



PUBLIC DISCLOSURE

March 24, 2014

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Citizens National Bank of Somerset
Charter Number 11544

44 Public Square Somerset, Kentucky 42501

Office of the Comptroller of the Currency

10200 Forest Green Blvd, Suite 501 Louisville, Kentucky 40223

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.

This document is an evaluation of the Community Reinvestment Act (CRA) performance of The Citizens National Bank of Somerset, Somerset, Kentucky (CNB or Bank) prepared by the Office of the Comptroller of the Currency (OCC), the institution's primary regulator, as of December 31, 2013. The OCC rates the CRA performance of an institution consistent with the provisions set forth in appendix A to 12 CFR 25.

INSTITUTION'S CRA RATING: SATISFACTORY.

- The Lending Test is rated satisfactory.
- The Community Development Test is rated outstanding.

CNB has a satisfactory record of meeting community credit needs. This conclusion is based on the following.

- CNB's loan-to-deposit (LTD) ratio is reasonable.
- A substantial majority of CNB's loans originated during this assessment period were within the Bank's assessment area (AA).
- CNB's distribution of loans to low- and moderate-income individuals is reasonable.
- CNB's geographic distribution of loans reflects reasonable dispersion throughout the AA.
- CNB's community development performance demonstrates excellent responsiveness to the community development needs of the AA.

Scope of the Evaluation

We evaluated CNB under the intermediate small bank evaluation procedures, which include a lending test and a community development test. The lending test evaluates the Bank's record of meeting the credit needs of its AA through its lending activities. We based our conclusions regarding the Bank's lending performance on one-to-four family residential and consumer loans originated between January 1, 2012 and December 31, 2013. The community development test evaluates the Bank's responsiveness to community development needs in its AA through community development lending, qualified investments, and community development services. We based the community development conclusions on community development activities between April 11, 2011 and March 24, 2014.

Description of the Institution

CNB is a full-service, intrastate bank headquartered in Somerset, Kentucky. CNB is 100 percent owned by Citizens Bancshares, Inc., Somerset, Kentucky. As of December 31, 2013, CNB had \$339 million in total assets, \$285 million in deposits, \$196 million in loans, and \$40 million in tier 1 capital. CNB offers traditional banking products and services and has eight locations. Seven offices are located in Pulaski County: a main office and four branches with drive-thru facilities in Somerset, Kentucky; one branch with a drive-thru facility in Science Hill, Kentucky; and one branch with a drive-thru facility in Nancy, Kentucky. CNB also has a branch in Monticello, Kentucky, located in Wayne County, Kentucky. The Monticello location was originally a loan production office, but converted to a full-service branch in November 2009. The Monticello branch is located in a moderate-income census tract and has a drive-thru facility. CNB has eight automated teller machines at the office locations and six other cash dispensers located throughout the AA. CNB is accessible to all segments of the community.

Since the previous CRA evaluation, CNB's primary lending focus was home mortgage loans. Consumer loans make up 52 percent by number and eight percent by dollar amount of all loans originated since the previous evaluation. Commercial real estate loans make up three percent by number and 26 percent by dollar. CNB also made loans to farms in the area. This evaluation focuses on home mortgage loans and consumer loans.

As of December 31, 2013, net loans represented approximately 58 percent of CNB's average assets. The loan portfolio mix is as follows: one-to-four family residential mortgages 38 percent, commercial loans 39 percent, consumer loans 8 percent, construction and development loans 6 percent, multi-family loans 3 percent, farm-related loans three percent, and other loans 3 percent.

There are no legal or financial impediments that affect the Bank's ability to meet community credit needs. The date of the previous CRA evaluation was April 11, 2011. CNB received a satisfactory rating.

Description of the Assessment Area

CNB identifies Pulaski County and Wayne County as its AA. The AA delineation is in conformance with regulatory requirements and is appropriate in relation to the location of CNB's offices. The delineation of the AA does not arbitrarily exclude any low- or moderate-income areas.

The entire AA is located in the non-metropolitan portion of the state of Kentucky. The 2010 United States (U.S.) Census divided the AA into 19 census tracts, with six moderate-income tracts, 11 middle-income tracts, and two upper-income tracts. There are no low-income census tracts in the AA. According to the federal government, all 11 of the middle-income census tracts in the Bank's AA are distressed, nonmetropolitan

census tracts due to high levels of poverty. Approximately 17 percent of families fall below the poverty level.

The AA is located in Southeastern Kentucky. The total population is 83,876, according to the 2010 U.S. Census. There are 34,476 households, of which 10,014, or 29 percent, have low- or moderate-incomes. Other significant factors to consider include: 2 percent of the households receive public assistance and 39 percent receive Social Security benefits. Unemployment levels of 9.8 percent in Pulaski County, and 11.5 percent in Wayne County, are higher than the State average of 7.8 percent, as of January 2014.

