

SUPERVISORY AGREEMENT

This Supervisory Agreement ("Agreement") is made and is effective this 13th day of, December, 1999 (the "Effective Date"), by and between Middlesboro Federal Bank, Federal Savings Bank ("Middlesboro" or the "Association") OTS Docket No. 02438, a federally chartered stock association, having its main office located at 1431 Cumberland Avenue, Middlesboro, Kentucky 40965 and the Office of Thrift Supervision ("OTS"), an office within the United States Department of the Treasury, having its principal executive offices located at 1700 G Street, N.W., Washington, D.C. 20552, acting through its Central Regional Director or his designee ("Regional Director"). It is understood and agreed that this Agreement is a "written agreement" entered into with the OTS within the meaning of 12 U.S.C. §§ 1818(b)(1) and (i)(2).¹

WHEREAS, the OTS is the primary federal regulator of Middlesboro; and

WHEREAS, based on the Report of Compliance Examination dated September 21, 1998 ("Compliance ROE") and the Federal Regular Report of Examination dated March 24, 1999 ("Federal Regular ROE"), the OTS is of the opinion that Middlesboro has engaged in acts and practices that: (i) have resulted in violations of certain of the laws or regulations to which Middlesboro is subject, and/or (ii) are considered to be unsafe and unsound; and

WHEREAS, the OTS is of the opinion that grounds exist for the initiation of administrative proceedings against Middlesboro; and

WHEREAS, the OTS is of the view that it is appropriate to take measures intended to ensure that Middlesboro will: (i) comply with all applicable laws and regulations, and (ii) engage in safe and sound practices; and

WHEREAS, Middlesboro, acting through its Board of Directors (the "Board"), wishes to cooperate with the OTS and to evidence the intent to: (i) comply with all applicable laws and regulations, and (ii) engage in safe and sound practices.

NOW THEREFORE, in consideration of the above premises and the mutual undertakings set forth herein, the parties hereto agree as follows:

COMPLIANCE MANAGEMENT

I. Compliance Officer.

A. Within thirty (30) days of the Effective Date, the Board shall establish the position of full-time Compliance Officer for the Association. In addition, the Board shall develop a detailed written job description for the position of Compliance Officer with the minimum functions for conducting a comprehensive self-assessment and internal review of all compliance areas in which the Association conducts regular activity. The job description shall assign this position with the appropriate level of

¹ All references to the United States Code ("U.S.C.") are as amended, unless otherwise indicated.

responsibility and authority to carry out the duties of a Compliance Officer. The job description shall also delineate the reporting responsibilities of the Compliance Officer.

B. Within sixty (60) days of the Effective Date, the Board shall employ or appoint a qualified individual to act as Compliance Officer, consistent with the provisions of paragraph 1.A. Upon his/her employment or appointment, the Board shall forward to the OTS the name and qualifications of the Compliance Officer.

2. Compliance Program.

A. Within one hundred-twenty (120) days of the Effective Date, the Compliance Officer shall develop, and the Board shall adopt, a written compliance program (the "Compliance Program") designed to ensure that the Association is operating in compliance with nondiscrimination, consumer protection, and other public interest laws and regulations. Guidelines for such a review process are outlined, in part, in the OTS Compliance Activities Regulatory Handbook and the OTS manual, Compliance: A Self-Assessment Guide. The Compliance Program shall be submitted to the OTS upon its adoption, and shall include, but not necessarily be limited to, the following:

- i. the preparation of a policies and procedures manual covering nondiscrimination, consumer protection, and all other applicable public interest laws and regulations for use by Association personnel;
- ii. provisions for the adequate training of new, and the periodic retraining of existing personnel as to their duties and responsibilities under nondiscrimination, consumer protection, and other public interest laws and regulations;
- iii. ongoing procedures, including periodic internal or external compliance audits, to monitor the effectiveness of the Association's compliance with nondiscrimination, consumer protection, and other public interest laws and regulations. Such compliance audits shall include transactional testing;
- iv. procedures to ensure that exceptions noted in the compliance audits and through the Compliance Program are immediately addressed and corrected by appropriate Association personnel;
- v. mechanisms for effective Board oversight, which shall include, at a minimum, quarterly regulatory compliance reports presented to the Board by the Compliance Officer; and
- vi. procedures for updating the Compliance Program to address changes to nondiscrimination, consumer protection, and other public interest laws and regulations, and for correcting deficiencies that arise.

