

FEDERAL RESERVE SYSTEM

Sky Financial Group, Inc.
Bowling Green, Ohio

Order Approving the Acquisition of a Bank

Sky Financial Group, Inc. (“Sky”), a bank holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval under section 3 of the BHC Act¹ to acquire Falls Bank, Stow, Ohio, a state-chartered savings bank.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (70 Federal Register 48,548 (2005)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

¹ 12 U.S.C. § 1842.

² Sky also has requested the Board’s approval under section 3 of the BHC Act to acquire Falls Interim Savings Bank, Bowling Green, Ohio, a subsidiary formed by Sky that will merge with Falls Bank (with Falls Bank as the surviving entity) after receiving regulatory approval from the Federal Deposit Insurance Corporation (“FDIC”) and the Ohio Division of Financial Institutions. In a separate application that is not subject to this order, Falls Bank has requested the Board’s approval to become a state member bank, subsequently merge with Sky Bank (with Falls Bank as the surviving entity), and operate Sky Bank’s offices as branches of Falls Bank pursuant to section 9 of the Federal Reserve Act and section 18(c) of the Federal Deposit Insurance Act. Sky intends to change the name of Falls Bank to Sky Bank and move its headquarters to Salineville, Ohio.

Sky, with total consolidated assets of approximately \$15.2 billion, controls Sky Bank³, Salineville, Ohio, with branches in Ohio, Indiana, Michigan, Pennsylvania, and West Virginia. Sky is the eighth largest depository organization in Ohio, controlling deposits of approximately \$8 billion, which represent 4 percent of the total amount of deposits of insured depository institutions in the state (“state deposits”).⁴

Falls Bank is the 189th largest insured depository institution in Ohio, controlling deposits of approximately \$53.8 million, representing less than 1 percent of state deposits. On consummation of the proposal, Sky would remain the eighth largest depository organization in Ohio, controlling deposits of approximately \$8.1 billion, which represent 4 percent of state deposits.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.⁵

³ Sky also controls Sky Trust, National Association, Pepper Pike, Ohio (“Sky Trust”), a limited-purpose bank that provides only trust services.

⁴ Deposit, asset, and ranking data are as of June 30, 2005, and reflect merger and acquisition activity as of October 27, 2005. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

⁵ 12 U.S.C. § 1842(c)(1).

Sky and Falls Bank compete directly in the Akron banking market in Ohio.⁶ The Board has reviewed carefully the competitive effects of the proposal in this banking market in light of all the facts of record, including the number of competitors that would remain in the market, the relative shares of total deposits in depository institutions in the market (“market deposits”) controlled by Sky and Falls Bank,⁷ the concentration level of market deposits and the increase in this level as measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Merger Guidelines (“DOJ Guidelines”),⁸ and other characteristics of the market.

⁶ The Akron banking market is defined as Summit County, excluding the cities of Macedonia, Twinsburg, and Hudson and the townships of Sagamore Hills, Northfield Center, Twinsburg, Richfield, and Boston; Portage County, excluding the cities of Aurora, Streetsboro, and Mantua and the townships of Hiram, Nelson, Shalersville, Freedom, and Windham; the townships of Sharon, Homer, Harrisville, Westfield, Guilford, and Wadsworth in Medina County; the townships of Lawrence and Lake in Stark County; and the townships of Milton and Chippewa in Wayne County, all in Ohio.

⁷ Market deposit and share data are as of June 30, 2005, and reflect merger acquisition activity as of October 27, 2005. The market share data also are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. See, e.g., Midwest Financial Group, 75 Federal Reserve Bulletin 386 (1989); National City Corporation, 70 Federal Reserve Bulletin 743 (1984). Because the deposits of Falls Bank are being acquired by a commercial banking organization, they are included at 100 percent in the calculation of Sky’s post-consummation share of market deposits. See Norwest Corporation, 78 Federal Reserve Bulletin 452 (1992); First Banks, Inc., 76 Federal Reserve Bulletin 669 (1990).

⁸ Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice (“DOJ”) has informed the

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Akron banking market. After consummation, there would be no increase in the HHI, and 24 competitors would remain in the banking market.⁹

The Department of Justice also has reviewed the competitive effects of the proposal and advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the Akron banking market or in any other relevant banking market. Accordingly, based on all the facts of record, the Board has determined that competitive considerations are consistent with approval.

Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher than normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

⁹ Sky operates the tenth largest depository institution in the Akron market, controlling deposits of approximately \$173 million, which represent approximately 2.1 percent of market deposits. Falls Bank is the 21st largest depository institution in the market, controlling deposits of approximately \$26.9 million, which represent less than 1 percent of market deposits. On consummation, Sky would operate the ninth largest depository institution in the market, controlling weighted deposits of approximately \$226.7 million, which represent approximately 2.7 percent of market deposits. The HHI would decrease by 6 points to 1348.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by the applicant.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of measures, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

Based on its review of these factors, the Board finds that Sky has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange and cash purchase. Sky will use existing resources to fund the cash portion of the transaction. Sky and its subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board

has reviewed the examination records of Sky and its subsidiary banks and Falls Bank, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law. Sky and its subsidiary depository institutions and Falls Bank are considered to be well managed. The Board also has considered Sky's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").¹⁰ The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.¹¹

¹⁰ 12 U.S.C. § 2901 et seq.

¹¹ 12 U.S.C. § 2903.

The Board has considered carefully all the facts of record, including the CRA performance evaluation records of Sky Bank and Falls Bank, data reported by Sky Bank in 2004 under the Home Mortgage Disclosure Act (“HMDA”),¹² small business lending data reported under the CRA,¹³ other information provided by Sky, confidential supervisory information, and public comment received on the proposal. A commenter criticized Sky’s record of small business lending, alleging that it disproportionately lent to businesses in middle- and upper-income census tracts and did not provide enough loans to businesses in the LMI census tracts. The commenter also alleged, based on 2004 HMDA data, that Sky had low levels of home mortgage lending to minority borrowers and engaged in disparate treatment of minority individuals in its home mortgage operations.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions.

¹² 12 U.S.C. § 2801 et seq.

¹³ Under the Board's CRA regulations, state member banks (other than small banks) are subject to reporting requirements for loans with original amounts of \$1 million or less ("small business loans") for each geography in which the bank originated or purchased a small business loan. Banks must report the aggregate number and amount of small business loans in specified origination amount categories and the aggregate number and amount of small business loans to businesses with gross annual revenues of \$1 million or less (“small businesses”). 12 CFR 228.42.

An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.¹⁴

Sky Bank received a "satisfactory" rating at its most recent CRA evaluation by the Federal Reserve Bank of Cleveland ("Reserve Bank"), as of October 14, 2003 ("2003 CRA Evaluation").¹⁵ Falls Bank also received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of June 1, 2001.¹⁶ After consummation of the proposed series of transactions, Sky will implement in the resulting institution the community development strategy, including products, services, outreach, and initiatives, that is currently in place at Sky Bank.

¹⁴ See Interagency Questions and Answers Regarding Community Reinvestment, 66 Federal Register 36,620 and 36,639 (2001).

¹⁵ Examiners evaluated Sky Bank's CRA performance in its 17 assessment areas in Ohio, Pennsylvania, Michigan, and Indiana and in one assessment area that included a part of the Steubenville-Weirton Metropolitan Statistical Area ("MSA") that covers portions of Ohio and West Virginia. The substantial majority of the bank's deposits, loans, and branches were in Ohio. In determining Sky Bank's overall rating, examiners gave the greatest weight to the bank's performance in the Steubenville-Weirton MSA and the bank's other assessment areas in Ohio, particularly the Toledo and Youngstown-Warren MSAs. The evaluation period for home mortgage loans and small business loans was January 1, 2001, through December 31, 2002. The evaluation period for community development loans and the investment and services tests was August 7, 2000, through October 14, 2003. Sky Trust, a special-purpose bank, is not subject to the CRA. 12 CFR 225.11(3).

¹⁶ The evaluation period for Falls Bank's CRA performance was from July 1, 1999, through January 24, 2001. Falls Bank's CRA performance was evaluated according to the FDIC's small-bank performance standards. 12 CFR 345.26.

In its 2003 CRA Evaluation, Sky Bank received a “high satisfactory” rating under the lending test. Examiners reported that the majority of Sky’s lending was inside its assessment areas and that Sky Bank’s lending levels reflected good responsiveness to the credit needs of its communities.¹⁷ Furthermore, examiners noted that Sky Bank’s distribution of loans showed a good penetration among geographies and customers of different income levels and among businesses of different revenue sizes.

