



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

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

November 24, 2008

Daniel F. Kaplan, Esq.  
Perry, Guthery, Haase  
& Gessford, P.C., L.L.O.  
233 13th Street, Suite 1400  
Lincoln, Nebraska 68508

Dear Mr. Kaplan:

This is in response to the request by Union Bank and Trust Company (“Union Bank”) for an exemption from section 23A of the Federal Reserve Act and the Board’s Regulation W to allow Union Bank to purchase \$[ ] in federally guaranteed student loans from its affiliate, Nelnet, Inc. (“Nelnet”), both of Lincoln, Nebraska.

Nelnet is one of the largest originators, holders, and servicers of student loans in the United States.<sup>1</sup> Almost all the student loans originated by Nelnet are at least 97 percent guaranteed by the U.S. Department of Education under the Federal Family Education Loan Program (“FFELP”).

Nelnet historically has financed its student loans almost entirely in the securitization markets. Nelnet, like other student lenders, has encountered severe difficulties in securitizing its student loans profitably after the beginning of the credit market turmoil in August 2007. Since then, it has been financing a large share of its student loans through a short-term bank warehouse facility. Nelnet’s warehouse lenders have been making repeated and increasing margin calls on the facility. To provide liquidity to Nelnet, Union Bank now proposes to purchase from Nelnet, at par, up to \$[ ] of FFELP student loans (the “Portfolio”).

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.<sup>2</sup> Under section 23A and Regulation W, “covered transactions” include the purchase of assets by a bank from an affiliate, the extension of credit by a bank to an affiliate, the issuance of a guarantee by a

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<sup>1</sup> Union Bank is a commercial bank and also engages in originating and holding student loans.

<sup>2</sup> 12 U.S.C. § 371c(a)(1); 12 CFR 223.11 and 223.12.

bank on behalf of an affiliate, and certain other transactions.<sup>3</sup> The statute and regulation also require a bank to secure its extensions of credit to, and guarantees on behalf of, affiliates with prescribed amounts of collateral.<sup>4</sup> In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate and require that all covered transactions between a bank and an affiliate be on terms that are consistent with safe and sound banking practices.

Nelnet and Union Bank are affiliates for purposes of section 23A and Regulation W because the [ ] controls more than 25 percent of the voting shares of Nelnet and of Farmers and Merchants Investment, Inc., Lincoln (“Holding Company”), the parent holding company of Union Bank.<sup>5</sup> Consequently, Union Bank’s purchase of the Portfolio from Nelnet would be a covered transaction subject to the quantitative limits and qualitative requirements of section 23A and Regulation W. Under Regulation W, the value of the covered transaction would be approximately \$[ ] – the purchase price to be paid by Union Bank for the Portfolio.<sup>6</sup> Because the capital stock and surplus of Union Bank is approximately \$[ ], the bank’s quantitative limit per affiliate is approximately \$[ ]. The proposed covered transaction would therefore exceed the bank’s quantitative limits under section 23A and Regulation W.

Accordingly, Union Bank has requested an exemption from section 23A and Regulation W to permit it to acquire the Portfolio from Nelnet. 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 the exemption to be in the public interest and consistent with the purposes of section 23A.<sup>7</sup>

The Board has routinely 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.<sup>8</sup> Although this request differs from previous corporate-reorganization exemption requests in several material ways, there are a number of factors that weigh in favor of granting the exemption, and the parties have made a number of commitments to reduce the risks to the bank.<sup>9</sup>

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<sup>3</sup> 12 U.S.C. § 371c(b)(7); 12 CFR 223.3(h).

<sup>4</sup> 12 U.S.C. § 371c(c); 12 CFR 223.14.

<sup>5</sup> [ ].

<sup>6</sup> See 12 CFR 223.22(a).

<sup>7</sup> 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

<sup>8</sup> See, e.g., Board letters dated March 25, 2008, to Karen Grandstrand, Esq. (Minnwest Corporation); December 21, 2007, to Andres L. Navarette, Esq. (Capital One Financial Corporation); and June 30, 2006, to Carl Howard, Esq. (Citigroup Inc.).

<sup>9</sup> The commitments made by Union Bank and its affiliates are set forth in the appendix.

First, credit risk to the bank in this case is very low because the Portfolio is substantially guaranteed by an agency of the U.S. government. Second, Nelnet, Holding Company, and [ ] have agreed to place and maintain in escrow at Union Bank an amount of cash equal to the entire amount of the Portfolio that is not government guaranteed. In addition, Nelnet, Holding Company, and [ ] have committed to guarantee the bank against any losses on the Portfolio and to make quarterly payments as necessary to reimburse Union Bank for any Portfolio losses. To address the possibility that the cost of funding the Portfolio might to exceed the return on the Portfolio, Nelnet, Holding Company, and [ ] have agreed to take a series of actions to ensure that Union Bank will earn a positive spread on the Portfolio. Finally, Holding Company and Union Bank have committed to maintain regulatory capital ratios at levels in excess of the well-capitalized thresholds, including maintaining a total risk-based capital ratio of at least 11 percent.

