



INTERMEDIATE SMALL BANK

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

PUBLIC DISCLOSURE

September 07, 2005

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Merchants Bank, National Association
Charter Number 14488**

**102 Plaza East
Winona, MN 55987**

**Comptroller of the Currency
Minneapolis South
1310 West Clairemont Avenue Suite 100
Eau Claire, WI 54701**

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

INSTITUTION'S CRA RATING: Outstanding

The Lending Test is rated: **Outstanding**

The Community Development Test is rated: **Outstanding**

The major factors that support this rating include:

- The loan-to-deposit ratio evidences a high volume of lending activity.
- The level of loan originations and purchases in the bank's assessment areas is reasonable.
- The overall distribution of loans to borrowers of different income levels and businesses of different sizes is excellent.
- Responsiveness to community development needs is excellent in relation to the bank's capacity and area opportunities.

SCOPE OF EXAMINATION

We evaluated the bank's performance using intermediate small bank performance standards, specifically using lending and community development tests.

The lending test analysis is based on the bank's primary loan products for the period January 1, 2002, through December 31, 2004. We used the bank's HMDA and CRA data to perform the lending test analysis (whole years to be consistent with prior evaluations and data integrity reviews). Examiners tested the accuracy of HMDA and CRA data earlier in the year and did not identify any material errors.

The bank's primary loan products are home refinance, home purchase and small business loans. These loans respectively represent 49%, 20% and 19% of the bank's lending activity in the Winona assessment area (by number of loan originations). In the Rochester assessment area, these ratios are 43%, 22% and 20%, respectively.

We did not analyze the geographic distribution of loans in the Winona assessment area. This analysis is not meaningful, as the area had no low- or moderate-income tracts during the evaluation period.

The community development test considers qualified loans, investments and services for the period April 30, 2002 through August 31, 2005. Examiners reviewed all of the bank's community development activities. Only those activities that qualified are presented and considered in this evaluation.

We performed a full-scope review of the Winona assessment area as it accounts for most bank deposits (89% by dollar volume) and a significant majority of loan originations over the

evaluation period (73% by dollar volume). A limited scope review was performed in the Rochester assessment area, which consists of Olmsted County (a portion of the Rochester, MN Metropolitan Statistical Area #40340).

DESCRIPTION OF INSTITUTION

Merchants Bank, National Association (Merchants) is an intrastate bank headquartered in Winona, Minnesota. As of December 31, 2004, the bank had assets of \$483 million and Tier I Capital of \$51.7 million. In addition to its main office, Merchants operates three additional branches in Winona, one branch in St. Charles and two branches in Rochester.

Merchants is a subsidiary of Merchants Financial Group, Inc., a \$689 million multi-bank holding company, also headquartered in Winona. Merchants has two subsidiaries, neither of which significantly impacts its capacity to lend or invest. Activities of the subsidiaries were not considered in this evaluation.

Merchants is a full-service financial institution that offers a wide variety of retail and commercial banking products and services. Its focus is commercial lending, home mortgage lending and industrial leasing. As of December 31, 2004, the bank's net loans and leases totaled \$356 million, representing 74% of total assets and 109% of bank deposits. The loan portfolio is comprised of commercial and commercial real estate loans (37%), residential real estate loans (19%), construction and land development loans (11%), leases (18%), loans to individuals (9%), and other loans (6%).

Merchants plays a somewhat unique role in the region by helping smaller financial institutions originate home mortgage loans via a correspondent lending program. This program generates a significant volume of HMDA loans and serves consumers across a broad trade area (Wisconsin, Minnesota, South Dakota, North Dakota, and Iowa). Consumers can apply for a home mortgage loan with their local financial institution that, in turn, forwards the application to Merchants. Merchants underwrites (and therefore also HMDA-reports) the loan. Merchants does not, however, provide the permanent financing - the loans are sold to Fannie Mae or Freddie Mac instead. Through these correspondent relationships, Merchants helps smaller financial institutions originate a wide variety of mortgage loans to their local customers at terms and prices the banks might not otherwise be able to offer.

There are no legal, financial, or other factors that impede Merchants' ability to help meet the credit needs in its assessment areas. The bank's previous CRA evaluation, dated April 29, 2002, resulted in a "Satisfactory" rating using Large Bank performance standards.

