BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 25, 2008

Karen Grandstrand, Esq.
Fredrikson & Byron, P.A.
200 South Sixth Street, Suite 4000
Minneapolis, Minnesota 55402

Dear Ms. Grandstrand:

This is in response to the request by Minnwest Corporation, Minnetonka, on behalf of its wholly owned subsidiary banks, Minnwest Bank Metro, ("Metro Bank"), Rochester, and Minnwest Bank, M.V. ("Minnwest Bank"), Redwood Falls, all in Minnesota, for an exemption from section 23A of the Federal Reserve Act and the Board's Regulation W.[1] The requested exemption would permit (1) Metro Bank to acquire all the shares of its affiliate, Minnwest Capital Corporation ("MCC"), also in Minnetonka, and (2) Minnwest Bank to purchase from Metro Bank $5.6 million in lease participations originated by MCC immediately after the transfer of MCC to Metro Bank.

Section 23A and Regulation W limit the amount of "covered transactions" between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank's capital stock and surplus. "Covered transactions" include a bank's purchase of assets from an affiliate and a bank's extension of credit to an affiliate. The statute and regulation also require a bank to secure its extensions of credit to, and certain other covered transactions with, affiliates with prescribed amounts of collateral. In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate.

Regulation W provides that a bank's acquisition of a security issued by a company that was an affiliate of the bank before the acquisition is treated as a

[1] 12 U.S.C. § 371c; 12 CFR part 223.

purchase of assets by the bank from an affiliate if (i) the company becomes an operating subsidiary of the bank as a result of the transaction and (ii) the company has liabilities at the time of the acquisition.[2] MCC is currently an affiliate of Metro Bank and would become an operating subsidiary of Metro Bank immediately after the reorganization. When the reorganization occurs, MCC will have outstanding liabilities. Accordingly, Minnwest Corporation's transfer of all the capital stock of MCC to Metro Bank would be an asset purchase subject to the quantitative and qualitative limitations of section 23A and Regulation W. The Regulation W value of the covered transaction would be approximately $16.4 million – the total liabilities of MCC at the time of the reorganization.[3] Because the capital stock and surplus of Metro Bank at the time of the contribution would be approximately $15.9 million, the proposed covered transaction would exceed Metro Bank's quantitative limits under section 23A and Regulation W. Accordingly, Metro Bank has requested an exemption to permit it to accomplish the reorganization.

In addition, Metro Bank plans to sell participations in MCC-originated leases to its affiliated banks, including $5.6 million in lease participations to Minnwest Bank. Because the capital stock and surplus of Minnwest Bank is approximately $46.1 million, the proposed covered transaction would exceed Minnwest Bank's quantitative limits under section 23A and Regulation W. Accordingly, Minnwest Bank has requested an exemption to permit it to purchase these lease participations in connection with the reorganization.[4]

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[2] See 12 CFR 223.31(a).

[3] See 12 CFR 223.31(b).

[4] As noted, Metro Bank and Minnwest Bank are wholly owned subsidiaries of Minnwest Corporation. Covered transactions between the banks generally would be exempt from the quantitative limits of section 23A under the "sister bank" exemption, which exempts covered transactions between insured depository institutions where 80 percent or more of the voting shares of the institutions are controlled by the same company. See 12 U.S.C. § 371c(d)(1)(C). In this case, however, staff believes that where Bank A purchases assets from an affiliate and Bank B immediately purchases those assets from Bank A, it is the functional equivalent of Bank B purchasing the assets from the affiliate directly. This interpretation prevents banks from using the "sister bank" exemption to circumvent the quantitative limitations by using a larger bank to purchase assets from an affiliate and then having those assets purchase by a smaller bank in quantities that the smaller bank could not buy directly from the affiliate.