B. Once the Compliance Program required under paragraph 2.A. has been adopted by the Board, the Association shall adhere to it in all material respects.

COMPLIANCE LAWS AND REGULATIONS

3. Truth in Lending.

A. The Board shall ensure that the Association complies with all disclosure requirements set forth in the Truth-in-Lending Act, 15 U.S.C. § 1601 et seq. and Regulation Z, 12 C.F.R. Part 226, and the terms of the legal obligation.

B. Within thirty (30) days of the Effective Date, the Association shall conduct and complete a loan file search of its adjustable rate mortgage loan ("ARM") portfolio to determine if the ARM adjustments comply with the terms of their respective notes. The file search shall identify all loans where incorrect interest rate adjustments resulted in overcharges to the borrower. Upon completion of the file search, the Association shall immediately prepare a list of borrowers who were overcharged. The list shall indicate the borrower's name, loan number, and the amount of the overcharge.

C. Within forty-five (45) days of the Effective Date, the Association shall (i) notify all borrowers identified under paragraph 3.B. that the interest rates on their loans were incorrectly adjusted; (ii) provide the borrowers on the list with corrected adjustment notices; and (iii) reimburse these borrowers for the amount of overcharges.

D. The Association, under the direction of the Board, shall conduct ongoing and regular transactional testing to ensure that the interest rates on all ARMs are adjusted in accordance with the terms of their legal obligations.

E. The Association, pursuant to 12 C.F.R. § 226.18, shall include insurance premiums in its Truth in Lending statements as a finance charge, unless the Association clearly discloses to borrowers the following: (i) the cost of the insurance; (ii) the term of the insurance; (iii) the fact that the insurance is voluntary; and (iv) the borrower may obtain the insurance from a source of its choice.

LENDING

4. Lending Policy.

A. As of the Effective Date, prior to committing to make any loan, the Association shall have in its possession documentation sufficient to meet its current loan underwriting standards, as set forth in its current written policies. As appropriate for the type of loan proposed to be made, such documentation shall include, but not be limited to, the following:

- i. current financial statements of the borrowers, and where appropriate, the guarantors, which are to be certified by such borrowers and guarantors as being true and correct;
- ii. documentation identifying all sources for loan repayment;

- iii. the two most recent federal income tax returns for self-employed borrowers and, at a minimum, copies of the most recent payroll statements for other types of individual borrowers;
- iv. current credit reports for all borrowers, and where appropriate, guarantors;
- v. documentation collected by the Association which evidences that the sources of income for the borrowers and guarantors have been verified and that the financial statements have been analyzed by appropriate Association staff to ensure there are sufficient assets and cash flow to retire the loan under the terms of the note, and where appropriate, the guarantee;
- vi. copies of written notices issued to borrowers and guarantors of business loans, that indicate the Association will require business loan borrowers and guarantors to provide updated financial information on an annual basis; and
- vii. written certification by the underwriter that the proposed loan complies with the Association's written loan policies and underwriting guidelines.

B. As of the Effective Date, any proposed exception to the Association's written loan policies and underwriting guidelines will be presented to the Board for review and approval prior to the loan's origination, and the Board's deliberations on such exceptions will be documented in its minutes.

C. The Association shall not amend its current lending policies without prior Board approval. Copies of Board approved amendments to the Association's current lending policies are to be submitted to the OTS within ten (10) days after approval.

D. As of the Effective Date, the Board must approve any loan proposed by Association management involving troubled debt restructuring. The Board's deliberations on such loans shall be fully documented in the Board minutes.

E. As of the Effective Date, the Association shall cease the practice of capitalizing late charges on delinquent loans.

F. As of the Effective Date, the Association shall limit the origination of "interest-only" loans to terms of one year or less and establish well-defined repayment plans before granting such loans. Loans secured by deposit accounts shall not be subject to the limitations contained in this paragraph as long as the value of the collateral exceeds the amount financed.

G. As of the Effective Date, the Association shall not originate any loan in excess of the limits set forth in OTS Thrift Bulletin 72a ("TB 72a"), including but not limited to, the aggregate volume of such loans shall not at any time exceed 100% of the Association's total capital.