DESCRIPTION OF THE WINONA ASSESSMENT AREA

Winona Assessment Area - Demographic Information					
Demographic Characteristics	#	Low % of #	Moderate % of #	Middle % of #	Upper % of #
Geographies (Census Tracts)	13	0.00	0.00	84.62	15.38
Population by Geography	59,821	NA	NA	77.46	22.54
Owner-Occupied Housing by Geography	16,430	NA	NA	78.25	21.75
Businesses by Geography	3,738	NA	NA	87.32	12.68
Farms by Geography	697	NA	NA	92.54	7.46
Family Distribution by Income Level	14,390	14.31	18.59	26.00	41.10
Distribution of Low- and Moderate- Income Families by Geography	4,734	NA	NA	81.96	18.04
Median Family Income	\$45,925	Weighted Avg Median Housing Value		\$96,176	
2005 HUD Adjusted Median Family Income	\$54,100	Unemployment Rates for			
Percent of Households Below Poverty	10.25%	Winona County (November 2005)		2.9%	
		Fillmore County (November 2005)		3.4%	

Source: 2000 U.S. Census, 2005 HUD updated MFI, and MN Department of Employment and Economic Development

The Winona Assessment Area (AA) is a non-metropolitan area in southeastern Minnesota. The AA consists of Winona County and roughly half of the adjacent Fillmore County (tracts #9601, #9604, and #9606). The portion of Fillmore County excluded from the AA is not close to any of Merchants' branches and is entirely comprised of middle-income geographies. The Winona AA meets regulatory requirements and does not arbitrarily exclude any low- or moderate-income tracts.

Merchants operates four full-service offices and six ATMs in the AA. The main office and two branch facilities are in Winona and one branch is in St. Charles. The bank also operates a fifth office, to provide banking services to residents of a Winona nursing home during limited hours. The bank provides a full range of financial products and services in this market and is an active home mortgage and small business lender.

Bank competition is strong. Merchants has the largest share of deposits of more than thirteen financial institutions with offices in the area. Per June 30, 2005 FDIC information, the bank has 40% of the deposits in Winona County (Merchants has no branches in Fillmore County). Of the nine local institutions that publicly reported home mortgage loan data in 2004, Merchants had the highest number of home purchase, and the second highest number of home refinance loans in the area. And of the five local institutions that publicly reported CRA data in 2004, Merchants had the highest number of small business loans in the area.

The local economy is healthy and diverse. Manufacturing is the predominant industry with more than 100 manufacturers in the area. The largest employers are TRW Automotive Electronics and Fastenal Company. Winona is also home to three institutions of higher learning – Winona State University, St. Mary's University and the South Eastern Minnesota Technical College, which draw approximately 10,000 students to the area each year.

There is a good level of opportunity for contributions and service work with nonprofit community development organizations. Our performance context research, community contact work, and a review of the CRA performance evaluations of competing banks, however, indicate more limited opportunities for community development equity investments, particularly at the local level.

We recently contacted a local government community development representative. The contact reaffirmed a continued need for affordable housing stock in the area as well as an increasing need for the rehabilitation of existing housing stock. The contact specifically complimented Merchant’s involvement with community development projects and other financing programs.

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

Lending Test

Lending performance is excellent. Merchant’s loan-to-deposit ratio evidences a high volume of lending activity. The bank’s level of loan originations and purchases in its assessment areas is reasonable. The overall distribution of loans to borrowers of different income levels and businesses of different sizes is excellent.

Loan-to-Deposit Ratio

Merchant’s loan-to-deposit ratio evidences a high volume of lending activity in light of its size, financial condition and assessment area credit needs. The bank’s quarterly average loan-to-deposit ratio is 97% for the 13 quarters since the previous CRA evaluation. This ratio is higher than ratios for other similarly situated banks (institutions with total assets of \$100 million to \$500 million and a branch facility in the Winona or Rochester Assessment Areas).

