



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF BANKING
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SECRETARY OF BANKING

April 2, 1999

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Dear

This letter responds to your letter of _____ in which you request that the Pennsylvania Department of Banking ("Department") consider interpretations of the Credit Union Code, 17 Pa.C.S.A. § 101 et seq., which would:

- i) permit Pennsylvania state-chartered credit unions ("credit union" or "credit unions") to add both occupational and associational groups to the same field of membership;
- ii) permit credit unions to add unlike groups to their fields of membership; and
- iii) permit credit unions to add groups with a potential membership larger than 500 people to their existing fields of membership.

I. *Adding Occupational and Associational Groups and Unlike Groups to the Field of Membership of the Same Credit Union (Items i and ii From Your Letter)*

Section 701(a) of the Credit Union Code ("Section 701(a)"), 17 Pa.C.S.A. § 701(a), governs the kinds of groups which may be added to the field of membership of an existing credit union. Section 701(a) states in pertinent part:

[a] credit union may also retain its original field of membership and, additionally, include in its field of membership other occupational groups, as well as like associational groups having a common bond with the original field of membership, with insufficient number of members to form or conduct the affairs of a separate credit union, if the existing credit union obtains prior permission from the Department of Banking.

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17 Pa.C.S.A. § 701(a) (emphasis added). As highlighted above, the statutory language discussing the addition of occupational groups and associational groups is connected by the phrase "as well as". The phrase "as well as" means "and in addition : AND"¹ as a conjunction and "in addition to : BESIDES"² as a preposition. Therefore, the Department interprets the phrase "as well as" in Section 701(a) to mean that occupational groups and associational groups may both be added to the same occupationally or associationally based field of membership of an existing credit union.

Section 701(a) also requires that associational groups which are added to the field of membership of an existing credit union must be i) "like associational groups"³ (i.e. the associational groups are similar to one another in the sense that they are all based on membership in either a religious congregation, fraternal organization or labor organization⁴) and ii) the associational group must have a common bond with the field of membership of the existing credit union. The Department will determine on a case by case basis i) whether an associational group which seeks to be added to the field of membership of an existing credit union is similar to other associational groups that have already been admitted to that credit union's field of membership and ii) whether an associational group has a common bond with the original occupationally or associationally based field of membership of the existing credit union. Of course, the other requirements of Section 701(a), which are discussed below, must also be met.

A credit union may also add to its field of membership "other occupational groups".⁵ Unlike adding associational groups, Section 701(a) permits any occupational group to be added to the field

¹ Webster's Ninth New Collegiate Dictionary (Merriam-Webster 1989).

² Id. See also Webster's Third New International Dictionary of the English Language Unabridged (Merriam-Webster 1961) ("as well as *prep* : in addition to : BESIDES <a real scholar *as well as* . . . a composer of the highest integrity -- Norman Demuth>".)

³ 17 Pa.C.S.A. § 701(a).

⁴ The first time an associational group is added to the field of membership of an existing credit union will be the point at which a credit union should decide on the kind of "like associational groups" it will seek to add to its field of membership in the future. Thus, when a credit union adds the first associational group to its field of membership, it should decide whether it will add religious congregations, fraternal organizations or labor organizations. This decision will govern any future proposed additions of associational groups to an existing credit union.

⁵ 17 Pa.C.S.A. § 701(a).

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of membership of an existing credit union provided the other requirements of Section 701(a) (discussed below) are met. Therefore, any occupationally based or associationally based credit union may add occupational groups to its field of membership regardless of whether an occupational group is like or similar to other occupational groups already within a credit union's field of membership and regardless of whether an occupational group has a common bond with the original field of membership of the existing credit union.

