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COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF BANKING AND SECURITIES

PA DEPARTMENT OF
BANKING AND SECURITIES

In the Matter of:

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Docket No. 170014 (BNK-APP)

Members Choice Financial Credit Union

NOTICE OF RIGHT TO APPEAL

You are hereby notified that you have the right to appeal the attached Final Report and Order ("Order") issued by the Secretary of Banking and Securities.

If you wish to appeal the attached Order you may file a petition for review with the Prothonotary of the Commonwealth Court of Pennsylvania that complies with the format and timing requirements of the applicable Pennsylvania Rules of Appellate Procedure. Pa. R.A.P. 1511-1561. Failure to file a petition for review within 30 days of the mailing date of this Order will result in the attached Order becoming final and unappealable. You may reach the Commonwealth Court at 717-255-1650.

Please be advised that this Notice of Right to Appeal is not intended to and does not constitute legal advice. You should consult an attorney regarding your legal rights including your right to appeal the attached Order or your right to file an application for rehearing or reconsideration under the General Rules of Administrative Practice and Procedure. 1 Pa. Code § 35.241.

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In the Matter of: :
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Members Choice Financial Credit Union : **Docket No. 170014 (BNK-APP)**
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FINAL REPORT AND ORDER

Dates of Hearing: September 20, 2017
September 21, 2017

Presiding Officer: Robin L. Wiessmann
Secretary of Banking and Securities

PROCEDURAL HISTORY

This proceeding originated on April 20, 2017 with the filing of a Petition for Appeal and Administrative Hearing (“Petition”) by Members Choice Financial Credit Union (“Members Choice”) to appeal the Disapproval of Branch Application and Order to Close Branch (“Denial Order”) issued by the Pennsylvania Department of Banking and Securities (“Department”) Bureau of Credit Unions & Trust Supervision & Corporate Applications (“Bureau”).

Members Choice filed its Application for a Letter of Authority to Establish a Credit Union Branch with the Bureau on October 3, 2016, seeking approval to operate a branch in Mount Carmel, Pennsylvania (“Application”), which it had previously opened on May 10, 2016. The Bureau issued the Denial Order on April 10, 2017, which disapproved Members Choice’s Application, ordered Members Choice to wind-up activities of the branch within 60 days, provide written notice of the closing to the branch members, and pay a civil monetary penalty to the Department in the amount of \$10,000 no later than May 10, 2017.

On April 20, 2017, Members Choice filed a timely Petition to challenge the Denial Order. Robin L. Wiessmann, Secretary of the Department of Banking and Securities, is acting as the Presiding Officer in this matter.

By letter dated June 12, 2017, Members Choice, through its counsel, Christopher P. Pippett, Esq. of Fox Rothschild, LLP, requested that the Department issue a subpoena for certain documents and requested to take the deposition of certain Bureau individuals (“Discovery Request”).

By letter dated June 14, 2017, Thomas S. Lee, Esq., counsel for the Department, opposed the Discovery Request.

Secretary Wiessmann scheduled and held a pre-hearing conference on June 29, 2017 to discuss the Discovery Request.

On June 30, 2017, Secretary Wiessmann issued a Scheduling Order to schedule a pre-hearing conference for July 20, 2017 and to schedule the hearing for August 23, 2017. The Scheduling Order required pre-hearing statements to be filed on or before July 14, 2017. Both parties filed timely pre-hearing statements.

On August 21, 2017, Attorney Lee filed the Bureau's Motion for Continuance of Hearing. By email the same day, Attorney Pippett advised the Department that Members Choice did not oppose the motion. On August 22, 2017, Secretary Wiessmann issued an Order continuing the hearing to September 20-21, 2017.

The hearing proceeded as scheduled on September 20-21, 2017 at the Department's hearing room located at 17 North Second Street, Harrisburg, Pennsylvania.

The hearing transcripts were made available to the parties on or about October 30, 2017. On October 31, 2017, Secretary Wiessmann issued a Post-Hearing Briefing Order. Under the terms of the Briefing Order, the post-hearing brief of each party shall be filed on or before November 30, 2017, and any reply briefs shall be filed on or before December 15, 2017.

On November 8, 2017, Attorney Lee, on behalf of the Bureau, filed a Motion to Correct Hearing Transcript, which was granted by Secretary Wiessmann on November 29, 2017.

On November 9, 2017, Attorney Lee, on behalf of the Bureau, filed a Motion to Attach Admitted Exhibits to the Hearing Transcript and Motion for Ruling on Department ("DoBS"¹) Exhibit 9. Counsel for Members Choice filed a response objecting to the Motion for Ruling on

¹ "DoBS" refers to the "Department of Banking and Securities "

DoBS Exhibit 9. The Bureau's motion was granted by Secretary Wiessmann on November 29, 2017.

Both parties filed timely post-hearing briefs and reply briefs.