Loan to Deposit Analysis (By Dollars)		
Institution	Total Assets (000’s) as of June 30, 2005	Average Loan-to-Deposit Ratio (June 30, 2002 to June 30, 2005)
Merchants Bank, N.A.	\$493,186	96.80%
Sterling State Bank	\$252,135	92.18%
Premier Bank Rochester	\$132,723	89.68%
Eastwood Bank	\$276,005	89.30%
Winona National Bank	\$265,794	77.79%

Lending in Assessment Area

The bank’s level of loan originations and purchases in its assessment areas is reasonable. Excluding the effects of the correspondent lending program (explained in the Description of Institution section), a majority of Merchant’s home mortgage and small loans to businesses over the evaluation period are in its assessment areas.

In-Out Analysis (By Number of Loans)					
Loan Type	Total Loans	Correspondent Loans	Total – Net of Correspondent Loans	In Assessment Areas	
				#	%
Home Mortgage	18,211	12,435	5,776	3,663	63%
Small Business	1,594	---	---	982	62%

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

The overall distribution of loans to borrowers of different income levels and businesses of different sizes is excellent in the Winona Assessment Area. We gave the most weight to home mortgage loans in this assessment as they comprise a significant majority (68%) of the bank's lending activity in the area.

Home Mortgage Loans

The distribution of home mortgage loans to borrowers of different income levels is excellent.

As illustrated in the following tables, the bank's percentage of loans to moderate-income borrowers almost always exceeds the percentage of moderate-income families in the area.

The bank's percentage of loans to low-income borrowers is typically lower than the percentage of low-income families in the area. Our evaluation, however, gives consideration to the percentage of families living below poverty level (7.5% in 2002; and 5.74% in 2003 and 2004), the area's median housing value (currently \$96,176), and the identified need for affordable housing stock. It is also noteworthy that Merchants reported more refinance and home purchase loans to low-income borrowers than any of the other nine local banks that publicly reported home mortgage loan data in the year 2004.

Borrower Distribution of Home Refinance Loans in the Winona Assessment Area						
Borrower Income Level	2002 (665 loans)		2003 (966 loans)		2004 (252 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
Low	14.54	6.09	14.38	9.44	14.31	11.25
Moderate	17.28	17.95	18.67	17.34	18.59	26.25
Middle	24.50	28.37	26.08	32.27	26.00	29.17
Upper	43.68	47.60	40.88	40.94	41.10	33.33

* The demographic comparator is the percentage of families in the assessment area based on 1990 census data for the year 2002, 2000 census data for the year 2003, and 2000 census data with revised metropolitan statistical area definitions for the year 2004.

Borrower Distribution of Home Purchase Loans in the Winona Assessment Area						
Borrower Income Level	2002 (256 loans)		2003 (225 loans)		2004 (281 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
Low	14.54	11.29	14.38	8.29	14.31	17.91
Moderate	17.28	17.74	18.67	28.11	18.59	22.39
Middle	24.50	31.85	26.08	28.57	26.00	23.13
Upper	43.68	39.11	40.88	35.02	41.10	36.57

* The demographic comparator is the percentage of families in the assessment area based on 1990 census data for the year 2002, 2000 census data for the year 2003, and 2000 census data with revised metropolitan statistical area definitions for the year 2004.

Small Loans to Businesses

The distribution of small loans to businesses of different sizes in the Winona Assessment Area is good. As the following table illustrates, the bank’s percentage of loans to businesses with revenues of \$1 million or less has consistently improved over the evaluation period. It is also noteworthy that Merchants originated more loans to businesses with revenues less than \$1 million than any of the other five local banks that publicly reported small business loan data in the year 2004.

Borrower Distribution of Small Loans to Businesses in the Winona Assessment Area						
Borrower Income Level	2002 (222 loans)		2003 (257 loans)		2004 (248 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
< \$1 million	71.86	56.31	66.82	62.65	67.36	70.16

*** The demographic comparator is the percentage of businesses with revenues of \$1 million or less as a percentage of all business in the assessment area based on 2002, 2003, and 2004 Dunn & Bradstreet information, respectively.*

Geographic Distribution of Loans

Geographic distribution is not a meaningful analysis in the Winona Assessment Area because the area is entirely comprised of middle- and upper- income tracts.

Responses to Complaints

Merchants received one complaint during the evaluation period regarding its closure of a grocery store branch in the Rochester Assessment Area. After reviewing the facts and circumstances, we concluded the branch closure did not significantly affect the availability of retail banking services in this market.