II. *Adding Groups with a Potential Membership of 500 or More Adult Persons to the Field of Membership of an Existing Credit Union (Item iii From Your Letter)*

Section 701(a) provides two alternative bases pursuant to which the Department may permit a group to be added to the field of membership of an existing credit union. If a group has either an "insufficient number of members to form . . . a separate credit union"⁶ or if a group has an "insufficient number of members to . . . conduct the affairs of a separate credit union",⁷ the Department may permit that group to be added to the field of membership of an existing credit union. These two alternative bases for adding groups to the field of membership of an existing credit union are explained in detail below.

a. Insufficient Number of Members to Form . . . a Separate Credit Union

The Department is authorized by the Credit Union Code to permit groups to be added to the field of membership of an existing credit union if that group has an "insufficient number of members to form . . . a separate credit union. . ."⁸ Unlike the 500 or more potential members required to initially apply for a credit union charter,⁹ the Department interprets the phrase "insufficient number of members to form . . . a separate credit union . . ."¹⁰ to mean that not enough members of a group will become actual members of a new credit union after incorporation. This interpretation is based in part on the text of Section 701(a) which differentiates between potential and actual members. This interpretation is also based in part on the requirements of Section 304 of the Credit Union Code ("Section 304"), 17 Pa.C.S.A. § 304, which governs the incorporation of new credit unions. The Department construes the statutory language in Section 701(a) governing the addition of new groups

⁶ Id.

⁷ Id.

⁸ Id.

⁹ Id.

¹⁰ Id.

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to existing credit unions together with Chapter 3 of the Credit Union Code governing the incorporation of new credit unions ("Chapter 3") because they relate to the same topic: forming a new credit union. As one pertinent provision in Chapter 3 states, the Department must ascertain:

[w]hether the *character* and *number of the group* proposed to be served affords *reasonable promise of sufficient support for the enterprise* so as to make the establishment of the proposed credit union *economically advisable*.¹¹

Thus, the Department must assess whether a group seeking to be added to the field of membership of an existing credit union is so large that it could form its own separate credit union because the group shows "reasonable promise"¹² of having enough members of the group who will become actual members of the credit union to make the incorporation of a new credit union "economically advisable."¹³ It is important to note that the statute only refers to whether the establishment of a credit union is "economically advisable"¹⁴ and not whether such a credit union could simply survive. Thus, the statute requires the Department to assess whether establishing a credit union to serve a particular group is, under the totality of the relevant circumstances, a reasonably good idea.

The Department has concluded, based on its experience and a study of publicly available data, that, as a general matter, it is reasonable for the Department to presume that credit unions with approximately 500 or fewer actual members are not large enough to be economically advisable. However, the Department recognizes this to be a rebuttable presumption, as discussed below.

Difficulties Experienced by Small Credit Unions

Return on Assets: First, the Department has studied publicly available December Call Report Data for 1995, 1996, 1997 and 1998. Based on this study, it appears that credit unions with approximately 500 or fewer actual members experience relatively more difficulty in achieving a satisfactory Return on Assets ("ROA") than larger credit unions. The following chart summarizes the Department's research:

¹¹ 17 Pa.C.S.A. § 304(a)(2) (emphasis added).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

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Range of Number of Actual Credit Union Members	Median Number of Actual Credit Union Members	Median Return on Assets
10,430 to 73,212	28,015	1.19%
3,105 to 10,212	4,425	1.10%
1,514 to 3,073	2,135	1.06%
1,029 to 1,505	1,152	1.08%
523 to 1,003	672	1.10%
118 to 507	252	0.83%

Credit unions ranging in size from 118 to 507 actual members experience a lower median ROA than any other category of credit union identified in the table reproduced above. Although the Department believes that a credit union's ROA is one of the most important measures of a credit union's financial health, the Department also simultaneously recognizes that a credit union's ROA, by itself, is not always the most accurate indicator of a credit union's financial health. Therefore, the Department considers the existing and/or prospective financial health of a credit union, a proposed group addition to a credit union,¹⁵ or a proposed new credit union, on a case by case basis, subject to the initial rebuttable presumption regarding ROAs as stated in this letter. Thus, while

¹⁵ The Department considers the prospective financial health of a proposed group addition to a credit union in so far as such a review is necessary to determine whether the group would be likely to form an economically advisable credit union as stated in this letter.

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statistics may be considered in a number of different ways, the Department believes that its research does indicate that credit unions with approximately 500 or fewer actual members tend to be less successful than larger credit unions and are, therefore, as a general matter, economically inadvisable.

