



# INTERMEDIATE SMALL BANK

---

Comptroller of the Currency  
Administrator of National Banks

---

Washington, DC 20219

## **PUBLIC DISCLOSURE**

April 11, 2011

## **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

Louisville Field Office  
10200 Forest Green Boulevard, Suite 501  
Louisville, Kentucky 40223-5165

**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: Outstanding.**

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 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 Examination**

The Citizens National Bank of Somerset was evaluated under the Intermediate Small Bank examination 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 Assessment Area (AA) through its lending activities. Conclusions regarding the bank's lending performance are based on a random sample of residential and consumer loans originated between January 1, 2009 and March 31, 2011. 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. Conclusions regarding the community development test are based on community development activities between September 2, 2008 and April 11, 2011.

## **Description of Institution**

The 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 December 31, 2010, CNB had \$325 million in total assets, \$265 million in deposits, \$174 million in loans, and \$38 million in Tier One capital. CNB offers traditional banking products and services and has ten locations. Nine offices are located in Pulaski County: the main office, five branches with drive-thru facilities in Somerset, Kentucky, two branches without drive-thru facilities, one branch with a drive-thru facility in Science Hill, Kentucky, and one branch with a drive-thru facility in Nancy, Kentucky. Since the last CRA examination, the bank opened a branch in

Monticello, Kentucky, located in Wayne County. 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 does not have a drive-thru facility. CNB has nine Automated Teller Machines and 16 other cash dispensers located throughout the AA. CNB is accessible to all segments of the community.

Since the last CRA examination, CNB's primary lending focus was home mortgage loans and consumer loans. CNB also made loans to businesses and farms in the area. Since June 30, 2008 home mortgages and consumer loans experienced growth. Consumer loans reported on the balance sheet increased 60 percent and real estate loans increased 43 percent. Business loans were considered a primary loan product at the last CRA examination, but were not reviewed during this examination as commercial loans declined 26 percent since June 30, 2008.

As of December 31, 2010, net loans represented approximately 53 percent of CNB's average assets. The loan portfolio mix is as follows: 1-4 family residential mortgages 42 percent, commercial loans 38 percent, consumer loans 9 percent, construction and development loans 6 percent, farm-related loans 4 percent, and other loans 1 percent.

There are no legal or financial circumstances that affect the bank's ability to meet community credit needs. The last CRA evaluation was performed September 8, 2008. CNB received a rating of Satisfactory.

## **Description of Assessment Area**

The Citizens National Bank of Somerset (CNB) has identified Pulaski County and three census tracts of Wayne 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 Pulaski County in its entirety and three census tracts in northeast Wayne County. Two of the three Wayne County census tracts are contiguous to Pulaski County. The entire AA is located in the non-metropolitan portion of the state of Kentucky. The 2000 U.S. Census divided the AA into fourteen census tracts, with three moderate-income tracts, ten middle-income tracts, and one upper-income tract. There are no low-income census tracts in the AA. This determination was based on the Department of Housing and Urban Development 2010 estimated Median Family Income for the state of Kentucky of \$42,500 for a non-metropolitan area. According to the Federal Government all ten of the middle-income census tracts in the bank's AA are distressed nonmetropolitan census tracts due to the AA's poverty level. Approximately 22 percent of the population falls below the poverty level.

The Pulaski and Wayne County assessment area is located in Southeastern Kentucky with a total population of 67,404 according to the 2000 U.S. Census. The population of the AA is comprised of 27,226 households, of which 11,866, or 44 percent, are considered to have low- or moderate-incomes. Other significant factors to consider include: 4 percent of the households receive public assistance and 34 percent receive social security benefits. Pulaski and Wayne County have unemployment levels higher than the state average (12.3 percent and 14.9 percent, versus 11.2 percent, as of February 2011). The AA is rural and

experienced several company closings in recent years. The AA has two industrial parks and a technology complex to attract industrial and technology-based companies to the county. The Somerset Chamber of Commerce lists five industrial firms employing over 300, including Toyotetsu America, Super Service, Armstrong Wood products, Wal-Mart, and Eagle Hardwood. An industrial firm employing over 300 in the Wayne County AA census tracts is Belden Inc. Other major employers include federal, state, and local governments, hospitals, and schools.

Competition is strong and numerous financial institutions service the assessment area. According to the Federal Deposit Insurance Corporation (FDIC), ten banks with 31 offices operate in the AA. These offices hold a combined total of \$1 billion in deposits within the AA as of June 30, 2010, and CNB has a 25 percent market share. The competition includes one large bank with total deposits of \$103 billion nationally and eight community banks with total deposits ranging from \$103 million to \$2 billion.

A review of a community contact familiar with the area’s credit needs indicated all local banks are active in the community and willing to provide financing for potential projects. The contact could not identify any major credit need of the community not currently being met by the area banks.