Conclusions for Area Receiving Limited-Scope Review

Based on a limited scope review, performance in the Rochester Assessment Area is weaker than the bank’s overall “Outstanding” assessment under the Lending Test. Refer to the tables in Appendix A for the facts and data that support this conclusion. While borrower income distributions are excellent, geographic distributions are considered adequate. Performance in the Rochester Assessment Area did not significantly affect Merchants’ overall Lending Test assessment, as the bank derives relatively few deposits from this market.

Community Development Test

Community development lending, investment and service activities reflect excellent responsiveness to community development needs in relation to the bank's capacity and assessment area opportunities.

Number and Amount of Community Development Loans

Merchants made a \$920 thousand community development loan over the evaluation period. The loan refinanced a subsidized housing complex for very low-income people with disabilities and also provided new monies for improvements to the property. Bank personnel worked closely with various legal and government authorities to obtain a tax-exempt status for the housing complex, which resulted in a lower interest rate for the borrower. The bank also waived its customary 1% origination fee on this loan.

Number and Amount of Qualified Investments

Merchants continues to have a \$75 thousand equity investment in a proprietary community development corporation (CDC). The bank formed the CDC in 1999 to provide a flexible means to meet the credit needs of businesses and individuals that might not qualify for financing under typical underwriting standards.

Over the evaluation period, the CDC originated 8 loans totaling \$22 thousand under the "Partners for Tomorrow's Workforce" program. This program provides loans to low-income individuals for transportation or housing needs as they transition from welfare to work. Bank loan officers also provide credit counseling during the application process to help these individuals establish or improve their credit ratings.

The CDC also made a contribution of \$25 thousand to "West Central Revitalization," a community development project created by the City of Winona to provide funding for the refurbishment of existing housing. The CDC's contribution was placed in a pool of funds to provide deferred loans to low- and moderate-income people.

Merchants also provided \$224 thousand in community development grants and donations over the evaluation period. These grants and donations benefited 20 different organizations that serve the Winona Assessment Area. Three of the organizations focus on affordable housing issues for low- and moderate-income families and individuals, a key need in the area.

Extent to Which the Bank Provides Community Development Services

Delivery systems are reasonably accessible to individuals of different income levels. Merchants operates four full-service offices, five full service automated teller machines (ATMs) and one cash-dispensing ATM in the assessment area. Extended hours are available through walk-up and drive-up facilities at each branch office and at the lobby of one office. All of the bank's loan products are available at the Main and St. Charles offices. The Goodview and Lakeside facilities only offer consumer loans, but these branches are within close proximity to the Main office.

In addition to these traditional facilities, the bank also operates a limited service branch at an assisted living home for senior citizens in Winona. The bank provides depository services from this branch during one hour per month as a convenience to the home's residents.

During the evaluation period, Merchant's employees provided technical assistance and financial expertise to approximately a dozen different community development organizations. Bank personnel serve as officers or board members for organizations that promote small business and that provide affordable housing and community services to low- and moderate-income individuals. At least three of the organizations served focus on affordable housing issues for low- and moderate- income families and individuals, a key need in the area.

The bank also conducts/sponsors workshops targeted to first time homebuyers and small business owners. The workshops help first time homebuyers understand the process and available financing options. The small business workshops cover such topics as accounting basics, how to read and use financial statements, budgeting and forecasting, cost and pricing relationships and small business financing options.

The bank continues to actively sponsor an annual fund-raiser for the local food shelf, providing significant donations of time and money (included in the qualified investment totals).

Bank's Responsiveness to Community Development Needs

As previously noted, several of the bank's community development activities are responsive to identified needs in the assessment area, which include affordable housing for low- and moderate-income individuals and the rehabilitation of existing housing stock.

Conclusions for Area Receiving Limited-Scope Review

Based on a limited scope review, performance in the Rochester Assessment Area is weaker than the bank's "Outstanding" assessment under the Community Development Test. Community development activities are more limited in this market, consisting of charitable grants to five different organizations totaling \$9 thousand and three community development services over the evaluation period. Performance in the Rochester Assessment Area did not significantly affect Merchants' overall community development test assessment as the bank derives relatively few deposits from this market.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs."