H. As of the Effective Date, the Association shall cease the origination of all commercial loans, commercial real estate loans and unsecured consumer loans until such time as (1) the Board has certified to the OTS that adequate controls are in place to ensure compliance with paragraphs 4.A. through 4.F. of the Agreement, and (2) approval has been received from the Regional Director.

5. Administration of Problem Assets.

A. Within sixty (60) days of the Effective Date, the Association, under the direction of the Board, shall develop and implement a written program designed to improve and strengthen the Association's collection of delinquent loans.

B. Within seventy-five (75) days of the Effective Date, a copy of the written program required in paragraph 5.A. shall be forwarded to the OTS.

C. Once the written program required under paragraph 5.A. has been implemented, the Association shall adhere to it in all material respects.

D. The Association shall not deviate from or amend the implemented written program, required under paragraph 5.A., without the prior approval of the Board. Copies of Board approved amendments to the Association's written program required in paragraph 5.A., are to be submitted to the OTS within ten (10) days after approval.

E. Within sixty (60) days of the Effective Date, the Board shall review, and where necessary revise, the Association's current policies and procedures for the identification and administration of problem assets, which include: a) adversely classified assets; b) loans or loan relationships involving troubled debt restructuring; and c) other loans or loan relationships with well defined weaknesses that jeopardize repayment ("Problem Assets"). The revised policies and procedures shall be consistent with OTS policies and regulations and, at a minimum, provide for the following:

- i. the identification and qualifications, whether employees of the Association, or third parties retained by the Association or the Board, of each individual responsible for conducting internal asset reviews;
- ii. procedures outlining the type and frequency of internal asset reviews;
- iii. criteria to be used in assessing asset risk and for classifying assets as special mention, substandard, doubtful or loss;
- iv. detailed procedures to be followed by Association management to address specific Problem Assets with a book value greater than \$150,000; and

- v. dollar value and time line for the reduction of aggregate Problem Assets, first to an amount equal to no more than 50% of tangible capital plus the allowance for loan and lease losses, then to an amount equal to no more than 25% of tangible capital plus the allowance for loan and lease losses.

F. Within seventy-five (75) days of the Effective Date, the Board shall forward copies of the revised policies and procedures required under paragraph 5.E. to the OTS.

G. By execution of this Agreement, the Board commits to maintaining an adequate allowance for loan and lease losses that meets the guidelines included in the Federal Financial Institutions Examination Council Policy on Allowance for Loan and Lease Losses.

H. The Board, on at least a quarterly basis, will review the status of the Association's Problem Assets and forward a copy of its review to the OTS within fifteen (15) days of the review.

6. Loans To One Borrower.

The Board shall ensure that reports prepared by the Association to determine compliance with loans to one borrower limitations, pursuant to 12 C.F.R. Part 32 and 12 C.F.R. § 560.93, are comprehensive and accurate.

7. Management.

A. Within ninety days (90) days of the Effective Date, the Board shall have a detailed study conducted and completed, focusing on the Association's management and organizational structure, by a qualified independent third party acceptable to the OTS. The findings and recommendations of the study are to be set forth in a written report to the Board ("Management Study"). At a minimum, the Management Study will focus and include discussions on the following:

- i. an identification of the managerial resources necessary to carry out the Board's approved business strategy and business plan;
- ii. identification of the managerial resources needed to correct the deficiencies described in the Compliance ROE and the Federal Regular ROE and to maintain compliance with the Agreement;
- iii. an evaluation of each officer's qualifications and abilities to effectively perform the duties of his or her position;
- iv. an evaluation of the efficiency and effectiveness of the Association's current organizational structure, including identification of any overlapping duties or responsibilities;
- v. recommendations for addressing managerial and organizational weaknesses identified in paragraphs 7.A.i. through 7.A.iv.;

- vi. recommendations for the establishment of systems and controls by the Board to prevent recurrence of deficiencies described in the Compliance ROE and Federal Regular ROE;
- vii. recommendations for the establishment of an effective internal audit program; and
- viii. recommendations for the correction and/or elimination of any other deficiencies in the supervisory or organizational structure of the Association.

B. Within one hundred-twenty (120) days of the Effective Date, the Board will forward a copy of the Management Study to the OTS for review.

