

FEDERAL RESERVE SYSTEM

Northern Star Financial, Inc.  
Mankato, Minnesota

Order Denying the Acquisition of a Savings Association

Northern Star Financial, Inc (“Northern Star”), a bank holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval under sections 4(c)(8) and 4(j) of the BHC Act (12 U.S.C. §§ 1843(c)(8) and 1843(j)) and section 225.24 of the Board’s Regulation Y (12 C.F.R. 225.24) to acquire all the voting shares of First Federal Holding Company of Morris, Inc. (“First Federal”), and thereby acquire First Federal Savings Bank (“First Federal Savings”), Morris, Minnesota.

Notice of the proposal, affording interested persons an opportunity to submit comments has been published (65 Federal Register 5873 (2000)). The time for filing comments has expired, and the Board has considered the notice and all comments received in light of the factors set forth in section 4 of the BHC Act.

Northern Star’s banking subsidiary, Northern Star Bank, Mankato, Minnesota (“Bank”), is the 417th largest depository institution in Minnesota, controlling deposits of \$6.9 million, representing less than 1 percent of the total deposits in depository institutions in the state (“state deposits”).<sup>1</sup> First Federal Savings is the 174th largest depository institution in Minnesota, controlling deposits of \$48.3 million, representing less than 1 percent of state deposits.

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<sup>1</sup> State and market data are as of June 30, 1999. In this context, depository institutions include commercial banks, savings banks, and savings associations.

Section 4(j) of the BHC Act requires that, in reviewing a proposal to acquire a savings association,<sup>2</sup> the Board consider whether the acquisition “can reasonably be expected to produce benefits to the public ... that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.”<sup>3</sup> The Board’s rules and longstanding practice provide that the evaluation of possible public benefits and adverse effects must include an evaluation of the financial and managerial resources of the notificant, including its subsidiaries and any company to be acquired, and the effect of the proposed transaction on those resources, as well as an evaluation of the management expertise, internal-control and risk-management systems, and capital of the notificant.<sup>4</sup>

In connection with its review of the factors under section 4 of the BHC Act in this case, the Board has carefully reviewed the financial and managerial resources of Northern Star, First Federal, and their respective subsidiaries and the effect the transaction would have on those resources.

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<sup>2</sup> The Board previously has determined by regulation that operating a savings association is closely related to banking for purposes of section 4(c)(8) of the BHC Act. 12 C.F.R. 225.28(b)(4)(ii).

<sup>3</sup> 12 U.S.C. § 1843(j)(2)(A).

<sup>4</sup> 12 C.F.R. 225.26(b). In assessing notices by small bank holding companies, the Board will take into account a full range of financial and other information about the notificant and its current and proposed subsidiaries, including the recent trend and stability of earnings, past and prospective growth, and the record and competency of management. See Appendix C to Regulation Y (12 C.F.R. Part 225, Appendix C). See also The Cedar Vale Bank Holding Company, 75 Federal Reserve Bulletin 257 (1990).

Northern Star contends that consummation of this proposal can reasonably be expected to result in public benefits that justify approval. In particular, Northern Star points out that Bank is currently well capitalized and that this proposal includes an exchange of stock and a stock offering that would raise a significant amount of additional capital for both Bank and First Federal Savings, which in turn would provide a source of funds to increase earning assets. Northern Star also asserts that the proposal would bring additional management to Northern Star, and expand its market and potential new business opportunities.

The Board has carefully considered all the facts of record, including relevant examination reports, information obtained from other federal and state banking authorities, other confidential supervisory information, and information provided by the management of Northern Star. This proposal represents a substantial expansion by a bank holding company that is considerably smaller than the company to be acquired, and is located in a community more than 100 miles from Bank. Bank began operations in January 1999, has had poor earnings, and has never met its earnings projections. The Board has considered the challenge that integrating the two organizations would pose, the history of current management, the earnings projections, and the history of Northern Star's management in achieving earnings projections. Management is working to improve earnings and an expansion by Northern Star at this time, in particular the acquisition of an institution that is substantially larger than and distant from Bank, would divert Northern Star's management from effectively attending to the management of Bank. Based on this review, the Board concludes that the financial and managerial resources at this time are not consistent with approval of the proposed expansion by Northern Star. The Board believes that the potential

benefits of consummation of this proposal, which are speculative and could be achieved in other ways, would not outweigh the adverse effects in this case.

Northern Star and First Federal do not compete directly in any banking market. Consummation of the proposal would not result in any significantly adverse effects on competition in any relevant banking market. On the other hand, there are no facts that indicate that the effects of this proposal on competition in any relevant market would result in public benefits that would outweigh the potential adverse effects discussed above. As noted above, to the extent this expansionary proposal distracts the attention of the management of Northern Star from focusing on Bank, it could have adverse effects on competition. The Board also has considered the CRA performance records of Bank and First Federal Savings and the other factors required under section 4(j)(2)(A) of the BHC Act. While these factors are consistent with approval, the Board concludes that they do not outweigh the adverse considerations discussed above.

For these reasons and based on all the facts of record, the Board has determined that the proposal does not meet the statutory requirements for approval under section 4 of the BHC Act that the notice should be and hereby is, denied.

By order of the Board of Governors,<sup>5</sup> effective June 26, 2000.

(signed)

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Jennifer J. Johnson  
Secretary of the Board

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<sup>5</sup> Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Kelley, Meyer, and Gramlich.