Appendix A – Rochester Assessment Area Lending Data

Borrower Distribution Information in the Rochester Assessment Area

Borrower Distribution of Home Refinance Loans in the Rochester Assessment Area						
Borrower Income Level	2002 (215 loans)		2003 (275 loans)		2004 (54 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
Low	15.48	20.85	15.78	13.19	14.78	9.62
Moderate	19.43	28.44	19.10	24.91	18.03	21.15
Middle	28.55	23.22	27.59	32.60	26.74	28.85
Upper	36.54	27.49	37.52	29.30	40.45	40.38

** The demographic comparator is the percentage of families in the assessment area based on 1990 census data for the year 2002, 2000 census data for the year 2003, and 2000 census data with revised metropolitan statistical area definitions for the year 2004.*

Borrower Distribution of Home Purchase Loans in the Rochester Assessment Area						
Borrower Income Level	2002 (114 loans)		2003 (97 loans)		2004 (75 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
Low	15.48	22.32	15.78	15.63	14.78	19.72
Moderate	19.43	29.46	19.10	22.92	18.03	21.13
Middle	28.55	21.43	27.59	34.38	26.74	23.94
Upper	36.54	26.79	37.52	27.08	40.45	35.21

** The demographic comparator is the percentage of families in the assessment area based on 1990 census data for the year 2002, 2000 census data for the year 2003, and 2000 census data with revised metropolitan statistical area definitions for the year 2004.*

Borrower Distribution of Small Loans to Businesses in the Rochester Assessment Area						
Borrower Income Level	2002 (83 loans)		2003 (89 loans)		2004 (83 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
< \$1 million	67.54	61.45	64.52	67.42	65.48	74.70

** The demographic comparator is the percentage of businesses with revenues of \$1 million or less as a percentage of all business in the assessment area based on 2002, 2003, and 2004 Dunn & Bradstreet information, respectively.*

Appendix A (Continued)

Geographic Distribution Information in the Rochester Assessment Area

Geographic Distribution of Home Refinance Loans in the Rochester Assessment Area						
Geography Income Level	2002 (215 loans)		2003 (275 loans)		2004 (54 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
Low	N/A	N/A	N/A	N/A	N/A	N/A
Moderate	14.39	18.60	10.87	5.09	10.87	5.56
Middle	66.29	64.19	66.85	74.18	61.08	72.22
Upper	19.32	17.21	22.27	20.73	28.04	22.22

**The demographic comparator is the number of owner-occupied units in a particular geography divided by the number of owner occupied housing units in the area based on 1990 census data for the year 2002, and 2000 census data for the year 2003, and 2000 census data with revised metropolitan statistical area definitions for the year 2004.*

Geographic Distribution of Home Purchase Loans in the Rochester Assessment Area						
Geography Income Level	2002 (114 loans)		2003 (97 loans)		2004 (75 loans)	
	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution	Demographic Comparator*	Bank Distribution
Low	N/A	N/A	N/A	N/A	N/A	N/A
Moderate	14.39	17.54	10.87	4.12	10.87	5.33
Middle	66.29	66.67	66.85	64.95	61.08	58.67
Upper	19.32	15.79	22.27	30.93	28.04	36.00

**The demographic comparator is the number of owner-occupied units in a particular geography divided by the number of owner occupied housing units in the area based on 1990 census data for the year 2002, and 2000 census data for the year 2003, and 2000 census data with revised metropolitan statistical area definitions for the year 2004.*

Geographic Distribution of Small Loans to Businesses in the Rochester Assessment Area						
Geography Income Level	2002 (83 loans)		2003 (89 loans)		2004 (83 loans)	
	Demographic Comparator*	Bank Distribution**	Demographic Comparator*	Bank Distribution**	Demographic Comparator*	Bank Distribution**
Low	N/A	N/A	N/A	N/A	N/A	N/A
Moderate	13.30	10.84	22.12	8.99	21.26	14.46
Middle	69.28	67.47	58.07	68.54	56.07	67.47
Upper	17.19	21.69	19.52	22.47	22.41	18.07

**The demographic comparator is the number of businesses in a particular geography divided by the number of businesses in the area based on 2002, 2003, and 2004 Dunn & Bradstreet information, respectively.*