The AA has two industrial parks and a technology complex to attract industrial and technology-based companies to the community. The Somerset Chamber of Commerce in Pulaski County lists three industrial firms employing over 300 workers, including Toyotetsu America, Inc; Armstrong Hardwood Products; and Eagle Hardwoods. An industrial firm employing over 300 in Wayne County is American Woodmark Corporation. According to the Kentucky Cabinet for Economic Development, six manufacturers expanded operations in Pulaski County since 2012 adding 50 to 74 jobs. Two manufacturers in Wayne County expanded operations since 2012 adding 30 jobs. Other major employers include federal, state, and local governments, hospitals, and schools.

Competition is strong and numerous financial institutions service the AA. According to Federal Deposit Insurance Corporation data, 10 banks with 38 offices operate in the AA, including CNB. These offices hold a combined total of \$1.3 billion in deposits within the AA as of June 30, 2013; CNB had a 21 percent market share. The competition includes one large bank with total deposits of \$179 billion (nationally) and eight community banks with total deposits ranging from \$139 million to \$3.5 billion.

We used information from two community contacts to help determine the performance context in which to evaluate the Bank's activities in the AA. The contact in Pulaski County indicated general economic conditions in the region were fair. The contact mentioned the recession was not as bad as in other areas of Kentucky. However, the contact confirmed unemployment remains high. The contact was not aware of any unmet credit needs, but identified small business lending as important for improving the economy. The contact in Wayne County indicated economic conditions in the county were below average. Some major employers downsized or did not survive the recession, resulting in high unemployment. The contact could not identify any unmet credit needs in the community. The contact said local financial institutions are involved in assisting community development organizations.

Demographic Information for the Pulaski and Wayne Counties					
	#	% Low	% Moderate	% Middle	% Upper
Geographies (Census Tracts)	19	0%	32%	58%	10%
Population by Geography	83,874	0%	28%	58%	14%
Owner-Occupied Housing by Geography	25,353	0%	29%	57%	14%
Businesses by Geography	6,404	0%	21%	66%	13%
Farms by Geography	429	0%	21%	70%	9%
Family Distribution by Income Level	23,694	25%	19%	20%	36%
Household Distribution by Income Level	34,476	30%	16%	17%	37%
Census Median Family Income (MFI)		\$32,003	Median Housing Value		\$61,799
FFIEC-estimated 2013 MFI		\$44,700	Families Below the Poverty Level		17%
FFIEC-estimated 2012 MFI		\$43,600			

Source: 2010 U.S. Census and American Community Survey.

Conclusions with Respect to the Performance Tests

LENDING TEST

CNB's performance under the lending test is satisfactory. The average LTD ratio is reasonable, and the Bank originated a substantial majority of loans inside its AA. CNB's borrower distribution reflects reasonable penetration among residents of all income levels. CNB's geographic distribution of loans reflects reasonable dispersion throughout the AA. There were no complaints regarding CNB's performance in meeting the credit needs of its community.

Loan-to-Deposit Ratio

CNB's net LTD ratio is reasonable given the Bank's size, financial condition, and AA credit needs. The Bank's net LTD ratio averaged 70 percent over the 10 quarters since the previous CRA evaluation, with a quarterly low of 67 percent and a quarterly high of 73 percent.

The Bank's net LTD ratio is reasonable compared to three other community banks of similar size, location, and product offerings. Those banks had average net LTD ratios averaging 73 percent over 10 quarters. Our conclusion took into consideration the Bank's competitive market and secondary market activity. CNB's average net LTD ratio

does not reflect all mortgage lending activity, as the Bank routinely originates and sells mortgages to the secondary market.

Institution	Average Net LTD Ratio
Citizens National Bank of Somerset	69.70
Bank #1	63.92
Bank #2	67.36
Bank #3	88.15

Lending in the Assessment Area

A substantial majority of loans originated by CNB are within its AA. The following table details the Bank’s lending within the AA by number and dollar amount of loans originated during the evaluation period. Loan originations to borrowers within the Bank’s AA totaled 88 percent by number and 87 percent by dollar amount.

Lending in Pulaski/Wayne County AA										
Loan Type	Number of Loans					Dollars of Loans (000's)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential	573	91	54	9	627	61,854	90	6,955	10	68,809
Consumer	1,439	87	215	13	1,654	11,942	75	3,935	25	15,877
Totals	2,012	88	269	12	2,281	73,796	87	10,890	13	84,686

Source: Bank records which include all one-to-four family, closed-end, first lien, residential real estate, and consumer loans originated between January 1, 2012 and December 31, 2013.