Services: Second, small credit unions are usually incapable of offering their members the kinds of services which Pennsylvanians have come to expect from a modern depository institution. For instance, credit unions currently under the Department's jurisdiction with approximately 500 or fewer actual members do not generally offer as basic a service as share draft accounts (checking accounts). Such deficiencies in service place small credit unions at an inherent competitive disadvantage with other depository institutions. Thus, the "reasonable promise of sufficient support"¹⁶ which a group may offer toward a newly incorporated credit union will almost always be less for small credit unions because such credit unions will be less attractive to most Pennsylvanians since credit unions with approximately 500 or fewer actual members will not offer the basic services expected from a depository institution in today's modern economy. For this reason, incorporating a small credit union which will have approximately 500 or fewer actual members is, as a general matter, inherently economically inadvisable.

Enforcement Actions: Third, the Department observes that, while some large credit unions have been the subject of some enforcement actions, an inordinate number of the Department's most serious enforcement actions have been directed at the small and not the large credit unions regulated by the Department in recent years. For instance, of the five credit unions most recently seized and liquidated by the Department, four have had approximately 500 or fewer actual members. Similarly, the only supervisory merger required by the Department has been at a credit union with fewer than 500 actual members. Since the Department almost always takes an enforcement action to protect a credit union and its depositors from economic harm, the Department concludes that credit unions with approximately 500 or fewer actual members do not afford "reasonable promise of sufficient support" so as to make the establishment of such small credit unions "economically advisable."

Vulnerability to Malfeasance: Fourth, based on the Department's enforcement experience, small credit unions appear to be inherently more vulnerable to the malfeasance of a single individual than large credit unions. In other words, small credit unions appear to be less able to endure the financial hardship wrought by a single person's misdeeds than large credit unions. Thus, as a general matter, a membership group of approximately 500 or fewer actual members does not afford "reasonable promise of sufficient support" so as to make the establishment of such a small credit union "economically advisable."

Based on the foregoing reasons, the Department presumes that groups which are likely to have approximately 500 or fewer actual credit union members will not usually afford "reasonable

¹⁶ 17 Pa.C.S.A. § 304(a)(2).

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promise of sufficient support for the enterprise so as to make the establishment of the proposed credit union *economically advisable*.¹⁷ This presumption may be rebutted by evidence which demonstrates that a particular group in question will afford a new credit union sufficient promise so as to make its establishment economically advisable. For instance, by requiring the Department to consider both the numerical size of a group and its character in Section 304(a)(2) of the Credit Union Code, the General Assembly thereby indicates that those factors are part and parcel of the same consideration. Thus, a small group which is only likely to yield 300 actual members from a potential membership of approximately 566 would generally be presumed to be economically inadvisable. However, such presumption may be rebutted by evidence which demonstrates to the Department that the anticipated numerical size or character of the group in question is adequate to overcome the initial presumption of economic inadvisability.

Estimating Actual Membership from Potential Membership

The Department has determined that a credit union which is likely to have approximately 500 or fewer actual members is presumptively economically inadvisable. This rebuttable presumption leads to the question of whether a group of potential members is likely to have enough actual members to incorporate a credit union or, conversely, whether a group has such a small number of potential members as to warrant the Department's approval of a request for a group to join an existing credit union. As reproduced in the tables above and below, the Department has calculated from the publicly available 1995, 1996, 1997 and 1998 December Call Reports the following data:

Range of Actual Members	Median of Actual Members
523 to 1,003	672
118 to 507	252

The Department will presume that a group which is similar in size to the credit unions which range in size from 118 to 507 actual members will tend to form an economically inadvisable credit union.¹⁸

¹⁷ *Id.* (emphasis added).

¹⁸ The Department recognizes that this presumption is not true in every case and that some credit unions with a size of between 108 and 507 actual members have ROAs exceeding 1.0%. That is one reason why the Department allows that the presumptions stated in this letter

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This presumption of economic inadvisability will constitute the starting point for the Department's review of an application from a group which seeks either to be added to the field of membership of an existing credit union or to incorporate its own credit union. The Department will accept evidence provided by the group and from all other sources deemed relevant by the Department to both rebut and confirm this presumption. After all relevant evidence has been reviewed, the Department will make a final determination.