The matter is now before Secretary Wiessmann for final disposition.²

FINDINGS OF FACT

General Background

1. Members Choice is a Pennsylvania Credit Union with a business address at 230 Walnut Street, Danville, Pennsylvania. (DoBS Exhibit 1, p. 99)
2. James Barberich ("Mr. Barberich") is the president/CEO of Members Choice. (DoBS Exhibit 1, p. 99)
3. Members Choice was chartered by the National Credit Union Administration ("NCUA") as a federal credit union in 1954. (N.T.³) 13)
4. In 2005, NCUA approved a field of membership expansion for Members Choice to include an underserved area that included Mount Carmel, PA. (N.T. 86, DoBS Exhibit 1, p. 102)
5. Once an "underserved area" has been approved, the NCUA Chartering and Field of Membership Manual requires a credit union to establish and maintain a "service facility" in the area within two years of approval. (App. B to Part 701, Ch. 3, § III. F, 12 CFR Part 1, Ch. 3, § III.F.); (N.T. 266)
6. Members Choice did not open a new branch in the underserved area of Mount Carmel as a federally chartered credit union. (N.T. 266-267)

² Under Section 1122-A of the Banking and Securities Code, 71 P S § 733-1121-A, the Banking and Securities Commission acts as the final adjudicator for administrative proceedings instituted by the Department. However, as this proceeding was instituted by Members Choice and not by the Department, Secretary Wiessmann, as head of the Department, acts as the final adjudicator.

³ "N.T." refers to "notes of testimony" from the September 20-21 administrative hearing

7. As a federally-chartered credit union, Members Choice was not required to obtain approval prior to operating a branch office. (N.T. 230)
8. Members Choice opened five branch offices while under federal charter. (N.T. 229-230)

Operating Under State-Charter

9. Members Choice converted from a federally-chartered credit union supervised by the NCUA to a state-chartered credit union supervised by the Department in 2014. (N.T. 173)
10. In accordance with the Department's supervisory authority, the Department conducts annual examinations to assess the safety and soundness of the credit union, its operations, and practices. As part of the examinations, the Department examines capital, asset quality, management, earnings, liquidity (includes asset-liability management) and assigns a rating to each CAMEL component and assigns an overall composite rating in accordance with the Federal Financial Institutions Examination Council's ('FFIEC') Uniform Financial Institution Rating System ("UFIRS") using a numeric scale of 1 to 5. One (1) indicates the highest rating, while a 5 rating indicates the lowest. (N.T. 131-132; DoBS Exhibit 3; DoBS Exhibit 9)
11. The term "capital position" refers to the net worth of a credit union and provides for expansion of activities and services and serves as a buffer against a credit union's potential losses. (N.T. 136-137)
12. A management rating includes:
 - a. Capabilities of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products;
 - b. Compliance with laws and regulations; and

c. Responsiveness to recommendations of supervisory authorities. (DoBS Exhibit 9, Appendix A, p. 7)

13. A management rating also assesses whether staff is adequately trained, whether policies and procedures are being followed, and whether there is sufficient staff to conduct the operations in a safe and sound manner. (DoBS Ex. 9, Appendix A, p. 7; N.T. 137)

14. An institution with an overall 3 composite rating is considered to be less than satisfactory or fair. A one rated institution is considered to be strong. (N.T. 167)

15. The NCUA defines a composite 3 rating as follows:

“Credit unions in this group exhibit some degree of supervisory concern in one or more component areas. These credit unions exhibit a combination of weaknesses that may range from moderate to severe. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Credit unions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those rated a composite 1 or 2. Additionally, these credit unions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the credit union’s size, complexity, and risk profile. These credit unions require more than normal supervision which may include enforcement actions. Failure appears unlikely, however, given overall strength and financial capacity of these credit unions.” (DoBS Exhibit 9, Appendix A, p. 2)

16. The Bureau defines a composite “3” rating as follows:

“3” - Institutions in this category exhibit financial, operational or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. (DoBS Exhibit 3, p. 114)

Pre-Application Operations

17. The Department conducted an examination of Members Choice in August 2015. The examination resulted in component ratings of 2 (capital), 3 (asset quality), 3 (management),

- 3 (earnings), and 3 (liquidity), and a composite CAMEL rating of 3. (DoBS Ex. 6, p. 113; N.T. 145-146)
18. The Department conducted an examination of Members Choice in August 2016. The examination resulted in component ratings of 2, 3, 3, 3, and 2, and a composite CAMEL rating of 3. (DoBS Ex. 6, p. 113; N.T. 145-146)
 19. The CAMEL rating for liquidity improved from a “3” to “2” in the August 2016 examination. (DoBS Ex. 6, p. 113)
 20. The August 2016 Examination Report includes several ongoing Documents of Resolution (Matters Requiring Board Attention), included the credit union’s earnings performance and failure to follow standard accounting and reporting standards for foreclosed real estate. (DoBS Ex. 3, p. 126)
 21. The August 2016 Examination Report indicates a net loss of \$51,541 for the period 1/1/16 - 6/30/16. (DoBS Ex. 3, p. 135)
 22. The August 2016 Examination Report revealed issues with asset quality, the level of nonperforming assets, earnings, and management’s lack of strategies to improve earnings performance. The asset quality, earnings, and management component ratings were all rated 3. (N.T. 143, DoBS Ex. 3, p. 111)
 23. The August 2016 Examination Report indicates that asset growth is outpacing net worth growth, which results in a decline of the net worth ratio. (N.T. 164-165; DoBS Ex. 3, pp. 123, 147)
 24. The August 2016 Examination Report indicates that the net worth ratio declined from 8.67% in the prior examination to 8.42% in the current examination, compared to a 10.92% peer ratio. (DoBS Ex. 3, p.123)

