



# INTERMEDIATE SMALL BANK

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

## PUBLIC DISCLOSURE

September 2, 2008

### COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Citizens National Bank of Somerset  
Charter Number: 11544

44 Public Square  
Somerset, KY 42501

Office of the Comptroller of the Currency

Louisville Field Office  
9200 Shelbyville Road, Suite 505  
Louisville, KY 40222

**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: This institution is rated Satisfactory.**

**The Lending Test is rated: Satisfactory.**

**The Community Development Test is rated: Satisfactory.**

The Citizens National Bank of Somerset (CNB) has a satisfactory record of meeting community credit needs. This conclusion is based on the following:

- CNB's loan-to-deposit ratio is reasonable.
- A substantial majority of CNB's loans originated during this assessment period were within the Assessment Area (AA).
- CNB's distribution of loans to low- and moderate-income individuals and businesses with gross revenues of less than \$1 million is reasonable.
- CNB's geographic distribution of loans reflects excellent dispersion throughout the AA.
- CNB's community development performance demonstrates satisfactory responsiveness to the community development needs of its AA.

## **Scope of Examination**

Citizens National Bank of Somerset (CNB) was evaluated under the Intermediate Small Bank examination procedures, which include a lending test and a community development (CD) test. The lending test evaluates the bank's record of meeting the credit needs of its assessment area (AA) through its lending activities. The CD test evaluates the bank's responsiveness to CD needs in its AA through CD lending, qualified investments, and community development services.

We evaluated CNB's lending performance based on residential mortgage and small business loans originated between January 1, 2006 and June 30, 2008. We evaluated the community development test based on community development activities between September 15, 2004 and June 30, 2008. The community development test includes a review of the investments, services, and loans meeting the definition of community development.

## **Description of Institution**

Citizens National Bank of Somerset (CNB) is a full-service intrastate bank 100 percent owned by Citizens Bancshares, Inc. and headquartered in Somerset, Kentucky. As of June 30, 2008, CNB had \$310 million in total assets, \$266 million in deposits, \$134 million in loans and \$34 million in Tier One capital. CNB offers traditional banking products and services. CNB has nine locations: the main office, four branches with drive-thru facilities in Somerset, two branches without drive-thru facilities, one branch with a drive-thru facility in Science Hill, and one branch with a drive-thru facility in Nancy. CNB has eight Automated Teller Machines (ATMs) and 16 other cash dispensers located throughout the AA. CNB is accessible to all segments of the community.

CNB's primary lending focus is home mortgage loans and business loans. CNB also makes loans to consumers and farms in the area. As of June 30, 2008, net loans represented approximately 41 percent of CNB's average assets. The loan portfolio mix is as follows: 1-4 family residential mortgages 43 percent, commercial loans 39 percent, consumer loans 8 percent, construction and development loans 6 percent, farm-related loans 3 percent, and other loans 1 percent.

Legal or financial circumstances do not significantly impact CNB's ability to meet community credit needs; however, over this assessment period management has slowed loan growth as they went through management and lending process changes.

The last CRA evaluation was performed September 15, 2004. CNB received a rating of Satisfactory.

## Description of Assessment Area

CNB has identified Pulaski County as its assessment area (AA). The AA delineation is in conformance with the 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 AA includes the county in its entirety, which is located in the non-metropolitan portion of the state of Kentucky. The 2000 U.S. Census divided the AA into eleven census tracts (CTs), with one moderate-income geography, nine middle-income geographies, and one upper-income geography. There are no low-income CTs in the AA. This determination was based on the Department of Housing and Urban Development 2008 estimated Median Family Income for the state of Kentucky of \$41 thousand for a non-metropolitan area.

Pulaski County is a rural county in Southeastern Kentucky with a total population of 56,217 according to the 2000 U.S. Census. That number has risen to approximately 59,749 in 2006. The 2000 population of the AA was comprised of 22,664 households, of which 9,514, or 42 percent, are considered to have low- or moderate-incomes. In addition, the percentage of households in the AA living below the poverty level is approximately 20 percent. Other significant factors to consider include: 4 percent of the households receive public assistance and 35 percent are on social security.

Pulaski County has unemployment of 6.8 percent similar to the state average of 6.7 percent, as of July 2008. The AA has seen several company closings in recent years. The AA has developed two industrial parks and a technology complex designed to attract industrial and technology-based companies to the county. The Chamber of Commerce lists five firms employing over 300, including Toyotetsu America, Super Service, The Adanta Group, Wal-Mart, and Eagle Hardwood. Other major employers include federal, state, and local governments, hospitals, and schools.