As an additional safeguard, and in recognition that this transaction is not intended to be a transfer of an operating business to the bank, this exemption will be temporary, expiring on September 30, 2010. Because the exemption is temporary, Union Bank must sell the Portfolio to Nelnet or to another purchaser, or find an alternative means to bring the covered transaction into compliance with section 23A and Regulation W, on or before September 30, 2010. Finally, Union Bank may not purchase any low-quality assets (as defined in Regulation W) from Nelnet as part of the proposed transfer, and the proposal must be reviewed and approved by the board of directors of Union Bank, including a majority of directors who are independent from Nelnet.

The proposed asset purchase by Union Bank from Nelnet would be subject to the market-terms requirement of section 23B of the Federal Reserve Act.<sup>10</sup> In light of the substantial government guarantee supporting most of the Portfolio and all the commitments made by Nelnet, Holding Company, and [ ], the proposed transaction appears to pose little risk to Union Bank and to provide the potential for income to benefit the bank. It also is expected to provide the public benefit of maintaining liquidity in the student loan market.

Accordingly, the exemption appears to be in the public interest and consistent with the purposes of section 23A. The Board, after consultation with staff of the Federal Deposit Insurance Corporation, hereby grants the requested exemption.

This determination is specifically conditioned on compliance by Union Bank, Nelnet, Holding Company, and [ ] with all the commitments and

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<sup>10</sup> See 12 U.S.C. §371c-1(a)(1). Section 23B requires that the proposed transaction be on terms that are substantially the same, or at least as favorable to Union Bank, as those prevailing at the time for comparable transactions with unaffiliated companies.

representations made in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing in connection with granting the exemption 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 any material change in those facts or circumstances or any failure by Union Bank, Nelnet, Holding Company, or [ ] to observe any of their commitments or representations. Granting this exemption does not represent a determination concerning the permissibility of any other transactions engaged in by Union Bank, Nelnet, Holding Company, or [ ] that are subject to section 23A and Regulation W.

Sincerely,

Robert deV. Frierson  
Deputy Secretary of the Board

Appendix

cc: Federal Reserve Bank of Kansas City  
Federal Deposit Insurance Corporation

## Appendix

1. Nelnet, Holding Company, and [ ] commit to make either (i) quarterly cash payments to Union Bank equal to the book value at the end of each calendar quarter, plus write-downs during that quarter by Union Bank, of any transferred assets that became and remained low-quality assets (as defined in Regulation W) during that quarter; or (ii) quarterly purchases from Bank of any transferred assets that became and remained low-quality assets during that quarter at a price equal to the book value at the end of that quarter plus write-downs during that quarter by Union Bank of any such assets. Nelnet, Holding Company, or [ ] will make the cash payment or will purchase the assets within 30 days after the end of each calendar quarter. Union Bank will hold an amount of risk-based capital equal to the book value of any transferred assets that become low-quality assets so long as Union Bank (or any operating subsidiary) retains ownership or control of such assets. For example, under this dollar-for-dollar capital requirement, the risk-based capital charge for each transferred asset that becomes a low-quality asset would be 100 percent (equivalent to a 1250 percent risk weight), rather than the 8 percent requirement that would apply to a similar defaulted loan asset that is not a part of the transferred asset pool.
2. Nelnet, Holding Company, and [ ] commit to establish and maintain throughout the term of the exemption an escrow account at Union Bank in an amount equal to the aggregate outstanding principal amount of the transferred assets that is not guaranteed by the U.S. Department of Education under the FFELP. Union Bank will be entitled to draw money from the escrow account to the extent that the bank incurs losses as a result of a breach by Nelnet, Holding Company, or [ ] in complying with any of the commitments made in connection with this exemption request.
3. Nelnet, Holding Company, and [ ] commit to reimburse Union Bank promptly for any losses incurred by the bank on the sale of any transferred assets.
4. Nelnet commits to waive servicing fees charged to Union Bank in connection with the transferred assets to the extent that Union Bank's spread on the transferred assets falls below 50 basis points. If a complete waiver of servicing fees by Nelnet leaves Union Bank with a negative spread on the transferred assets, Nelnet, Holding Company, and [ ] commit to make monthly cash contributions to Union Bank to enable it to earn a positive spread on the transferred assets.

5. Holding Company commits to maintain regulatory capital ratios equal to or greater than the pro forma regulatory capital ratios set forth on Attachment B to the exemption request. Specifically, Holding Company commits to maintain a tier 1 leverage ratio of at least 8.23 percent, a tier 1 risk-based ratio of at least 10.81 percent, and a total risk-based ratio of at least 11.22 percent.
6. Union Bank commits to maintain a tier 1 leverage ratio of at least 5 percent, a tier 1 risk-based ratio of at least 6 percent, and a total risk-based ratio of at least 11 percent.