25. During the August 2016 examination, the Bureau discovered that Members Choice had opened a branch in Mount Carmel on May 10, 2016 without approval from the Department. (N.T. 147-148, 229; DoBS Ex. 3, p. 120)
26. The Bureau discovered the existence of the branch during the August 2016 examination by reviewing the credit union's board of director meeting minutes. (N.T. 147)
27. During the August 2016 examination, the Bureau examiner orally advised the credit union to file a new branch application with the Department. (N.T. 241-242)
28. The August 2016 Examination Report was delivered to Members Choice on or about February 8, 2017. (DoBS Ex. 3, p. 111)

Application Process

29. Members Choice filed its Application with the Department for approval to operate the Mount Carmel branch on October 3, 2016. (N.T. 34; DoBS Ex. 1, p. 99)
30. The Application and supporting materials, including projections prepared by Members Choice, were received by the Department on or about October 3, 2016 and thereafter. (DoBS Ex. 1, p. 99)
31. The Application and supporting materials aver that the Mount Carmel branch will satisfy the credit union's 2005 commitment to serving the underserved, a designation obtained in 2005 from the NCUA. (DoBS Ex. 1, p. 102)
32. Members Choice included underserved business plans from 2005 and 2015 as part of the Application and supporting materials. (N.T. 85-87, DoBS Ex. 6, pp. 182-188, 218-228)
33. The 2015 business plan included in the Application provides that the credit union's goal is to be a depository branch institution (or increase market share). This strategy does not align with a strategy to serve an underserved area because the depository branch institution

strategy is to primarily to obtain deposits for the purpose of lending elsewhere. (N.T. 87-89, 101-102; DoBS Ex. 6, p. 219)

34. The business plan and financial projections included in the Application did not contain sufficient supporting information to be able to verify the financial reports and projections. (N.T. 160-162, 166,174; DoBS Ex. 6).
35. Members Choice does not have a branch accounting system that captures the assets, liabilities, income, and expenses associated with each branch of the credit union. (N.T. 353, 364).
36. The Application and supporting materials submitted by Members Choice include targets for the Mount Carmel branch based on \$25 million in deposits. The targets include \$8,750,000 in loans funded in year one, \$17,500,000 in year two, and \$21,250,000 in year three. (DoBS Ex. 6, p. 228)
37. A supervisory concern with a 3-rated credit union opening a new branch is that the new branch will cause an immediate decline in earnings due to the initial costs of the branch and the operational losses of the branch until it achieves break-even and becomes profitable. (N.T. 75-76, 90)
38. The Application states that the total costs to establish the Mount Carmel branch were \$377,478, and that the premises were purchased from Fulton National Bank. (DoBS Ex. 1, p. 23)
39. Following the submission and review of the Application, Mr. Joseph Moretz, Manager of the Corporate Applications Division, deemed the Application deficient and requested additional information from the credit union. (N.T. 78, 84-85; DoBS Ex. 1, pp. 36-38).

40. By letter dated December 2, 2016 to Members Choice, the Bureau sought additional information relating to five detailed issues to continue processing the Application. The December 2, 2016 letter was sent to Board Chairperson Mary Fasano, Mr. Barberich and Wendy Angus, NCUA Associate Region 2 Director for Programs. (DoBS Ex. 1, pp. 36-38).
41. The Bureau requested the following information in the December 2, 2016 letter:
 - (i) Total number of new accounts opened directly as result of the branch opening;
 - (ii) Total number and dollar amount of deposits and loans brought into the credit union as a result of the branch opening (as opposed to being transferred from another branch);
 - (iii) Copies of Board's minutes reflecting when the Board approved the purchase of the land and building to open the branch;
 - (iv) Copies of any due diligence performed by the credit union; and
 - (v) Copies of any documents to support the costs with establishment of the branch.(DoBS Ex. 1, pp. 36-38)
42. Members Choice responded to the Department's December 2, 2016 letter by letter dated December 27, 2016 and supporting materials. (DoBS Ex. 6)
43. The materials included with the December 27, 2016 letter included financial projections for the Mount Carmel branch that did not contain an estimate of loan loss provisions necessary to verify the projections. (DoBS Ex. 4; N.T. 93-95)
44. The materials included with the December 27, 2016 letter included Members Choice board minutes for December 21, 2015, which included loans funded projections of the Mount

Carmel branch of \$8,750,000 in year one, \$17,500,000 in year two, and \$21,250,000 in year three. (MC⁴ Ex. 6, p. 196)

45. The December 27, 2016 letter provides that the Mount Carmel branch has generated \$2,859,954 in loans to date. (DoBS Ex. 6, p. 180)

March 3, 2017 Meeting

46. The Bureau informed Members Choice by telephone of its decision to disapprove the branch application and suggested that Members Choice voluntarily withdraw the application and close the branch to minimize reputation risk to the credit union associated with a public denial. (N.T. 281-282)
47. Mr. Barberich requested a face-to-face meeting with the Bureau to discuss the concerns and reasons for the Bureau's determination to disapprove the Application. The meeting occurred on March 3, 2017 ("March 3rd Meeting"). (N.T. 282-283)
48. Following the March 3rd Meeting, Mr. Moretz indicated the following by e-mail to Mr. Barberich dated March 3, 2017:

"Due to safety and soundness concerns relating to the current status of your institution, as well as the stresses added by the addition of the proposed branch, during the meeting, we indicated to you that the Department is obligated to not approve a branch application. Therefore, we are not inclined to change our decision to deny the application based on today's conversation. No additional information was provided that would alter or eliminate the safety and soundness concerns." (N.T. 296; DoBS Ex. 10)

49. Mr. Moretz' March 3rd e-mail also provided the credit union the opportunity to file a response to the August 2016 Examination Report as additional information to the Application. (DoBS Ex. 10)

⁴ "MC" refers to Members Choice.