Competition is strong and involves both banks and finance companies. According to the Federal Deposit Insurance Corporation (FDIC) website, nine banks with 30 offices operate in the AA. These offices hold a combined total of \$962 million in deposits. As of June 30, 2007, CNB has a 27 percent market share. The competition includes two large banks with total deposits ranging from \$2 billion to \$84 billion and six community banks with total deposits ranging from \$130 million to \$612 million.

We contacted one community organization to ascertain the community and credit needs in the AA. The contact did not identify any credit needs in the county that were not being addressed by CNB or through other sources.

The following additional demographic information covering CNB’s AA of Pulaski County is based on 2000 census data unless otherwise noted.

Type of Information	AA per 2000 Census Data	
Total Population in AA	56,217	
Kentucky HUD Adjusted Median Family Income – 2008	\$41,000	
Families in AA:		
Income Levels of Families	#	%
Low	3,415	21%
Moderate	2,933	18%
Middle	3,499	21%
Upper	6,534	40%
Total Families within AA	16,381	100%
Median Home Value:	\$63,665	
Median Year Built:	1976	
Businesses in AA:	#	%
Under \$1 Million Revenue	3,187	55
Over \$1 Million Revenue	202	3
Revenue Not Reported	2,430	42
Total	5,819	100

## Conclusions with Respect to Performance Tests

### LENDING TEST

CNB’s performance under the lending test is satisfactory. The borrower distribution portion of the test received the majority of the weight. CNB was found to have reasonable penetration among borrowers of different income levels and businesses of different sizes. CNB’s geographical distribution of loans was excellent, but did not receive a lot of weight because the bank’s AA does not contain any low-income census tracts and only one moderate-income census tract.

All criteria of the lending test are documented below:

**Loan-to-Deposit Ratio**

CNB’s loan-to-deposit ratio indicates a reasonable level of lending activity given the bank’s size, financial condition, and assessment area credit needs. The bank’s average net loan-to-deposit ratio for the sixteen quarters since the last CRA evaluation is 61 percent. This ratio ranged from a quarterly low of 47 percent to a quarterly high of 76 percent during the time period. Our conclusion took into consideration the bank’s satisfactory rating in the lending test performed during this examination, we determined the bank is satisfying the needs of low-or moderate-income individuals within the assessment area. It is also notable that CNB’s average loan-to-deposit ratio does not reflect all home mortgage lending activity, as the bank originates and sells mortgages in the secondary market. As of June 30, 2008, CNB has approximately twenty-two million sold.

The OCC identified two other banks considered similarly situated and comparable to CNB in asset and deposit size, major lending products, and number of offices operating in the assessment area. Although these banks have higher average loan-to-deposit ratios during the same period, CNB’s lending responsiveness to community credit needs is considered satisfactory given the relatively good economic conditions and the high level of competition in the assessment area.

Institution	Average
Citizens National Bank of Somerset	60.72%
Bank #1	74.62%
Bank #2	88.88%

**Lending in Assessment Area**

A substantial majority of loans are in the AA. Our analysis shows 98 percent of the number and 98 percent of the dollar amount of loan originations were to borrowers in the AA. To reach this conclusion, we analyzed CNB’s lending activity by selecting a random sample of 30 residential and 30 business loans originated between January 1, 2006 and June 30, 2008. See the following table for details.

<b>Loan Originations Between January 1, 2006 and June 30, 2008</b>										
<b>Loan Type</b>	<b>Number of Loans</b>					<b>Dollars of Loans</b>				
	<b>Inside</b>		<b>Outside</b>		<b>Total</b>	<b>Inside</b>		<b>Outside</b>		<b>Total</b>
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>		<b>\$ (000's)</b>	<b>%</b>	<b>\$ (000's)</b>	<b>%</b>	
<b>Residential</b>	29	97	1	3	30	\$2,505	96	\$100	4	\$ 2,605
<b>Business</b>	30	100	0	0	30	\$2,832	100	0	0	\$ 2,832
<b>Totals</b>	59	98	1	2	60	\$5,337	98	\$100	2	\$ 5,437

\* Source: Randomly selected sample of 1-4 family residential real estate and business loans.