The following additional demographic information regarding CNB’s AA is based on 2000 census data unless otherwise noted.

| <b>Demographic Information for the Pulaski/Wayne County AA</b> |        |          |                                  |          |          |
|--|--------|----------|----------------------------------|----------|----------|
|  | #      | % Low    | % Moderate                       | % Middle | % Upper  |
| Geographies (Census Tracts)                                    | 14     | 0%       | 21%                              | 72%      | 7%       |
| Population by Geography  | 67,404 | 0%       | 13%                              | 72%      | 15%      |
| Owner-Occupied Housing by Geography                            | 20,730 | 0%       | 12%                              | 74%      | 14%      |
| Businesses by Geography  | 5,822  | 0%       | 15%                              | 67%      | 18%      |
| Farms by Geography   | 250    | 0%       | 20%                              | 73%      | 7%       |
| Family Distribution by Income Level                            | 19,752 | 23%      | 18%                              | 21%      | 38%      |
| Household Distribution by Income Level                         | 27,226 | 28%      | 16%                              | 18%      | 38%      |
| Census Median Family Income (MFI)                              |        | \$32,003 | Median Housing Value             |          | \$61,799 |
| HUD-Adjusted MFI: 2010   |        | \$42,500 | Families Below the Poverty Level |          | 22%      |
| HUD- Adjusted MFI: 2009  |        | \$42,300 |                                  |          |          |
| HUD- Adjusted MFI: 2008  |        | \$41,000 |                                  |          |          |

## **Conclusions with Respect to Performance Tests**

### **LENDING TEST**

Citizens National Bank of Somerset’s (CNB) performance under the lending test is satisfactory.

Because residential real estate lending is the bank’s primary business line, more weight and consideration was given to residential lending when evaluating performance under the criteria below.

**Loan-to-Deposit Ratio**

CNB’s net loan-to-deposit ratio is reasonable given the bank’s size, financial condition, and assessment area credit needs. The bank’s net loan-to-deposit ratio averaged 59 percent over the ten quarters since the last CRA examination, with a quarterly low of 51 percent and a quarterly high of 66 percent.

The bank’s net loan-to-deposit ratio is below other community banks of similar size, location, and product offerings. The other two banks had average net loan-to-deposit ratios averaging 74 percent over the ten quarters. However, our conclusion took into consideration the bank’s competitive market and secondary market activity. CNB’s average loan-to-deposit ratio does not reflect all home mortgage lending activity, as the bank routinely originates and sells mortgages to the secondary market. Since January 2009, CNB has sold approximately sixty-five million in mortgage loans to the secondary market.

| Institution                        | Average Net Loan-to-Deposit Ratio |
|------------------------------------|-----------------------------------|
| Citizens National Bank of Somerset | 58.89                             |
| Bank #1                            | 73.67                             |
| Bank #2                            | 75.35                             |

**Lending in Assessment Area**

A substantial majority of loans originated by CNB are within their Assessment Area (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 90 percent by number and 98 percent by dollar amount.

| <b>Lending in Pulaski/Wayne County AA</b> |                 |   |         |   |       |                          |   |         |   |       |
|---|-----------------|---|---------|---|-------|--------------------------|---|---------|---|-------|
| Loan Type                                 | Number of Loans |   |         |   |       | Dollars of Loans (000's) |   |         |   |       |
|   | Inside          |   | Outside |   | Total | Inside                   |   | Outside |   | Total |
|   | #               | % | #       | % |       | \$                       | % | \$      | % |       |
|   |                 |   |         |   |       |                          |   |         |   |       |

|             |    |     |   |    |    |       |     |    |    |       |
|-------------|----|-----|---|----|----|-------|-----|----|----|-------|
| Residential | 20 | 100 | 0 | 0  | 20 | 1,943 | 100 | 0  | 0  | 1,943 |
| Consumer    | 16 | 80  | 4 | 20 | 20 | 99    | 70  | 42 | 30 | 141   |
| Totals      | 36 | 90  | 4 | 10 | 40 | 2,042 | 98  | 42 | 30 | 2,084 |

Source: Random sample of 1-4 family residential real estate and consumer loans originated between January 1, 2009 and March 31, 2011.

**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 20 percent of sampled loans, which is slightly below the demographic comparator. However, loans to moderate-income borrowers were slightly above the demographic comparator. We also took into account the AA’s poverty rate of 22 percent. CNB achieved reasonable penetration despite 22 percent of the population living below the poverty level.

The following table shows the distribution of home loan products among borrowers of different income levels for the period of January 1, 2009 through March 31, 2011 as compared to the percent of families in each income category.

| <b>Borrower Distribution of Residential Real Estate Loans in Pulaski/Wayne County AA</b> |                  |                      |                  |                      |                  |                      |                  |                      |
|--|------------------|----------------------|------------------|----------------------|------------------|----------------------|------------------|----------------------|
| 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  | 23               | 20                   | 18               | 20                   | 21               | 35                   | 38               | 25                   |

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.