50. The Department received supplementary materials from Members Choice on March 15, 2017 and Members Choice's response to the August 2016 Examination Report on March 20, 2017. (DoBS Ex. 1, pp. 1-35; DoBS Ex. 5)
51. The materials included in the Members Choice March 15, 2017 submission indicated that the Mount Carmel branch generated \$3,879,131 in total loans from May 1, 2016 to February 28, 2017. (DoBS Ex. 1, p. 22)

The Denial Order

52. Following an analysis of the Application and supporting materials, and the Bureau's investigation, Begene Bahl, Bureau Director, Credit Union & Trust Supervision & Corporate Applications, issued the Denial Order on or about April 10, 2017. (N.T. 146; DoBS Ex. 2).
53. Upon review and investigation of Members Choice's application and supporting materials, the Bureau determined that the operation of the Mount Carmel branch creates operations and safety and soundness issues. (N.T. 28, 38-41; DoBS Ex. 2).
54. Members Choice received official notification of the Denial Order on or about April 10, 2017. (DoBS Ex. 2).
55. The Denial Order was drafted and issued with consideration of its effect on reputation risk and credit union's level of membership. (N.T. 36).
56. The Denial Order include a civil monetary penalty of \$10,000 for violating the Credit Union Code for opening a new branch without Bureau approval. (N.T. 43; DoBS Ex. 2).

Post-Order Operations

57. Members Choice filed a timely petition to challenge the Denial Order.

58. Jean Miller, Chief Financial Officer of Members Choice, assisted in the preparation of a Financial Analysis 2017 Budget, which the Members Choice Board approved. (MC Ex. 4; N.T. 352)
59. The Financial Analysis 2017 Budget indicates a net income of \$195,594.37 for April 2017 year to date. (MC Ex. 4; DoBS Ex. 7, p. 349)
60. Ms. Miller assisted in the preparation of a financial statement of the Mount Carmel branch (Mount Carmel Financial Statement) for the period May 2017 year to date with projections to 2020. (MC Ex. 6; N.T. 352-353)
61. The Mount Carmel Financial Statement indicates a net loss of \$17,105 for year to date May 2017. (MC Ex. 6)
62. The Mount Carmel Financial Statement projects a net income of \$90,857 for 2018. (MC Ex. 6)
63. Padden, Guerrini & Associates, P.C., conducted an audit of Members Choice as of December 31, 2016 and 2015 and prepared an Independent Auditor's Report ("Auditor's Report") The Auditor's Report is dated April 26, 2017. (MC Ex. 9; N.T. 386-388)
64. The Auditor's Report indicates Members Choice net worth of \$11,620,905 as of December 31, 2016, with a net worth ratio of 8.18%. (MC Ex. 9, p. 30; N.T. 390-91)
65. The Auditor's Report categorizes Members Choice as "well capitalized," which requires a minimum net worth ratio of 7% of assets and meet any applicable risk-based net worth requirement. (MC Ex. 9, p. 30)
66. The NCUA issued a Call Report for Members Choice effective March 31, 2017 which indicates a net income amount of \$276,799 as of June 30, 2017. (MC Ex. 8, p. 92)

67. On March 31, 2017, the NCUA conducted an onsite supervision contact of Members Choice. The NCUA report provides that the credit union's net worth ratio declined from 8.17% as of December 31, 2016 to 7.95% as of March 31, 2017. (DoBS Ex. 12, pp. 34, 37)
68. The NCUA issued a Financial Performance Report for Members Choice for the quarter ending June 2017. The net income or loss percentage change calculation in the NCUA Performance Report is based on annualization factors as follows: March = 4, June = 2, September = 4/3, December = 1 (or no annualizing). Applying these factors to the net income numbers results in significant increases from September to December 2016 (633.5%) and from December 2016 to March 2017 (383.7%), but a loss of 11.3% from March 2017 to June 2017. (DoBS Ex. 11).
69. The NCUA Financial Performance Report indicated a net worth ratio of 7.95 for the quarter ending June 2017, which was unchanged from the quarter ending March 2017. (DoBS Ex. 11; DoBS Ex. 12)
70. The Mount Carmel branch is operated by three employees, all of whom were transferred from other Members Choice branch locations. (N.T. 239)

III. CONCLUSIONS OF LAW

1. The Secretary of Banking and Securities has jurisdiction over this matter.
2. The Department is the Commonwealth's administrative agency authorized and empowered to administer and enforce the Credit Union Code ("Code") 17 Pa. C.S. § 101 et. seq..
3. The Department is authorized and empowered to issue general rules and regulations and specific orders for the protection of members of credit unions, for insuring the conduct of

the business of credit unions on a safe and sound basis and for the effective enforcement of the Code. 17 Pa. C.S. § 503(a).

