

FEDERAL RESERVE SYSTEM

Sky Financial Group, Inc.  
Bowling Green, Ohio

Order Approving Acquisition of Shares of a Bank Holding Company

Sky Financial Group, Inc. (“Sky”), a financial 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 Act<sup>1</sup> to acquire through its subsidiary, Sky Holdings, Inc., Wilmington, Delaware, up to 9.99 percent of the voting shares of LNB Bancorp, Inc. (“LNB”) and thereby indirectly acquire an interest in LNB’s subsidiary bank, The Lorain National Bank (“Lorain National”), both of Lorain, Ohio.<sup>2</sup>

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (70 Federal Register 76,850 (2005)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

Sky, with total consolidated assets of approximately \$15.7 billion, controls Sky Bank,<sup>3</sup> 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 \$8.1 billion, which represent 4 percent of the total amount of deposits of insured depository institutions in the

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<sup>1</sup> 12 U.S.C. section 1842.

<sup>2</sup> Sky currently owns 4.73 percent of LNB’s voting shares and proposes to acquire the additional voting shares through open-market purchases.

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

state (“state deposits”).<sup>4</sup> LNB, with consolidated assets of approximately \$801.1 million, is the 25th largest depository organization in Ohio, controlling approximately \$642.8 million in deposits. If Sky were deemed to control LNB on consummation of the proposal, Sky would become the seventh largest depository organization in Ohio, controlling approximately \$8.7 billion in deposits, which represents 4.3 percent of state deposits.

The Board received a comment from LNB objecting to the proposal on the grounds that the investment could create uncertainty about the future independence of LNB or result in Sky controlling and potentially harming LNB.<sup>5</sup> LNB asserted that the commitments that Sky has provided to prevent the exercise of a controlling influence over LNB are insufficient, and LNB requested that the Board impose additional commitments to ensure that Sky cannot exercise control over LNB. The Board has considered these comments carefully in light of the factors that the Board must consider under section 3 of the BHC Act.

The Board previously has stated that the acquisition of less than a controlling interest in a bank or bank holding company is not a normal

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<sup>4</sup> Asset data are as of December 31, 2005. State deposit and ranking data are as of June 30, 2005, and reflect merger and acquisition activity as of February 6, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

<sup>5</sup> LNB also expressed concern that investor uncertainty over the future of LNB due to Sky’s investment could result in the sale of LNB shares by long-term investors and undermine LNB’s business plan. The Board is limited under the BHC Act to consideration of the factors specified in the act. See Western Bancshares, Inc. v. Board of Governors of the Federal Reserve System, 480 F.2d 749 (10<sup>th</sup> Cir. 1973). The potential effect of a proposal on the behavior of other investors in the market is not among the factors the Board is charged with considering under the BHC Act or other applicable statutes.

acquisition for a bank holding company.<sup>6</sup> The requirement in section 3(a)(3) of the BHC Act, however, that the Board's approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that Congress contemplated the acquisition by bank holding companies of between 5 percent and 25 percent of the voting shares of banks.<sup>7</sup> On this basis, the Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company.<sup>8</sup>

Sky has stated that the acquisition is intended as a passive investment and that it does not propose to control or exercise a controlling influence over LNB. Sky has agreed to abide by certain commitments on which the Board previously has relied in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding company or bank for purposes of the BHC Act.<sup>9</sup> For example, Sky has committed not to exercise or attempt to exercise a controlling influence over the management

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<sup>6</sup> See, e.g., Penn Bancshares, Inc., 92 Federal Reserve Bulletin \_\_\_\_ (1996) (Order dated December 19, 2005) ("Penn Bancshares"); C-B-G, Inc., 91 Federal Reserve Bulletin 421 (2005) ("C-B-G"); S&T Bancorp Inc., 91 Federal Reserve Bulletin 74 (2005) ("S&T Bancorp"); Brookline Bancorp, MHC, 86 Federal Reserve Bulletin 52 (2000) ("Brookline"); North Fork Bancorporation, Inc., 81 Federal Reserve Bulletin 734 (1995); First Piedmont Corp., 59 Federal Reserve Bulletin 456, 457 (1973).