**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 at each 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, 2009 through March 31, 2011 as compared to the percent of households in each income category.

**Borrower Distribution of Consumer Loans in 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        | 28                 | 35                   | 16                 | 25                   | 18                 | 25                   | 38                 | 15                   |

Source: Randomly selected sample of consumer loans originated within CNB’s AA.

**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 loans reviewed showed 15 percent of residential loans were made to borrowers in the moderate-income census tracts, which is above the demographic comparator of 12 percent.

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

| <b>Geographic Distribution of Residential Real Estate Loans in Pulaski/Wayne County AA</b> |                                |                      |                                |                      |                                |                      |                                |                      |
|--|--------------------------------|----------------------|--------------------------------|----------------------|--------------------------------|----------------------|--------------------------------|----------------------|
| Census Tract Income Level  | Low                            |                      | Moderate                       |                      | Middle                         |                      | Upper                          |                      |
|  | % 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                  | 12                             | 15                   | 74                             | 45                   | 14                             | 40                   |

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.

**Consumer Loans**

CNB’s geographic distribution of consumer loans reflects reasonable dispersion throughout the census tracts of different income levels. The loans reviewed showed 15 percent of consumer loans were made to borrowers in the moderate-income census tracts. This is also above the demographic comparator of 13 percent.

The following table details the bank’s performance as compared to the percentage of households in each census tract income level.

| <b>Geographic Distribution of Consumer Loans in the Pulaski/Wayne County AA</b> |                       |                               |                       |                               |                       |                               |                       |                               |
|---|-----------------------|-------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|-----------------------|-------------------------------|
| Census Tract<br>Income<br>Level   | Low                   |                               | Moderate              |                               | Middle                |                               | Upper                 |                               |
|   | % of AA<br>Households | % of<br>Number<br>of<br>Loans |
| Consumer<br>Loans   | N/A                   | N/A                           | 13                    | 15                            | 73                    | 70                            | 14                    | 15                            |

Source: Randomly selected sample of consumer loans originated within CNB's AA.

**Responses to Complaints**

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

**COMMUNITY DEVELOPMENT TEST**

The bank's performance under the Community Development Test is rated Outstanding.

Citizens National Bank of Somerset's (CNB) community development performance through its record of retail services, community development loans, and qualified investments demonstrate excellent responsiveness to community development needs in its Assessment Area (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 eleven community development loans totaling \$5.9 million. These loans promote economic development and strengthen the availability of community services to low- and moderate-income individuals within the AA.

Four of the community development loans financed the startup of new businesses in the AA. One loan in particular was for the purpose of construction, equipment purchase, and initial operating costs of a fast-food restaurant. In addition to promoting economic development in the AA, this loan also revitalizes and stabilizes the distressed nonmetropolitan middle-income geography through job creation.

CNB made another community development loan to a local pharmacy. The loan helps revitalize and stabilize the community by serving its moderate-income level geography and residents of the surrounding distressed nonmetropolitan middle-income geographies. Three of the community development loans originated support community services targeted to low- and moderate-income individuals.

The remaining loans all comply with the community development definition and were 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 purchased two Small Business Investment Company (SBIC) investments totaling \$2 million. Investments of this nature promote economic development and are eligible for receiving positive consideration for community development investments.

In addition to purchasing investments, the bank donated \$30 thousand to five community based organizations who provide educational and community development services for 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, three moderate-income geographies, and ten distressed middle-income geographies.

Since the last CRA examination, CNB increased the accessibility of financial services by opening a full-service branch in a moderate-income geography. CNB opened the full-service branch and Automatic Teller Machine (ATM) in Monticello, Kentucky in November 2009. All other branch locations are in distressed nonmetropolitan middle-income geographies.

CNB offers on-line 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, called Citizens 24 Hotline, which 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 Citizens 24 Hotline.

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.

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), Kentucky Housing Corporation (KHC), Veteran Affairs (VA), Farmers Home Administration (FHA), and Rural Housing Service Loans (RHS). Between January 1, 2009 and March 31, 2011, the bank originated \$52.3 million through Freddie Mac, \$3.6 million through KHC, \$1.3 million through VA, \$3.5 million through FHA, and \$3.7 million through RHS.

Through the bank's officers and employees, CNB is 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 bank 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. Participants learn how to set up a budget, reasonably cut expenses, and control spending through cash usage instead of credit cards.

Senior management actively participates in many organizations. Below are some examples:

- **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. The officer provides financial expertise to the organization.
- **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 bank's 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 organizations bank officers either serve as board members or provide financial expertise to include: Downtown Somerset Development, Somerset Community College Foundation, Habitat for Humanity, and the United Way of Kentucky (local chapter).

### **Responsiveness to Community Development Needs**

CNB's community development activities, as a whole, demonstrate excellent responsiveness to the needs and opportunities in this 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 the Small Business Investment Company, which promotes economic development. CNB 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**

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