4. The Bureau is authorized to approve or deny new branch applications under the Code for the Department. Section 904(b), 17 Pa. C.S. § 904(b).
5. Members Choice was required to obtain the Bureau's approval pursuant to Sec. 904 of the Code prior to the opening of a new branch location. (N.T. 24; Section 904(b), 17 Pa. C.S. § 904(b)).
6. Members Choice failed to meet its burden and establish the reasons for filing the new branch application and the factors that support the need for services contemplated and, therefore, the Application was properly denied by the Bureau and not an abuse of discretion.
7. Members Choice was served with the Denial Order and was granted an opportunity to be heard in accordance with Administrative Agency Law, 2 Pa. C.S. § 504.
8. The Bureau presented substantial evidence that the denial of Members Choice's application for a new branch was based on the operations and safety and soundness issues raised by the proposed branch was valid and the denial was not an abuse of discretion.
9. The Department acted lawfully in assessing a civil monetary penalty for \$10,000.
10. The Presiding Officer is not limited in her review of this matter to information available prior to the Bureau's issuance of the Denial Order on April 10, 2017.
11. The evidence supports a finding that the Mount Carmel branch may financially "break even" prior to the end of 2018.

12. The evidence supports a finding that Members Choice has exhibited a degree of financial improvement since the issuance of the Denial Order and may not be significantly impacted by the Mount Carmel branch.
13. The evidence supports a finding that Members Choice has exhibited financial improvement sufficient to warrant continued operation pending approval of the Mount Carmel branch upon satisfaction of additional criteria.

DISCUSSION

I. Preliminary Matters

The Department, acting through the Bureau, issued the Denial Order to Members Choice on April 10, 2017. The Denial Order is an enforcement order issued by a subordinate officer pursuant to the Code, which is subject to appeal to the agency head. See 1 Pa. Code § 35.20.⁵

Section 503 (a.2) of the Banking and Securities Code, 71 P.S. § 733-503(a.2), provides that the Department may conduct administrative hearings subject to the provisions of 7 Pa. C.S. Chs. 5 Subch. A, which includes the General Rules of Administrative Practice and Procedure (GRAPP). The Secretary acts as the Presiding Officer in this matter pursuant to 1 Pa. Code § 35.185, and also acts as the final adjudicator in this matter.

Petitioner has the initial burden to establish support in the Application to open a branch office. See, *Street Road Bar & Grille, Inc v. Pennsylvania Liquor Control Board*, 876 A.2d 346, 353 (Pa. 2005)

The review of an agency adjudication is limited to determining whether the necessary findings of fact were supported by substantial evidence, whether errors of law were made, or

⁵ The practice of subordinate officers initiating enforcement actions is necessary to meet constitutional principles of due process and the need to separate adjudicatory and prosecutorial functions *Lyness v. Dep't of State Board of Medicine*, 605 A 2d 1204 (Pa 1992).

whether constitutional rights were violated. *Shapiro v State Bd. of Accountancy*, 856 A.2d 864 (Pa. Cmwlth. 2004). Substantial competent evidence is such relevant evidence that a reasonable mind might accept as adequate to support a conclusion. *Minicozzi v. Workers' Comp Appeal Bd. (Ind. Metal Plating, Inc.)*, 873 A.2d 25 (Pa. Cmwlth. 2005); *Younkin v State Real Estate Commission*, 774 A.2d 1281 (Pa. Cmwlth. 2001); 2 Pa.C.S. 704. An abuse of discretion occurs where the findings of fact are not supported by substantial evidence. *Hafner v Zoning Hearing Bd. of Allen Twp.*, 974 A.2d 1204 (Pa. Cmwlth. 2009). Further, the Commonwealth Court has recognized that it is required to give due deference and great weight to the administrative agency's interpretation of a statute it is charged with enforcing and may not disregard or overturn its interpretation without cogent reasons and a decision determining the agency was clearly erroneous. *Rinaldi v. Bd of Vehicle Mfrs., Dealers & Salespersons*, 843 A.2d 418 (Pa. Cmwlth. 2004).

II. The Denial Order

The Pennsylvania Credit Union Code, 17 Pa. C.S. § 101 et.seq, empowers the Department to regulate credit unions. Section 503 of the Code, provides, in pertinent part:

§ 503. Regulation by department.

- (a) General rule.--Credit unions shall be under the supervision of the Department. The department is hereby authorized and empowered to issue general rules and regulations and specific orders for the protection of members of credit unions, for insuring the conduct of the business of credit unions on a safe and sound basis and for the effective enforcement of this title.

(17 Pa. C.S. § 503)

Section 503 gives the Department "broad authority to regulate and supervise credit unions. More specifically it authorizes the Department to issue 'specific orders' to protect credit union members, to ensure that credit unions engage in sound business practices, and to effectively

enforce the provisions of the Credit Union Code.” *Cooper v Department of Banking*, 720 A.2d 832, 834 (Cmwlth. 1998), *appeal denied*, 737 A.2d 1227 (Pa. 1999).