<sup>7</sup> See 12 U.S.C. section 1842(a)(3).

<sup>8</sup> See, e.g., Penn Bancshares (acquisition of up to 24.89 percent of the voting shares of a bank holding company); C-B-G (acquisition of up to 24.35 percent of the voting shares of a bank holding company); S&T Bancorp (acquisition of up to 24.9 percent of the voting shares of a bank holding company); Brookline (acquisition of up to 9.9 percent of the voting shares of a bank holding company).

<sup>9</sup> See, e.g., Penn Bancshares, C-B-G; S&T Bancorp; Emigrant Bancorp, Inc., 82 Federal Reserve Bulletin 555 (1996); First Community Bancshares, Inc., 77 Federal Reserve Bulletin 50 (1991). Sky's commitments are set forth in the appendix.

or policies of LNB or any of its subsidiaries; not to seek or accept representation on the board of directors of LNB or any of its subsidiaries; and not to have any director, officer, employee, or agent interlocks with LNB or any of its subsidiaries. Sky also has committed not to attempt to influence the dividend policies, loan decisions, or operations of LNB or any of its subsidiaries. The Board concludes that additional commitments are unnecessary to ensure that Sky does not acquire control of, or have the ability to exercise a controlling influence over, LNB through the proposed acquisition of voting shares. Moreover, the BHC Act prohibits Sky from acquiring shares of LNB in excess of the amount considered in this proposal or attempting to exercise a controlling influence over LNB without the Board's prior approval.

The Board has adequate supervisory authority to monitor Sky's compliance with its commitments and can take enforcement action against Sky if it violates any of the commitments.<sup>10</sup> The Board also has authority to initiate a control proceeding<sup>11</sup> against Sky if facts presented later indicate that Sky or any of its subsidiaries or affiliates, in fact, controls LNB for purposes of the BHC Act. Based on these considerations and all the other facts of record, the Board has concluded that Sky would not acquire control of, or have the ability to exercise a controlling influence over, LNB through the proposed acquisition of voting shares.<sup>12</sup>

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<sup>10</sup> See 12 U.S.C. section 1818(b)(1).

<sup>11</sup> See 12 U.S.C. section 1841(a)(2)(C).

<sup>12</sup> LNB asserted that Sky did not fully investigate or disclose whether it and any associated persons had already acquired more than 5 percent of the shares of LNB without prior approval of the Board, or whether Sky and any such persons constitute a "group acting in concert" under the Change in Bank Control Act ("CIBC Act") (12 U.S.C. section 1817(j)) and are required to file a CIBC Act Notice. Sky surveyed its management officials with major policymaking functions about their ownership of LNB shares and reported those findings as part

### Financial and Managerial Considerations and Future Prospects

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, information provided by the applicant, and public comments received.

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. When applicable, the Board also evaluates the financial condition of the combined organization on consummation, including its capital position,

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of this proposal. In addition, Sky has represented and committed to the Board that it does not and will not have any agreement, understanding, or arrangement with any person regarding voting or transferring LNB shares and that it has not provided financing for the purchase of LNB shares. The Board has reviewed information provided by Sky and LNB and confidential supervisory information about the current ownership of both organizations, including information about the ownership of LNB's shares by individuals associated with Sky, in light of the Board's rules and precedent for aggregating shares held by a company and persons associated with the company. The record does not support a finding that Sky has acted together with any of its directors, officers, or employees or together with any other person to acquire voting shares of LNB in violation of the BHC Act or the CIBC Act.

asset quality, earnings prospects, and the impact of the proposed funding of the transaction.<sup>13</sup>

The Board has carefully considered the financial factors. Sky and Sky Bank are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board believes that Sky has sufficient financial resources to effect the proposal. The proposed transaction would be funded from Sky's general corporate resources.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of Sky, Sky Bank, Sky Trust, LNB, and Lorain National, 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 laws. Sky, Sky Bank, Sky Trust, LNB, and Lorain National are considered to be well managed.