Section 23A and Regulation W specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds such exemptions to be in the public interest and consistent with the purposes of section 23A.[5] The Board has approved exemptions under section 23A for one-time asset transfers that are part of a corporate reorganization and that are structured to ensure the quality of the transferred assets. As in previous cases reviewed by the Board, the proposed transaction in this case is a by-product of a one-time corporate reorganization. Minnwest is consolidating its equipment leasing activities into Metro Bank as part of a larger reorganization. According to Minnwest Corporation, this exemption is in the public interest because the reorganization is expected to enhance the efficiency of its lending programs, to streamline its management, and to reduce its operating expenses.

In addition, Minnwest Corporation has made the following commitments as part of the exemption request:

1. Minnwest Corporation commits for a two-year period following the contribution of MCC to make a cash payment to Metro Bank equal to the book value at the end of each calendar quarter plus write-downs during that quarter by Metro Bank of any transferred assets that were low-quality assets at the end of that quarter. For any assets associated with the reorganization that are transferred to another subsidiary insured depository institution of Minnwest Corporation and subsequently become low-quality assets during this two-year period, Minnwest Corporation will make a cash payment to that subsidiary depository institution that is equal to the book value at the end of each calendar quarter plus write-downs during that quarter by that subsidiary insured depository institution of any transferred assets that were low-quality assets at the end of that quarter. Minnwest Corporation will make the cash payment within 30 days after the end of each calendar quarter.

2. Minnwest Corporation also commits that Metro Bank, or any other subsidiary insured depository institution of Minnwest Corporation to which the above noted assets are transferred, will hold an amount of risk-based capital equal to the book value of any transferred assets

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[5] 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

that become low-quality so long as the bank retains ownership or control of the transferred assets. For example, under this dollar-for-dollar capital requirement, the risk-based capital charge for each transferred low-quality loan asset would be 100 percent (equivalent to a 1250 percent risk weight), rather than the 8 percent requirement (equivalent to a 100 percent risk weight) that would apply to a similar defaulted loan asset that is not a part of the transferred asset pool.

3. Before the purchase of assets is consummated, a majority of Metro Bank's and Minnwest Bank's directors will review and approve the transaction.

As a condition of this exemption, Metro Bank or any other subsidiary insured depository institution of Minnwest Corporation to which the assets associated with this transaction are transferred must remain well capitalized, based on the Federal Deposit Insurance Corporation's risk-based capital guidelines and the modifications to those guidelines described in the commitments above. These commitments are similar to commitments relied on by the Board in previous cases.[6] These commitments have been modified, however, to clarify that any funds transferred by Minnwest Corporation to its subsidiary banks to support any low-quality assets will provide a cushion of additional capital in excess of the banks' required regulatory capital. The commitments ensure that such funds will remain available to the banks and will not be returned to Minnwest Corporation through a dividend or a return of capital.

The Federal Deposit Insurance Corporation has also informed the Board that it has no objection to the proposal. In light of these considerations and all the facts you have presented, the reorganization transaction appears to be consistent with safe and sound banking practices and on terms that would ensure the quality of the assets transferred. Accordingly, the transaction appears to be consistent with the purposes of section 23A, and the Director of the Division of Banking Supervision and Regulation, pursuant to authority delegated by the Board, and with the concurrence of the General Counsel, hereby grants the requested exemption.

[6] See Board letter dated December 21, 2007, to Andres L. Navarette, Esq. (Capital One Financial Corporation).

This determination is specifically conditioned on compliance by Minnwest Corporation, Metro Bank, Minnwest Bank, and MCC with all the commitments and representations made to the Board in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances surrounding the proposed transaction and may be revoked in the event of a material change in those facts and circumstances or failure by Minnwest Corporation, Metro Bank, Minnwest Bank, or MCC to observe its commitments or representations. Granting this exemption does not represent a determination concerning the permissibility of any other transactions in which Minnwest Corporation, Metro Bank, Minnwest Bank, or MCC engages that are subject to section 23A or Regulation W.

Sincerely yours,

Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Minneapolis
Federal Deposit Insurance Corporation