The Denial Order issued by the Bureau consists of two parts: First, the Civil Penalty in the amount of \$10,000 for failure to provide notice to and obtain approval from the Department prior to opening the Mount Carmel branch as required by Section 904(b) of the Code; and Second, the order to close the Mount Carmel branch due to “safely and soundness” concerns. Each part will be discussed separately.

A. The Civil Penalty

Section 904(b) of the Code, 17 Pa. C.S. § 904(b), clearly requires that prior approval of a branch office is required, and provides as follows:

§ 904 Place of Business

* * *

(b) Branch offices and service facilities.--If a credit union gives the department prior written notification and, in the case of branch offices, receives prior approval from the department, it may establish and maintain, at locations other than its principal place of business, additional branch offices and service facilities to furnish services to its members.

The Bureau included in the Denial Order a civil penalty for failure to provide notice and obtain approval in violation of Section 904(b) of the Code, and based the civil penalty in Section 503(a.1) of the Code, which provides, in pertinent part:

(a.1) Fines, removals, prohibition, suspension. – For any violation of this title or regulation issued pursuant to this or any final order issued by the department under this title or any unsafe or unsound practice or breach of fiduciary duty involving a credit union, the Department may take any one or more of the following actions:

(1) The department may impose a civil penalty of up to \$10,000 for each violation of this title against a credit union or any director, officer, committee member, employee, volunteer or agent of a credit union.

There is no evidence in the record that Members Choice intentionally failed to provide notice to the Department prior to opening the Mount Carmel branch in May 2016. Likewise, there is no direct evidence that Members Choice was aware that prior notice and approval was required.

However, a violation of Section 904(b) of the Code is not premised on a finding of intentional conduct. Moreover, the fact that the NCUA does not require prior notice and approval for opening a branch does not excuse Members Choice from the requirements of Section 904(b).

Members Choice switched from a federal charter to a state charter months before it opened the Mount Carmel branch. Mr. Barbarach testified that he had reviewed the Code “when we were looking at conversion from a federal to a state charter” (N.T. 327-28), and that he had online access to the Code. (N.T. 330-31).

The language of Section 904(b) is clear and unambiguous. The entire Code, in fact, is only 46 pages. The failure of anyone at the credit union to read the Code provision relating to opening a branch office, particularly prior to actually opening a branch office, demonstrates a serious flaw in compliance. Accordingly, the Bureau’s Denial Order relating to the payment of a civil fine in the amount of \$10,000 is proper and supported by substantial evidence.

B. Closing the Branch

The Denial Order provides that Members Choice must wind-up activities of the branch and provide its members with at least 30 days’ notice of the branch closing to give its members an opportunity to transfer accounts elsewhere.

The initial issue before the tribunal is whether there is substantial evidence to support the Denial Order at the time it was issued on April 10, 2017. “Substantial evidence” has been defined as “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.” *Republic Steel Corp v Workmen’s Compensation Appeal Board*, 421 A.2d 1060, 1062 (Pa. 1980).

The record here establishes that the Department conducts examinations at least on an annual basis to assess the safety and soundness of credit unions. The Department examines capital, asset quality, management earnings, and liquidity (CAMEL) and assigns a rating to each category, and also assigns an overall composite rating in accordance with the Federal Financial Institution Examination Council's ("FFIEC") Uniform Financial Institution Rating System ("UFIRS") using a numeric scale of 1 (highest) to 5 (lowest). (DoBS Ex. 2).

The Department examined Members Choice in 2015 and 2016. Both examinations resulted in a composite rating of 3. (N.T. 145-146; DoBS Ex. 6, p. 113)

Members Choice's last examination prior to the filing of the application to open the Mount Carmel branch was in August 2016, which was conducted using financial data as of June 30, 2016. The CAMEL ratings were 2-3-3-3-2 with a composite rating of 3. (N.T. 131; DoBS Ex. 6, p. 113).

The NCUA in its December 2007 letter to credit unions explained the CAMEL composite 3 rating:

Rating 3 – Credit unions in this group exhibit some degree of supervisory concern in one or more of the component areas. These credit unions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Credit unions in this group general are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those rated a composite 1 or 2. Additionally, these credit unions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the credit union's size, complexity, and risk profile. These credit unions require more than normal supervision which may include enforcement actions. Failure appears unlikely, however, given overall strength and financial capacity of these credit unions.

(DoBS Ex. 9).

The Bureau's August 2016 examination of Members Choice, which was delivered to Members Choice by letter dated February 8, 2017, provides the following description of a "3" composite rating:

“3” - Institutions in this category exhibit financial, operational or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness.

(DoBS Exhibit 3, p. 114)

The component rating for “liquidity” improved from a “3” in the August 2015 examination to a “2” in the 2016 examination; however, the composite rating remained at a “3”. (DoBS Ex. 3, p. 116).

The evidence also established that that Bureau took into consideration the fact that Members Choice obtained its underserved designation for the Mount Carmel area from the NCUA in 2005. The Bureau based its concern on the fact that the NCUA gives a credit union two years to open a branch after an underserved designation approval. Although, Members Choice correctly argues in its post-hearing reply brief that the failure to establish a “service facility” in the area within two years of the approval does not necessarily result in the NCUA rescinding the designation, the Bureau was correct in considering the time lapse since the NCUA designation in its determination.