Lending to Borrowers of Different Incomes

The distribution of loans, given the demographics of the AA, reflects reasonable penetration among individuals of different income levels, including low- and moderate-income borrowers.

Residential Real Estate Loans

The distribution of home loans to borrowers reflects reasonable penetration. The Bank’s performance in helping meet the overall home loan needs of low- and moderate-income families is reasonable. Residential loans to low-income borrowers represented 10 percent of total loans originated from January 1, 2012, through December 31, 2013. Loans to moderate-income borrowers represented 14 percent of total loans. These numbers are reasonable given 17 percent of low-income families live below the poverty level. This is a barrier to homeownership because these families are less likely to pursue or qualify for a home loan.

The following table shows the distribution of home loan products among borrowers of different income levels for the period of January 1, 2012 through December 31, 2013, as

compared to the percent of families in each income category.

Borrower Distribution of Residential Real Estate Loans in the Pulaski/Wayne County AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Residential Real Estate Loans	25	10	19	14	20	22	36	54

Source: Bank records which include all 1-4 family residential real estate loans originated within CNB's AA from January 1, 2012 through December 31, 2013. Further segmentation of home mortgage lending activity by purpose was not compiled from the data used for this analysis.

Consumer Loans

The distribution of consumer loans to borrowers reflects reasonable penetration among borrowers of different income levels. Consumer loans to low- and moderate-income borrowers within the loan sample exceeded the percentage of households in the moderate-income level in the Bank's AA.

The following table shows the distribution of consumer loans among borrowers of different income levels for the period of January 1, 2012 through December 31, 2013, as compared to the percent of households in each income category.

Borrower Distribution of Consumer Loans in the Pulaski/Wayne AA								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	30	28	17	25	17	23	36	24

Source: Bank records which include all consumer loans originated within CNB's AA between January 1, 2012 and December 31, 2013.

Geographic Distribution of Loans

The overall geographic distribution of loans reflects reasonable dispersion throughout the AA. CNB's lending activity extends throughout the AA. We did not note any conspicuous gaps in lending. The Bank's lending activity includes the moderate-income census tracts. There are no low-income census tracts in CNB's AA.

Residential Real Estate Loans

The Bank’s geographic distribution of home loans in the AA reflects a reasonable dispersion throughout census tracts of different income levels, including the moderate-income census tracts. The Bank originated 15 percent of residential loans to borrowers in the moderate-income census tracts, which is below the demographic comparator of 29 percent. However, this distribution is reasonable considering four of the six moderate-income tracts are located in Wayne County, where the Bank has only one office. Forty-nine of 59 residential loans, or 83 percent of loans originated in Wayne County, were made to borrowers in the moderate-income census tracts.

The following table details the Bank’s performance as compared to the percentage of owner-occupied housing units in each census tract income level.

Geographic Distribution of Residential Real Estate Loans the in Pulaski/Wayne County AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
Residential Real Estate Loans	N/A	N/A	29	15	57	62	14	23

Source: Bank records which include all one-to-four family residential real estate loans originated between January 1, 2012 and December 31, 2013 within CNB’s AA. Further segmentation of home mortgage lending activity by purpose was not analyzed from the data used.

Consumer Loans

The distribution of consumer loans to borrowers reflects reasonable dispersion throughout the census tracts of different income levels. Consumer loans to borrowers in moderate-income census tracts within the loan sample are below the percentage of households in moderate-income tracts in the Bank’s AA.

This is reasonable considering four out of six moderate-income tracts are in Wayne County. CNB has a small presence in Wayne County with only one branch, which is located in Monticello, Kentucky. Of the consumer loans originated in Wayne County, 75 percent of the loans went to borrowers living in moderate-income tracts.

The following table shows the distribution of consumer loans among borrowers of different income levels for the period of January 1, 2012 through December 31, 2013, as compared to the percent of households in each income category.

Geographic Distribution of Consumer Loans in the Pulaski/Wayne County AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loans	N/A	N/A	29	17	58	67	13	16

Source: Bank records which include all loans originated from January 1, 2011 through December 31, 2013 originated within CNB's AA.

Responses to Complaints

CNB has not received any complaints regarding its CRA performance during the evaluation period.

COMMUNITY DEVELOPMENT TEST

The Bank's performance under the Community Development Test is rated outstanding.

CNB's community development performance through its record of retail services, community development loans, and qualified investments demonstrates excellent responsiveness to community development needs in its AA.

Number and Amount of Community Development Loans

CNB's Community Development Lending reflects excellent responsiveness to community development needs within the Bank's AA. CNB originated 15 community development loans totaling \$10.5 million. These loans promote economic development and strengthen the availability of community services to low- and moderate-income individuals within the AA.