In the Ohio and the Steubenville-Weirton MSA assessment areas, examiners concluded that Sky Bank’s lending activity was good, and they commended the overall geographic distribution of the bank’s loans. Examiners noted that Sky Bank’s lower levels of HMDA-reportable lending in low-income census tracts was offset by the bank’s strong lending levels in moderate-income census tracts. Examiners also took into consideration programs offered by Sky Bank in evaluating Sky’s flexible lending practices to address the credit needs of LMI individuals and geographies. These programs included a partnership with the Federal Home Loan Bank of Cincinnati to increase homeownership opportunities and the supply of affordable housing, partnerships with four Metropolitan Housing Authorities to originate loans using conversions of the U.S. Department of Housing and Urban Development’s section 8 rental subsidies into mortgage payments, and partnerships with Fannie Mae and others to develop the GoodStart Mortgage Program, which focuses on LMI and

¹⁷ The commenter noted that Sky originated mortgages in various states outside its assessment areas in 2004. HMDA data from 2004 indicate that the majority of Sky’s HMDA-reportable loans were generated in its assessment areas. Sky has represented that it does not actively lend outside its five core states of Ohio, Pennsylvania, Michigan, West Virginia, and Indiana, and that the loans made outside those states are generally for non-owner-occupied or multifamily housing properties.

underserved minority borrowers. The GoodStart Mortgage Program provides 100 percent financing and a more competitive rate and fee structure than the Federal Housing Administration loan program.¹⁸

With respect to Sky Bank's small business lending performance, the 2003 CRA Evaluation found that the bank demonstrated an adequate overall record of serving the credit needs of small businesses. Although the percentage of small business loans¹⁹ made by the bank in LMI census tracts in some parts of its primary assessment areas was less than the percentage of the aggregate of all lenders ("aggregate lenders"), it exceeded that of the aggregate lenders in other parts of its primary assessment areas.²⁰ For example, in Sky Bank's multistate Steubenville-Weirton MSA assessment area, although Sky Bank's percentage of small business lending in low-income census tracts was less than that of the aggregate lenders, Sky Bank's percentage of small business loans in moderate-income census tracts exceeded the percentage for the aggregate lenders. In the Youngstown-Warren MSA, examiners found the geographic distribution of the

¹⁸ During the evaluation period, Sky provided more than \$41 million in financing to LMI households in the GoodStart Mortgage Program.

¹⁹ In this context, "small business loans" are loans that have original amounts of \$1 million or less and are either secured by nonfarm nonresidential properties or are classified as commercial and industrial loans. The commenter criticized Sky Bank's record of small business lending in LMI census tracts outside the bank's assessment areas in Indiana and West Virginia, as well as its lending in Illinois and New York, both states where the bank has no assessment areas. Sky Bank asserted that only a very small portion of the small business loans it closed in 2004 were outside the five core states in its assessment areas.

²⁰ The lending data of the aggregate lenders represent the cumulative lending for all financial institutions subject to reporting requirements in a particular area.

bank's small business loans to be "excellent," with its percentage of small business lending in LMI geographies exceeding the percentage for the aggregate lenders.²¹

The Board has also considered additional information about Sky Bank's small business lending performance since the 2003 CRA Evaluation. The 2004 CRA data reported by Sky Bank indicated that the percentage of the bank's total dollar amount of small business loans to businesses in LMI census tracts in Ohio was generally comparable to the percentage for the aggregate lenders. Furthermore, Sky represented that Sky Bank was recognized each fiscal year by the Small Business Administration ("SBA") from 2000 to 2004 as a "top five" lender on the basis of the number of loans made to small businesses in the SBA's northern Ohio district. Sky also represented that it participates in economic development programs in Toledo and Youngstown, two cities that have a significant concentration of LMI census tracts, and that it conducts various outreach efforts to small businesses in LMI areas, including advertising its small business products in media that focus on minority-owned and emerging businesses and holding meetings about its small business products with small business owners in an LMI area of Cleveland.²²

²¹ Although the bank's small business lending in LMI census tracts in its assessment area in the Toledo MSA was less than that of the aggregate lenders, examiners noted competitive factors affecting the bank's performance and considered it to be adequate.

²² The commenter criticized Sky Bank's level of small business lending in LMI census tracts in its assessment areas in Indiana and West Virginia in 2004. The 2003 CRA Evaluation indicated that the bank's overall small business lending record was adequate. The Reserve Bank will continue to evaluate Sky Bank's lending activities in future CRA performance evaluations, including its small business lending activities.

In the 2003 CRA Evaluation, examiners commended Sky Bank for having an “excellent” level of community development lending throughout its assessment areas, particularly in Ohio. During the evaluation period, Sky Bank originated 70 community development loans totaling \$81.8 million, the majority of which supported affordable housing initiatives.