The record also establishes that, based on the Bureau’s experience, it generally takes a new branch at least three years to break even. (N.T. 90, DoBS Ex. 6). During this period, new branches tend to be a drain on earnings, until the branch profits are equal to the cost already expended to open the branch. It is noted, however, that the costs associated with opening the Mount Carmel branch were relatively small, due in part to the purchase of an existing building rather than constructing a new one.

It appears that the Bureau had sufficient evidence to issue the Denial Order to close the branch at the time.⁶ The Bureau's concerns about the safety and soundness of opening and maintaining the Mount Carmel branch are well-founded, and include:

- The consistent composite CAMEL rating of a "3," indicating "financial, operational or compliance weaknesses ranging from moderately severe to unsatisfactory;"
- The fact that generally new branches take at least three years to "break even," and the resulting stress on the financial stability of the credit union;
- The fact that the NCUA underserved designation is from 2004;
- That preliminary information regarding the Mount Carmel branch submitted in December 2016 indicated loan and income results below anticipated levels;
- The fact that the August 2016 Examination Report indicates asset growth outpacing net worth growth; and
- The fact that Members Choice failed to obtain prior approval for the branch, which reflects poorly on the management of the credit union.

III. Post-Denial Order Operations

The conclusion that the Bureau's Denial Order was based on substantial evidence does not, however, end the determination of this matter. The Bureau's Denial Order was issued based on

⁶ The hearing included some conflicting testimony regarding whether the Department reviewed the Members Choice Financial Analysis 2017 and the Mount Carmel Financial Statement (DoBS Ex. 7, MC Exs 4 & 6, respectively) prior to the Denial Order. Brenda Doran, Manager of the Credit Union Division, testified that she reviewed the financial statements prior to the Denial Order (N T 186-187), however, Begene Bahl, Director of the Bureau, testified that she believed the Bureau received the financial statements afterward (N T 72). Given that the financial statements are labeled "April YTD" and "05-2017 YTD" respectively, and that the Members Choice Financial Analysis 2017 includes the date "6/16/17" at the bottom of the page (DoBS Ex. 7, p 349), it can be assumed that the Bureau did not have these financial statements at the time the Denial Order was issued on April 10, 2017. Accordingly, these financial statements are discussed *infra* in the "Post-Denial Order Operations" section.

information at a point in time - April 10, 2017 - and in issuing the Denial Order, the Bureau fulfilled its statutory mandate to ensure the conduct of the business of credit unions on a safe and sound basis and to effectively enforce the Code.

However, in the final determination of this matter, the Presiding Officer is not limited to the information as of April 10, 2017, but instead can take into consideration the entire record in this matter.

The record in this matter establishes that while the credit union continues to experience some financial difficulties, it has exhibited some sporadic improvement. Likewise, although the Mount Carmel branch had only been in operation approximately 16 months at the time of the hearing, it has exhibited some degree of financial improvement and although it has not yet “broken even,” it does not appear to be significantly affecting the financial stability of the credit union itself.

For example, the record includes an Independent Auditor’s Report submitted by Padden, Guerrini & Associates P.C. on April 26, 2017, which indicates Members Choice is capitalized at 8.18%, above the industry standard of 7%. (MC Ex. 9, H.T. 391).

The NCUA Financial Summary for quarter ending June 2017 indicates significant fluctuation in the credit union’s net income on an annualized percentage basis. According to the financial summary, Members Choice’s income decreased 22% from June-September 2016, then increased 633.5% from September-December 2016. The net income increase continued as of March 2017 (383.7%), but then decreased 11.3% from March-June 2017. (See DoBS Ex. 11)

The NCUA Call Report effective March 31, 2017 indicates the credit union’s net income to date is \$276,749 as of June 2017. (MC Ex. 8, p. 82). However, applying the annualization factors

as set forth in the NCUA Financial Summary, that net income figure is actually a net loss of 11%. (See MC Ex. 11)

The income statement for year to date April 2017 indicates net income of \$195,594.37 compared to the budget of \$133,020.00. (MC Ex. 4).

The NCUA conducted a supervision contact of Members Choice as of March 31, 2017, and the resulting report indicates net income of \$155, 946. (DoBS Ex. 12, p. 37). The report also indicated that the net worth ratio for Members Choice had declined from 8.91 as of December 31, 2015 to 7.95 as of March 31, 2017. (DoBS Ex. 12, p. 34). However, the NCUA Financial Summary for the quarter ending June 2017 indicates the net worth ratio had stabilized at 7.95. (DoBS Ex. 11)

Finally, Members Choice's CFO, Jean Miller, prepared financial information regarding the Mount Carmel branch in accordance with generally accepted accounting principles. (MC Ex. 6, N.T. 353, 385). The Branch Financial Statement indicates a net loss of \$17,105 as of May 2017. However, the financial statement projects that the Mount Carmel branch will be earning a profit by 2018.

It should be noted that determining the success of the Mount Carmel branch is difficult considering that Members Choice does not have a branch-specific accounting system. MC Exhibit 6 was created by Ms. Miller by pulling numbers off the general ledger.