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

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) and businesses of different sizes. To reach this conclusion, we analyzed CNB’s lending activity for each of its primary loan types and selected a random sample of 30, 1-4 family residential mortgages and 30, business loans, originated in the AA between January 1, 2006 and June 30, 2008. See the following tables for details.

CNB’s borrower distribution of residential loans is reasonable as reflected in the following table.

<b>Borrower Distribution of 1-4 Family Residential Real Estate Loans in AA</b>					
<b>Borrower Income Level</b>	<b>Loan Originations Between Jan 1, 2006 and June 30, 2008*</b>				<b>Percentage of Families within each Income Category**</b>
	<b>Number of Loans</b>	<b>Percentage</b>	<b>Dollars \$(000's)</b>	<b>Percentage</b>	
<b>Low</b>	4	13%	\$ 175	7%	21%
<b>Moderate</b>	6	20%	\$ 310	13%	18%
<b>Middle</b>	8	27%	\$ 465	20%	21%
<b>Upper</b>	12	40%	\$1,402	60%	40%
<b>Total</b>	30	100%	\$2,352	100%	100%

Sources:

\* Randomly selected sample of 1-4 family residential real estate loans originated within CNB’s AA. Further segmentation of home mortgage lending activity by purpose was not available from the data used for this analysis.

\*\*2000 U.S. Census and 2008 HUD updated MFI.

CNB’s borrower distribution of small business loans is reasonable. The 70 percent of number of loans and 73 percent of dollar of loans we sampled to businesses with income levels less than \$1 million compares favorably with the 55 percent of businesses in the AA reporting income levels less than \$1 million. CNB’s business lending performance is reasonable as reflected in the following table.

<b>Borrower Distribution of Loans to Businesses in AA</b>					
<b>Business Income Level in Gross Annual Revenues</b>	<b>Loan Originations Between Jan 1, 2005 and June 30, 2008*</b>				<b>Percentage of Businesses in the AA**</b>
	<b>Number of Loans</b>	<b>Percentage</b>	<b>Dollars \$(000's)</b>	<b>Percentage</b>	
<b>≤ \$1 million</b>	21	70%	\$2,061	73%	55%
<b>&gt; \$1 million</b>	9	30%	\$ 771	27%	3%
<b>Not Reported</b>	0	0	0	0	42%
<b>Total</b>	30	100%	\$2,832	100%	100%

Sources:

\* Randomly selected sample of business loans originated within CNB’s AA. Further segmentation of home mortgage lending activity by purpose was not available from the data used for this analysis.

\*\*2000 U.S. Census.

### **Geographic Distribution of Loans**

The overall geographic distribution of loans reflects excellent dispersion throughout the AA. CNB’s lending activity extends throughout the AA. Based on random sampling, we did not note any conspicuous gaps in lending. To reach this conclusion, we analyzed CNB’s lending activity of loans for each of its primary loan types. The primary loan types for this analysis included 1-4 family residential mortgages (both purchase and refinance) and business loans. See the tables below for details.

The following table shows CNB has excellent penetration in originating residential loans in the moderate-income CTs. There are no low-income CTs in the AA. The loans reviewed showed 13 percent of the number and 5 percent of the dollar amount of residential loans were made in the moderate-income CT. Residential lending is considered excellent given only 3 percent of all families in the AA are located in the moderate-income CT.

<b>Geographic Distribution of 1-4 Family Residential Loans By Geography Income Designation</b>					
<b>Income Level of Census Tracts</b>	<b>Loan Originations Between Jan 1, 2006 and June 30, 2008*</b>				<b>Distribution of Owner Occupied Housing</b>
	<b>Number of Loans</b>	<b>Percentage</b>	<b>Dollars \$(000's)</b>	<b>Percentage</b>	
<b>Moderate</b>	4	13%	\$ 124	5%	3%
<b>Middle</b>	21	70%	\$ 1,565	67%	80%
<b>Upper</b>	5	17%	\$ 662	28%	17%
<b>Total</b>	30	100%	\$ 2,351	100%	100%

\* Source: Randomly selected sample of 1-4 family residential real estate loans originated within CNB's AA. Further segmentation of home mortgage lending activity by purpose was not available from the data used for this analysis.

The following table shows CNB has reasonable penetration in making business loans in the moderate-income CTs considering the demographic comparator. While CNB has made no business loans in the moderate-income CT, this tract contains only 1 percent of all business in the AA.