Conversely, the Department will presume that a group which is similar in size to or larger in size than the credit unions which range in size from 523 to 1,003 actual members will tend to form an economically advisable credit union.¹⁹ Based on a median number of actual members for this group of 672 actual members and an overall penetration rate²⁰ for all credit unions of 53%,²¹ the Department estimates that a group with approximately 672 actual members is likely to have a potential membership of approximately 1,268²² potential members and is likely to be able to form a credit union which is economically advisable. This presumption of economic advisability will constitute the starting point for the Department's review of an application from a group which seeks either to be added to the field of membership of an existing credit union or to incorporate its own credit union. The Department will accept evidence provided by the group and from all other sources deemed relevant by the Department to both rebut and confirm this presumption. After all relevant evidence has been reviewed, the Department will make a final determination.

The Department recognizes that it may be possible for a group which is likely to only have

may be rebutted on a case by case basis. But when the ROAs of small credit unions are considered as a group, their overall ROA is weaker than that of the larger credit unions.

¹⁹ This group of credit unions, ranging in size from 523 to 1,003 actual members, represents the next occurring group of credit unions by size. The Department believes that such similarly sized groups which border one another numerically are appropriate to utilize in the Department's analysis which establishes rebuttable presumptions regarding the economic advisability of credit unions.

²⁰ By penetration rate, the Department means the rate, measured as a percentage, by which a credit union is able to acquire actual credit union members from the pool of the credit union's potential members.

²¹ The Department calculated this figure based on data from the publicly available December Call Reports for 1995, 1996, 1997 and 1998.

²² 672 Actual Members

672 Actual Members
 .53 Penetration Rate

= 1,268 Potential Members

approximately 500 or fewer actual members to form and operate an economically advisable credit union. The Department's statements in this letter concerning the economic advisability of a group likely to have approximately 500 or fewer actual members in a credit union are generalities based on the Department's experience in recent years and a statistical analysis of publicly available December Call Report data. Such statements are not intended as hard and fast rules but rather as an explanation of the Department's perspective based on experience and study. The Department will approach each application to add a group to the field of membership of an existing credit union or to incorporate a new credit union on a case by case basis and will take into account the presumptions and related facts as stated herein as well as all relevant facts and circumstances which are unique to the group in question.

***b. Insufficient Number of Members to Conduct the Affairs of a
Separate Credit Union***

The Department is also authorized by Section 701(a) to permit a group to be added to the field of membership of an existing credit union if the group has an "insufficient number of members to conduct the affairs of a separate credit union . . .". 17 Pa.C.S.A. § 701(a). The Department interprets this statutory language to mean that a group may be added to the field of membership of an existing credit union if the group cannot identify, before a new credit union would be incorporated, enough members of the group who would be willing to operate the credit union as a member of the board of directors or as treasurer, upon formation of the new credit union. Section 303 of the Credit Union Code identifies the positions in a new credit union which must be filled by members of the group to be served by the new credit union upon incorporation. As the pertinent provision of Section 303 of the Credit Union Code states:

Articles of incorporation shall be signed by each of the incorporators.
The articles of incorporation shall set forth:

* * * * *

(7) The names and residences of each of the first directors, not less than five in number, who shall serve until the first annual meeting of the credit union, and the name and residence of the treasurer.

17 Pa.C.S.A. § 303(7). See also 17 Pa.C.S.A. §§ 304(a)(3) and 708. Thus, the members needed to conduct the affairs of a separate credit union are the directors and the treasurer.

It is important to note that the Credit Union Code requires that a credit union's directors and treasurer must be competent to perform their duties and the Department may reject an application to incorporate a credit union if it is not so satisfied. As Section 304 of the Credit Union Code states in pertinent part:

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(a) General rule.-- The articles of incorporation and two copies of the proposed bylaws for the general governance of the credit union shall be presented to the Department of Banking, together with such reasonable fees as shall be established, by the department, for such examination and such investigation as it may deem necessary to ascertain:

(1) Whether the character and general fitness of the incorporators, directors, and the treasurer named in the articles of incorporation is satisfactory.

17 Pa.C.S.A. § 304(a)(1) (emphasis added). In order for the Department to determine that a group has an "insufficient number of members to . . . conduct the affairs of a separate credit union" pursuant to Section 701(a), the Department must determine that the group seeking credit union service does not have enough members of satisfactory character and general fitness who are willing to serve as a member of the board of directors or as treasurer of a newly formed credit union. Therefore, the Department will determine whether a group seeking credit union service has designated five or more directors and a treasurer, all of whom must be of character and general fitness satisfactory to the Department.

I trust this is responsive to your letter.

Sincerely,

Richard C. Fisher