C. Within sixty (60) days of the completion of the Management Study, the Board will adopt a written plan, with specific time frames, to eliminate managerial and organizational deficiencies identified in the Management Study.

8. Strategic Plan and Budget.

A. Within sixty (60) days of the Effective Date, the Association, under the direction of the Board, shall modify its existing strategic plan and budget in order to properly reflect the findings of the Compliance ROE, Federal Regular ROE and the Association's current financial performance. At a minimum, the Association's strategic plan and budget shall include the following:

- i. growth and income projections which reflect the restrictions detailed in the Agreement;
- ii. the identification of products, services and market segments that management intends to promote and/or develop; and
- iii. a strategy to address the low balance sheet ratio of interest earning assets to interest costing liabilities. The Association's Asset Liability Committee shall monitor management's progress in achieving improvement in this ratio and include within its periodic reports to the Board a report on the status of the improvement.

B. Within ninety (90) days of the Effective Date, the Board shall review and adopt the strategic plan and budget modified by the Association.

C. Once the Board has adopted the strategic plan and budget, the Association shall adhere to it in all material respects.

D. As of the Effective Date, senior management of the Association shall monitor its strategic plan and budget at least quarterly, and submit written updates and variance reports to the Board for review.

E. Within thirty (30) days of the Board's review, as required under paragraph 8.D., the Board shall forward copies of the Association's quarterly written updates and variance reports to the OTS.

9. Board Composition.

Within one hundred-fifty (150) days of the Effective Date, the Board shall submit to the OTS the names and other information required pursuant to the provisions of 12 C.F.R. § 563.570, of three individuals not currently affiliated with the institution to fill the current vacancies on the Association's board of directors.

GENERAL

10. Violations of Law.

The Board shall immediately take all steps necessary to correct each violation of law, rule or regulation cited in the Compliance ROE and the Federal Regular ROE. As each violation is corrected, the Board shall provide written notice to the OTS of the date and manner in which each correction has been effected.

11. Director Responsibility.

Notwithstanding the requirements of this Agreement that the Board submit various matters to the OTS for consideration, non-objection or notice of acceptability, such regulatory oversight does not derogate or supplant each individual director's continuing fiduciary duty. The Board shall have the ultimate responsibility for overseeing the safe and sound operation of Middlesboro at all times, including compliance with the determinations of the OTS as required by this Agreement.

12. Compliance with Agreement.

A. The Board and officers of Middlesboro shall take immediate action to cause the Association to comply with the terms of this Agreement and shall take all actions necessary or appropriate thereafter to cause Middlesboro to continue to carry out the provisions of this Agreement.

B. The Board, on a quarterly basis, shall adopt a board resolution (the "Compliance Resolution") formally resolving that, following a diligent inquiry of relevant information (including reports of management), to the best of its knowledge and belief, during the immediately preceding calendar quarter, Middlesboro has complied with each provision of this Agreement currently in effect, except as otherwise stated.

The Compliance Resolution shall: (i) specify in detail how, if at all, full compliance was found not to exist, and (ii) identify all notices of exemption or non-objection issued by the Regional Director that were outstanding as of the date of its adoption.

C. The minutes of the meetings of the Board shall set forth the following information with respect to the adoption of each Compliance Resolution: (i) the identity of each director voting in favor of its adoption, and (ii) the identity of each director voting in opposition to its adoption or abstaining from voting thereon, setting forth each such director's reasoning for opposing or abstaining.

D. The Board shall promptly respond to any request from the OTS for documents that the OTS reasonably requests to demonstrate compliance with this Agreement.

MISCELLANEOUS

13. Definitions.

All technical words or terms used in this Agreement for which meanings are not specified or otherwise provided by the provisions of this Agreement shall, insofar as applicable, have meanings as defined in Chapter V of Title 12 of the Code of Federal Regulations, Home Owners' Loan Act ("HOLA"), Federal Deposit Insurance Act ("FDIA") or OTS Publications. Any such technical words or terms used in this Agreement and undefined in said Code of Federal Regulations, HOLA, FDIA, or OTS Publications shall have meanings that are in accordance with the best custom and usage in the savings and loan industry.