<b>Geographic Distribution of Business Loans By Geography Income Designation</b>					
<b>Income Level of Census Tracts</b>	<b>Loan Originations Between Jan 1, 2006 and June 30, 2008*</b>				<b>Distribution of Businesses in the AA</b>
	<b>Number of Loans</b>	<b>Percentage</b>	<b>Dollars \$(000's)</b>	<b>Percentage</b>	
<b>Moderate</b>	0	0%	0	0%	1%
<b>Middle</b>	23	77%	\$2,290	81%	78%
<b>Upper</b>	7	23%	\$ 542	19%	21%
<b>Total</b>	30	100%	\$2,832	100%	100%

\* Source: Randomly selected sample of business loans originated within CNB's AA.

## **Responses to Complaints**

CNB has not received any written complaints regarding its Community Reinvestment Act performance during the evaluation period.

## **COMMUNITY DEVELOPMENT TEST**

The bank's performance under the Community Development Test is rated Satisfactory. CNB's community development performance through its record of retail services, qualified investments, and community development loans demonstrate adequate responsiveness to community development needs in its AA.

### **Number and Amount of Community Development Loans**

CNB's Community Development Lending reflects adequate responsiveness considering the opportunities available within the bank's assessment area. CNB originated one loan totaling \$180 thousand to God's Food Pantry; a non-profit organization that provides services to low- and moderate- income individuals. The loan complied with the community development definition and was responsive to the needs of the local community.

### **Number and Amount of Qualified Investments**

CNB's Community Development Investments reflect adequate responsiveness to meeting the community's needs. The bank donated \$404 thousand to eight community based organizations that provide educational and community development services targeted toward low- and moderate-income individuals.

### **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 and only one moderate-income geography in the AA.

CNB's delivery systems are accessible to essentially all geographies and individuals of different income levels in the AA. Full financial services are offered at nine branches and drive-thru service is offered at seven of the nine branches as well. In addition, the bank has twenty-four ATM's located throughout the AA. Eight of the ATM's are full-service and sixteen are cash-only dispensers.

The bank has not opened or closed any branches during our period of review. As of April 5, 2008, CNB has opened the Waitsboro Branch for Saturday Banking, to meet the needs of their customers.

In addition to the bank's branches, ATMs, and cash-only dispensers, CNB offers on-line banking, providing customer access to consumer and business accounts. Bank customers can access accounts, check balances, view statements, transfer funds between accounts, make loan payments, and initiate stop payments. CNB also offers free online bill pay to all customers. Also offered are various checking and deposit products for all bank customers. And finally, CNB provides a telephone banking system, called Citizens 24 Hotline, which allows 24-hour toll free service so customers can transfer funds, verify account balances, verify deposits and debit items, and inquire about loan and deposit rates.

To meet the 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), Kentucky Housing Corporation (KHC), Veteran Affairs (VA), and Farmers Home Administration (FHA). As of June 30, 2008, the bank had sold \$22 million to Freddie Mac, \$1.8 million to KHC, \$416 thousand to VA, and \$67 thousand to FHA.

Through the bank's officers and employees, CNB is involved in a variety of community development services. Several 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 are designed to help an individual understand bank products (checking, savings, and mortgages), the fees associated with the products, the differences between a debit and credit card, how to balance a checking account, the importance of savings and other investment options, credit scores and the importance of maintaining good credit.

In addition, several members of the bank have participated in numerous presentations given to two firms employing low-and moderate- income individuals within the AA. The presentations include: how to open a free checking account, the benefits of direct deposit, and how to use a debit card.

Below are some, but not all, of the organizations senior management is actively participating with:

- **Somerset-Pulaski Economic Development Foundation**  
The primary purpose of this organization is to recruit business and industry to Pulaski County. These businesses would provide employment opportunities for low- and moderate-income individuals. A senior bank officer is currently serving as a board member of the organization. In addition, the officer provides financial expertise to the organization regarding financing needs of businesses.
- **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

regarding a bank's perspective on new businesses and the financial needs of those businesses.

- **God's Food Pantry**

This is a nonprofit organization that is 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.

Other organizations bank officers either serve as Board members or provide financial expertise to include: Downtown Somerset Development, Somerset Community College Foundation, YMCA, and the United Way of Kentucky (local chapter).

## **Fair Lending or Other Illegal Credit Practices Review**

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