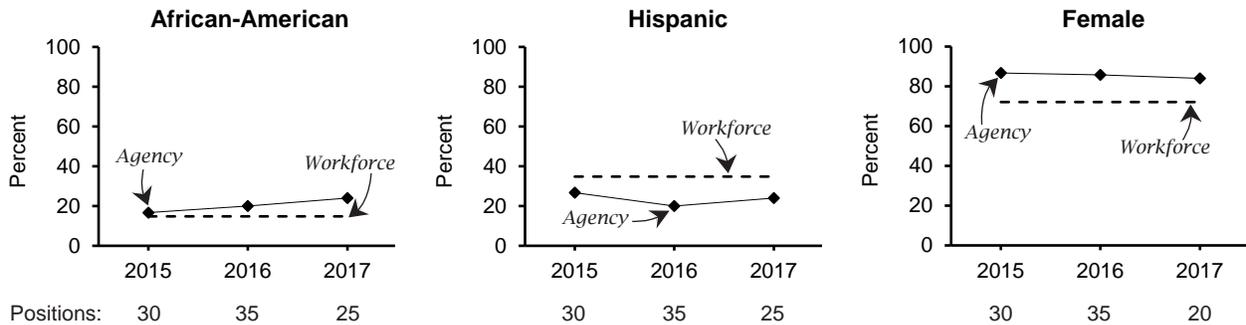
## Appendix C

### Professional



The agency exceeded the civilian workforce percentages for African-Americans in this category for the last three fiscal years. The agency fell below the workforce percentages for Hispanics and females in the same time period.

### Administrative Support



The agency exceeded the civilian workforce percentages for African-Americans and females in the last three fiscal years. The agency fell below the percentages in this category for Hispanics in the same time period.

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

<sup>2</sup> Section 21.501, Texas Labor Code.

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

# APPENDIX D

## ***Staff Review Activities***

During the review of the State Securities Board, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended board meetings; met with staff from key legislative offices; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state and federal statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research.

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

- Conducted an online survey of stakeholders about the agency and current regulations
- Observed a scheduled inspection of an investment adviser registered with the agency
- Interviewed agency field staff
- Attended internal staff trainings
- Interviewed staff from various government agencies, including the Department of Information Resources, Texas Adult Protective Services, the office of the attorney general, and the Financial Industry Regulatory Authority.



# Sunset Staff Review of the *State Securities Board*

————— *Report Prepared By* —————

Alan Leonard, *Project Manager*

Taj Sheikh

Brittany Calame

Steven Ogle, *Project Supervisor*

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Jennifer Jones  
*Acting Director*

Sunset Advisory Commission

Location

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

Mail

PO Box 13066  
Austin, TX 78711

Website

[www.sunset.texas.gov](http://www.sunset.texas.gov)

Email

[sunset@sunset.texas.gov](mailto:sunset@sunset.texas.gov)

Phone

(512) 463-1300