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 supervisory factors under the BHC Act.

#### Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposed bank acquisition that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any

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<sup>13</sup> As previously noted, the current proposal provides that Sky would acquire only up to 9.99 percent of LNB's voting shares and would not be considered to control LNB. Under these circumstances, the financial statements of Sky and LNB would not be consolidated.

relevant banking market. Section 3 also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.<sup>14</sup>

The Board previously has stated that one company need not acquire control of another company to lessen competition between them substantially.<sup>15</sup> The Board has found that noncontrolling interests in directly competing depository institutions may raise serious questions under the BHC Act and has stated that the specific facts of each case will determine whether the minority investment in a company would be anticompetitive.<sup>16</sup>

Sky and LNB compete directly in the Cleveland, Ohio banking market (“Cleveland market”).<sup>17</sup> In particular, the Board has considered the number of

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<sup>14</sup> See 12 U.S.C. section 1842(c)(1).

<sup>15</sup> See, e.g., SunTrust Banks, Inc., 76 Federal Reserve Bulletin 542 (1990); First State Corp., 76 Federal Reserve Bulletin 376, 379 (1990); Sun Banks, Inc., 71 Federal Reserve Bulletin 243 (1985) (“Sun Banks”).

<sup>16</sup> See, e.g., BOK Financial Corp., 81 Federal Reserve Bulletin 1052, 1053-54 (1995); Mansura Bancshares, Inc., 79 Federal Reserve Bulletin 37, 38 (1993); Sun Banks at 244.

<sup>17</sup> The Cleveland market is defined as Cuyahoga, Geauga, Lake, and Lorain Counties; all of Medina County except the city of Wadsworth, the townships of Guilford, Sharon, and Wadsworth, and the village of Seville; the cities of Aurora and Streetsboro, the townships of Freedom, Hiram, Mantua, Nelson, Shalersville, and Windham, and the villages adjoining these townships in Portage County; the cities of Hudson, Macedonia, and Twinsburg, the townships of Boston, Northfield Center, Richfield, Sagamore Hills, and Twinsburg, and the villages adjoining these townships in Summit County; and part of the City of Vermilion in Erie County, all in Ohio.

competitors that would remain in the market, the relative shares of total deposits of depository institutions in the market (“market deposits”) controlled by Sky and LNB,<sup>18</sup> 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”),<sup>19</sup> and other characteristics of the market. If Sky and LNB were viewed as a combined organization, consummation of the proposal would be consistent with Board precedent and the DOJ Guidelines in the Cleveland market.<sup>20</sup> Although the market would remain highly

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<sup>18</sup> Deposit and market share data are as of June 30, 2005, reflect mergers and acquisitions through January 4, 2006, and 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, 387 (1989); National City Corporation, 70 Federal Reserve Bulletin 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the calculation of market share on a 50 percent weighted basis. See, e.g., First Hawaiian, Inc., 77 Federal Reserve Bulletin 52, 55 (1991).

<sup>19</sup> Under the DOJ Guidelines, 49 Federal Register 26,823 (June 29, 1984), 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 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 institutions.

<sup>20</sup> LNB expressed concern that Sky is expanding its operations in the Cleveland market by acquiring banks instead of internal growth. Bank holding companies may expand in any geographic market by acquisition, as long as the acquisition is consistent with the competitive requirements and other factors of the BHC Act.

concentrated, the increase in market concentration as measured by the HHI would be small and numerous competitors would remain in the market.<sup>21</sup>

The Department of Justice also has reviewed the proposal and has advised the Board that it does not believe that the acquisition would likely have a significantly adverse effect on competition in any relevant banking market. The appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Accordingly, in light of 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 any relevant banking market and that competitive considerations are consistent with approval of the proposal.