Six of the community development loans financed the startup of new businesses in the AA. Six of the community development loans were to revitalize buildings in moderate-income or middle- income distressed locations. The remaining three were to build commercial buildings for retail or office space within these same tracts.

Number and Amount of Qualified Investments

CNB's community development investments reflect adequate responsiveness to meeting the community's needs. The Bank purchased two Small Business Investment Company investments totaling \$3 million. These investments promote economic development and receive positive consideration for community development investments.

In addition to purchasing investments, the Bank donated \$31 thousand to seven community-based organizations who provide educational, healthcare, disaster relief or community development services for low- and moderate-income individuals. The Bank also donated \$20 thousand to Somerset High School, which serves both moderate-income and distressed middle-income tracts. The donation was to upgrade the school's technology wing.

Extent to Which the Bank Provides Community Development Services

The Bank shows an excellent responsiveness to meeting community needs through qualified community services.

In evaluating CNB's services, we considered the Bank's size in relation to the size of the AA as well as the fact there are no low-income geographies, six moderate-income geographies, and 11 distressed middle-income geographies.

Since the previous CRA evaluation, CNB increased the accessibility of financial services by creating a credit builder program. This program is targeted at individuals with low credit scores due to either past issues or a lack of credit history. The Bank originates small dollar loans to these individuals for 12 and 18 months.

CNB offers online banking to provide customers with additional access to their consumer and business accounts. Through online banking, customers can check account balances, view statements, transfer funds between accounts, make loan payments, and initiate stop payments. CNB also offers free online bill pay to all customers. CNB provides a telephone banking system that allows 24-hour toll free service for customers to transfer funds, verify account balances, and confirm transactions. Customers can also inquire about loan and deposit rates through this system.

CNB participates in the Federal Home Loan Bank of Cincinnati's Welcome Home Program. This program is designed to create homeownership by issuing grants to fund reasonable down payments and closing costs incurred in conjunction with the acquisition or construction of owner-occupied housing by low- and moderate-income homebuyers. Banks participating in this program are subject to an aggregate limit of \$200 thousand to disburse to eligible borrowers. The grants are limited to \$5 thousand per household. Households are eligible only if the total household income is at or below 80 percent of Mortgage Revenue Bond income limits.

To further meet the housing needs of low- and moderate-income individuals within the AA, CNB offers a full array of secondary market loans through Federal Home Loan Mortgage Corporation (Freddie Mac), Veteran Affairs (VA), Federal Housing Administration (FHA), and Rural Housing Service (RHS). Between March 31, 2011 and December 31, 2013, the Bank originated \$57.6 million through Freddie Mac, \$1.8 million through VA, \$3.9 million through FHA, and \$9 million through RHS. The preceding loans

include \$9.3 million of low interest loans originated through Kentucky Housing Corporation.

CNB officers and employees are involved in a variety of community development services. Many senior management employees have been involved with the Housing Authority of Somerset by participating in financial literacy workshops for low- and moderate-income individuals. These workshops assist individuals in understanding banking products. The workshops also provide guidance on purchasing a home and choosing a mortgage product.

Bank employees have facilitated presentations to a local firm, which employs low- and moderate-income individuals within the AA. The presentations teach basic budgeting skills. Senior management actively participates in many organizations in a financial advisory capacity. Below are some examples.

- **Pulaski County Chamber of Commerce.** The primary purpose of this organization is promoting, establishing, and maintaining businesses in Pulaski County, most of which are small businesses. A senior Bank officer serves as a board member and provides financial expertise. The officer provides a banking perspective on new businesses and the financial needs of those businesses.
- **God's Food Pantry.** This is a nonprofit organization dedicated to providing food to low- and moderate-income individuals and families. A senior Bank officer serves as a board member and provides financial expertise to the organization.
- **Wayne County Chamber of Commerce.** The primary purpose of this organization is promoting, establishing, and maintaining businesses in Wayne County, most of which are small businesses. A senior Bank officer serves as a board member and provides financial expertise. The officer provides a bank's perspective on new businesses and the financial needs of those businesses.

Other Bank officers either serve as board members or provide financial expertise to organizations, including Downtown Somerset Development, The Center for Rural Development, and Habitat for Humanity.

Responsiveness to Community Development Needs

CNB's community development activities, as a whole, demonstrate excellent responsiveness to the needs and opportunities in its AA. Several of the Bank's community development loans promote economic development and provide community services to low- and moderate-income individuals. The Bank also invested in a Small Business Investment Company that promotes economic development. CNB's employees provide numerous community services to organizations offering services to low- and moderate-income individuals or organizations assisting small businesses. Donations were also made to local organizations which provide community development services.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 CFR 25.28(c), in determining a national bank's CRA rating, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by CNB or in any AA by an affiliate whose loans have been considered as part of CNB's lending performance.

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