14. Successor Statutes, Regulations, Guidance, Amendments.

Reference in this Agreement to provisions of statutes, regulations, and OTS Publications shall be deemed to include references to all amendments to such provisions as have been made as of the Effective Date and references to successor provisions as they become applicable.

15. Notices.

A. Except as otherwise provided herein, any request, demand, authorization, direction, notice, consent, waiver or other document provided or permitted by the Agreement to be made upon, given or furnished to, delivered to, or filed with:

- i. the OTS, by Middlesboro, shall be sufficient for every purpose hereunder if in writing and mailed, first class, postage prepaid or sent via overnight delivery service or physically delivered, in each case addressed to Mr. Philip A. Gerbick, Regional Deputy Director, Office of Thrift Supervision, Department of the Treasury, 200 West Madison Street, Suite 1300, Chicago, Illinois 60606, or telecopied to (312) 917-5002 and confirmed by first class mail, postage prepaid, overnight delivery service or physically delivered, in each case to the above address.
- ii. the Association, by the OTS, shall be sufficient for every purpose hereunder if in writing and mailed, first class, postage prepaid or sent via overnight delivery service or physically delivered, in each case addressed to Mr. James J. Shoffner, President, Middlesboro at 1431 Cumberland Avenue, P.O. Box 639, Middlesboro, Kentucky 40965 or telecopied to (606) 248-6400, and confirmed by first class mail, postage prepaid, overnight delivery service or physically delivered, in each case to the above address.

B. Notices hereunder shall be effective upon receipt, if by mail, overnight delivery service or telecopy, and upon delivery, if by physical delivery. If there is a dispute about the date on which a written notice has been received by a party to this Agreement, then, in the event such notice was sent by the United States mail, there shall be a presumption that the notice was received two Business Days after the date of the postmark on the envelope in which the notice was enclosed.

16. Duration, Termination or Suspension of Agreement.

A. This Agreement shall become effective upon its execution by the OTS, through its authorized representative whose signature appears below. The Agreement shall remain in effect until terminated, modified or suspended in writing by the OTS, acting through its Director, Regional Director or other authorized representative.

B. The Regional Director, in his sole discretion, may, by written notice, suspend any or all of the provisions of this Agreement.

17. Time Limits.

Time limitations for compliance with the terms of this Agreement run from the Effective Date, unless otherwise noted.

18. Effect of Headings.

The Section and paragraph headings herein are for convenience only and shall not affect the construction hereof.

19. Separability Clause.

In case any provision in this Agreement is ruled to be invalid, illegal or unenforceable by the decision of any court of competent jurisdiction, the validity, legality and enforceability of the remaining provisions hereof shall not in any way be affected or impaired thereby, unless the Regional Director in his sole discretion determines otherwise.

20. No Violations of Law, Rule, Regulation or Policy Statement Authorized; OTS Not Restricted.

Nothing in this Agreement shall be construed as: (i) allowing the Association to violate any law, rule, regulation, or policy statement to which it is subject, or (ii) restricting or estopping the OTS from taking such action(s) that it believes is appropriate in fulfilling the responsibilities placed upon it by law, including, without limitation, any type of supervisory, enforcement or resolution action that the OTS determines to be appropriate.

21. Successors in Interest/Benefit.

The terms and provisions of this Agreement shall be binding upon, and inure to the benefit of, the parties hereto and their successors in interest. Nothing in this Agreement, express or implied, shall give to any person or entity, other than the parties hereto, the Federal Deposit Insurance Corporation and their successors hereunder, any benefit or any legal or equitable right, remedy or claim under this Agreement.

22. Integration Clause.

This Agreement represents the final written agreement of the parties with respect to the subject matter hereof and constitutes the sole agreement of the parties, as of the Effective Date, with respect to the subject matter.

23. Enforceability of Agreement.

Middlesboro represents and warrants that this Agreement has been duly authorized, executed, and delivered, and constitutes, in accordance with its terms, a valid and binding obligation of the Association. Middlesboro acknowledges that this Agreement is a "written agreement" entered into with the OTS within the meaning of Section 8 of the FDIA, 12 U.S.C. §1818.

IN WITNESS WHEREOF, the OTS, acting by and through the Regional Director, and Middlesboro hereby execute this Agreement as of the Effective Date.

OFFICE OF THRIFT SUPERVISION

By: / S /

Ronald N. Karr
/ Central Regional Director