#### 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 CRA.<sup>22</sup> 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

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<sup>21</sup> Sky is the eleventh largest depository organization in the Cleveland market, controlling \$1.1 billion in deposits, which represents 1.9 percent of the total deposits in depository institutions in the market (“market deposits”). LNB is the 13th largest depository organization in the market, controlling \$642.8 million in deposits. If considered a combined banking organization on consummation of the proposal, Sky and LNB would be the ninth largest depository organization in the Cleveland market, controlling approximately \$1.8 billion in deposits, which would represent 2.9 percent of market deposits. The HHI for the Cleveland market would increase by 4 points to 1883. Forty-three depository institutions would remain in the market.

<sup>22</sup> 12 U.S.C. section 2901 et seq.

agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in evaluating bank expansionary proposals.<sup>23</sup>

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. Sky Bank received a "satisfactory" rating at its most recent CRA evaluation by the Federal Reserve Bank of Cleveland as of October 14, 2003. Lorain National also received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of October 7, 2002.

Based on a review of the entire record, 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 other facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching this 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 and other applicable statutes.<sup>24</sup> The Board's approval is specifically conditioned on compliance by

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<sup>23</sup> 12 U.S.C. section 2903.

<sup>24</sup> LNB expressed concern that public disclosure of Sky's proposal was inadequate because it did not accompany disclosure in public reports filed with the Securities and Exchange Commission ("SEC"). All public notice required by the Board's regulations in connection with the application have been made, including publishing notice of the transaction in local newspapers in the communities where Sky and LNB are headquartered. 12 CFR 262.3(b)(1)(ii)(E). Furthermore, Sky has represented that it was not legally required to disclose the proposed transaction in filings with the SEC because the proposed investment would not qualify as a

Sky with the conditions imposed in this order and all the commitments made to the Board in connection with the application, including the commitments discussed in this order, and receipt of all required regulatory approvals.<sup>25</sup> The conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The acquisition of LNB's voting shares shall not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors,<sup>26</sup> effective February 24, 2006.

*(signed)*

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Robert deV. Frierson  
Deputy Secretary of the Board

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material investment for Sky and therefore would not trigger an SEC filing requirement. The SEC has jurisdiction to determine whether Sky has violated any federal securities laws or violations.

<sup>25</sup> LNB questioned when the passivity commitments that Sky provided would become effective. The commitments are effective when Sky owns, controls, or holds the power to vote at least 5 percent of LNB's voting shares.

<sup>26</sup> Voting for this action: Chairman Bernanke, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

APPENDIX

In connection with its application to acquire up to 9.99 percent of LNB, Sky commits that it will not, directly or indirectly, without the Federal Reserve System's prior approval:

- (1) exercise or attempt to exercise a controlling influence over the management or policies of LNB or any of its subsidiaries;
- (2) seek or accept representation on the board of directors of LNB or any of its subsidiaries;
- (3) serve, have, or seek to have any representative serve as an officer, agent, or employee of LNB or any of its subsidiaries;
- (4) take any action that would cause LNB or any of its subsidiaries to become a subsidiary of Sky or any of its subsidiaries;
- (5) acquire or retain shares that would cause the combined interests of Sky and its subsidiaries, and their respective officers, directors, and affiliates, to equal or exceed 25 percent of the outstanding voting shares of LNB or any of its subsidiaries;
- (6) propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of LNB or any of its subsidiaries;
- (7) solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of LNB or any of its subsidiaries;
- (8) attempt to influence the dividend policies or practices of LNB or any of its subsidiaries;
- (9) attempt to influence the investment, loan, or credit decisions or policies; pricing of services; personnel decisions; operations activities (including the location of any offices or branches or their hours of operation, etc.); or any similar activities or decisions of LNB or any of its subsidiaries;

- (10) dispose or threaten to dispose of shares of LNB or any of its subsidiaries in any manner as a condition of specific action or nonaction by LNB or any of its subsidiaries; or
- (11) enter into any other banking or nonbanking transactions with LNB or any of its subsidiaries, except that Sky may establish and maintain deposit accounts with depository institution subsidiaries of LNB, provided that the aggregate balance of all such accounts does not exceed \$500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with LNB or any of its subsidiaries.