Sky Bank received an overall “high satisfactory” rating under the investment test in the 2003 CRA Evaluation, reflecting what examiners reported as an “excellent” level of qualified investments in various assessment areas. For example, examiners found the bank’s investment performance in Ohio to be “outstanding” based on the bank’s qualified investments in the state that totaled approximately \$29.4 million.

Sky Bank also received an overall “high satisfactory” rating under the service test in the 2003 CRA Evaluation. Examiners reported that Sky Bank’s retail delivery systems were accessible to essentially all portions of its assessment areas and that the bank’s new branches improved accessibility in LMI geographies in the Youngstown-Warren and Pittsburgh MSAs. Examiners also commended the bank for providing a relatively high percentage of community development services throughout its assessment areas that promoted or facilitated affordable housing, services, and economic development in LMI areas and for LMI individuals.

B. HMDA and Fair Lending Record

The Board has considered carefully Sky’s lending record and HMDA data in light of public comment about its record of lending to minorities. The commenter expressed concern, based on 2004 HMDA data, that Sky disproportionately excluded or denied applications by African-American and Hispanic applicants for HMDA-reportable loans. The commenter also expressed concern that the 2004 HMDA data indicated that Sky made higher-cost loans to

African Americans more frequently than nonminorities in its overall business and in Ohio in particular.²³ The Board reviewed the HMDA data for 2004 reported by Sky Bank in its assessment areas on a statewide basis in Ohio, Pennsylvania, Michigan, West Virginia, and Indiana.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they are insufficient by themselves to conclude whether or not Sky Bank is excluding any racial or ethnic group or imposing higher credit costs on those groups on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.²⁴ HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

²³ Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity by 3 percentage points for first-lien mortgages and by 5 percentage points for second-lien mortgages. 12 CFR 203.4.

²⁴ The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance by Sky Bank with fair lending laws. In the fair lending review conducted in conjunction with the 2003 CRA Evaluation, examiners noted no substantive violations of applicable fair lending laws by Sky Bank. As the primary federal supervisor of Sky Bank, the Board will continue to carefully examine the bank's compliance with fair lending and other consumer protection laws.

The record also indicates that Sky has taken steps to ensure compliance with fair lending laws and other consumer protection laws. Sky represented that it undertakes significant monitoring of compliance in its mortgage lending operations using a wide variety of audit and review mechanisms, including file reviews, statistical analyses, and exception reviews. Furthermore, Sky Bank's mortgage products are conventional, conforming products such as those offered by government-sponsored enterprises that conform to secondary-market underwriting guidelines. Sky Bank's mortgage program offers risk-priced procedures consistent with these guidelines and it uses automated software for underwriting and pricing mortgage loans. The bank does not offer any nonprime or "Alt-A" mortgage loan products other than those offered through programs of government-sponsored enterprises.

The Board also notes that Sky has typically acquired rural community banks and has only recently entered into certain urban areas with significant minority populations. Sky has undertaken initiatives since entering those markets to enhance its outreach and loan distribution to minorities in urban areas. These initiatives have included hiring community mortgage originators and community development officers, marketing in local minority-focused media, and developing Spanish-language marketing materials.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of Sky Bank and of Falls Bank under the CRA. These established efforts demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

Conclusion on CRA Performance Records

The Board has carefully considered all the facts of record, including reports of evaluation of the CRA performance records of the institutions involved, information provided by Sky, comments received on the proposal, and confidential supervisory information. The Board notes that the proposal would expand the availability and array of banking products and services to the customers of Falls Bank, including access to expanded branch and ATM networks. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the

factors that it is required to consider under the BHC Act.²⁵ The Board's approval is specifically conditioned on compliance by Sky with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the fifteenth calendar day after the effective date of this order, or later than

²⁵ A commenter requested that the Board hold a public hearing or meeting on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for any of the banks to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from any supervisory authority. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. 12 CFR 225.16(e). The Board has considered carefully the commenter's requests in light of all the facts of record. In the Board's view, the public has had ample opportunity to submit comments on the proposal and, in fact, the commenter has submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why its written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the request for a public hearing or meeting on the proposal is denied.

three months after the effective date of this order, unless such period is extended for good cause by the Board or the Reserve Bank, acting pursuant to delegated authority.

By order of the Board of Governors,²⁶ effective November 14, 2005.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

²⁶ Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.