Given the general trend of improvement in the overall financial condition of the credit union, it does not appear to be experiencing a drag due to the "break in" period of the Mount Carmel branch. However, it remains to be seen whether the Mount Carmel branch will, in fact, break even or become profitable, and whether the credit union itself, given its CAMEL composite

“3” rating, can continue operating in a safe and sound manner in the event the branch does not perform as expected.

Accordingly, the undersigned has determined to modify the Bureau’s Denial Order to allow for a continued operation of the Mount Carmel branch pending final approval of the branch if required conditions are satisfied. The conditions set forth in the accompanying order will allow the Bureau to monitor, on an ongoing basis, the financial condition of both the credit union and the Mount Carmel branch.

ORDER

Therefore, based upon the pleadings, the post-hearing briefs, the record in this matter and the reasons more fully set forth above, the adjudicator hereby **ORDERS** and **DECREES** that:

1. The Disapproval of Branch Application and order to Close Branch (“Denial Order”) issued by the Bureau of Credit Unions & Trust Supervision & Corporate Applications (“Bureau”) is hereby **AFFIRMED** with respect to the civil penalty in the amount of \$10,000;
2. Payment of the civil penalty shall be by certified check, attorney’s check or U.S. Postal Service money order, made payable to the “Department of Banking and Securities” and sent to the attention of: Department of Banking and Securities, 17 N. 2nd Street, Suite 1300, Harrisburg, PA 17101 within 30 days of the date of this Order.
3. The Denial Order issued by the Bureau is hereby **MODIFIED** with respect to the denial of the application to open a branch as follows:
 - a. The application to open the Mount Carmel branch is **STAYED** for a period of two years based upon Members Choice fully satisfying the following **CONDITIONS**:

1. Members Choice shall implement and maintain Mount Carmel branch-specific accounting and financial reporting procedures within thirty (30) days of the date of this Order;
2. Members Choice shall, within thirty (30) days of the date of this Order submit to the Bureau an income statement and balance sheet for the Mount Carmel branch, prepared in accordance with generally accepted accounting principles;
3. Members Choice shall, thereafter, on a quarterly basis beginning with the first quarter of 2018 and continuing for the entire period of two years covered by this Order, submit to the Bureau, within thirty (30) days of the close of each quarter, an income statement and balance sheet for the Mount Carmel branch, prepared in accordance with generally accepted accounting principles;
4. Members Choice shall submit a feasibility study and obtain designation from the NCUA that Mount Carmel meets the definition of an underserved area;
5. Members Choice shall appoint a branch manager for the Mount Carmel branch who is solely dedicated to the operations of the Mount Carmel branch within thirty (30) days of the date of this Order;
6. Members Choice shall obtain, within ninety (90) days of the date of this Order, a Management/Staffing study conducted by a qualified third party approved by the Department to ensure that Members Choice, inclusive of

the Mount Carmel branch, has sufficient personnel with adequate knowledge and experience;

7. Members Choice shall obtain NAFCU Certified Volunteer Expert designations for all members of the Board and Senior Management within six (6) months of the date of this Order;

8. Members Choice shall achieve a 1:1 ratio or better between the Net Worth Growth Rate and the Asset Growth Rate, as reflected in NCUA quarterly FPR-Ratio Analysis Reports.

b. At the conclusion of the two-year period, the Bureau shall re-evaluate the application, based on satisfaction of the above conditions, as well as examinations and other information available to the Bureau, and, if satisfied that all conditions are adequately satisfied, may approve the Mount Carmel branch.

4. Nothing in this Final Order shall impact the authority of the Department to order the closure of the Mount Carmel branch or take any other action authorized under the Code at any time, if, in the opinion of the Department the credit union or its members have suffered or may suffer any significant financial harm or other prejudice.

Date: 2/13/18

Redacted

Robin L. Wiessmann
Secretary

FILED

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF BANKING AND SECURITIES

2018 FEB 13 AM 8:58

PA DEPARTMENT OF
BANKING AND SECURITIES

In the Matter of:

Docket No. 170014 (BNK-APP)

Members Choice Financial Credit Union

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused to be served a copy of the foregoing *Final Order* upon counsel for the parties who constitute the only parties of record in this proceeding, in accordance with the requirements of 1 Pa. Code §§ 33.35 and 33.36:

BY CERTIFIED, ELECTRONIC AND
FIRST CLASS MAIL:

BY HAND-DELIVERY AND
ELECTRONIC MAIL:

Christopher J. Pippett, Esq.
Fox Rothschild LLP
Eagleview Corporate Center
747 Constitution Drive, Ste. 100
P.O. Box 673
Exton, PA 19341
cpippett@foxrothschild.com

Thomas Lee
Commonwealth of Pennsylvania
Department of Banking and Securities
Market Square Plaza
17 N. Second Street, Suite 1300
Harrisburg, PA 17101
717.787.1471
tholec@pa.gov

Ashley L. Beach, Esq.
Fox Rothschild LLP
Eagleview Corporate Center
747 Constitution Drive, Ste. 100
P.O. Box 673
Exton, PA 19341
abeach@foxrothschild.com

Dated this 13th day of February, 2018

Redacted

Linnea Freeberg, Docket Clerk
Pennsylvania Department of Banking and Securities
17 N. 2nd Street, Suite 1300
Harrisburg, PA 17101