

SUPERVISORY AGREEMENT

This Supervisory Agreement ("Agreement") is made and is effective this 3rd day of May, 2002 (the "Effective Date"), by and between First State, F.S.B. ("First State" or the "Association") OTS Docket No. 15249, a federally chartered stock association, having its main office located at 386 Waller Avenue, Suite 10, Lexington, Kentucky 40504, 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 Southeast 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 First State; and

WHEREAS, based on the Report of Compliance Examination dated October 29, 2001 ("Compliance ROE"), the OTS is of the opinion that First State has engaged in acts and practices that: (i) have resulted in violations of certain of the laws or regulations to which First State 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 First State; and

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

WHEREAS, First State, acting through its Board of Directors ("Board"), without admitting or denying any violations of laws or regulations and/or unsafe and unsound practices, 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

1. Compliance Officer.

Within thirty (30) days after the Effective Date, the Board shall provide OTS with written certification that it has appointed a qualified individual to act as the Association's Compliance Officer. The Board shall ensure that the Association maintains the position of Compliance Officer, whose duties and responsibilities shall be consistent with the provisions

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

contained in paragraph 2.

2. Compliance Program.

A. Within ninety (90) days after the Effective Date, the Compliance Officer shall develop, and the Board shall adopt, a written compliance program ("Compliance Program") designed to ensure that the Association is operating in compliance with nondiscrimination, consumer protection, and other public interest laws and regulations. The Compliance Program shall include, but not necessarily be limited to, the following:

- i. incorporation of all eight (8) elements set forth in the "Components of an Effective Compliance Program" section of the October 1999 OTS handbook titled "Compliance: A Self-Assessment Guide", with emphasis on defined standards of accountability, ongoing monitoring, correction guidelines, and effective training;
- ii. policies and procedures covering nondiscrimination, consumer protection and public interest laws and regulations for use by Association personnel. Particular emphasis shall be placed on the Association's compliance with the following laws and regulations: Bank Secrecy Act, Flood Disaster Protection Act, Truth in Lending Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, Community Reinvestment Act, OTS's suspicious activity reporting regulation, and OTS's advertising regulation;
- iii. pursuant to a formal written training plan, provisions for the adequate training of Association personnel as to their duties and responsibilities under nondiscrimination, consumer protection, and other public interest laws and regulations;
- iv. provisions for ongoing periodic internal or external compliance reviews to monitor the Association's compliance with nondiscrimination, consumer protection, and other public interest laws and regulations. Such compliance audits shall be conducted at least annually and they shall include transactional testing;
- v. procedures to ensure that exceptions noted in the compliance reviews and through the Compliance Program are immediately addressed and corrected by appropriate Association personnel;
- vi. mechanisms for effective Board oversight, which shall include, at a minimum, quarterly regulatory compliance reports presented to the Board, by the Compliance Officer;
- vii. a provision to ensure that the Compliance Officer shall have unrestricted access to the Board; and,
- viii. procedures for amending the Compliance Program to address changes to

nondiscrimination, consumer protection, and other public interest laws and regulations, and as needed for new products and services offered by the Association.

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

3. Bank Secrecy Act.

The Association shall comply with the reporting and recordkeeping requirements set forth in 31 C.F.R. Part 103 and 12 C.F.R. § 563.177.

4. Reporting of Suspicious Activities.

A. The Association shall comply with the reporting, recordkeeping, and notification requirements set forth in 12 C.F.R. § 563.180(d). The Board shall develop and adopt specific policies and procedures to prevent violations of that regulation.

B. First State shall complete and file immediately a Suspicious Activity Report for the pattern of suspected criminal activity addressed on page 11 of the Compliance ROE.

5. Flood Disaster Protection Act.

The Association shall comply with the requirements set forth in the Flood Disaster Protection Act (42 U.S.C. § 4001 et seq.) and the corresponding OTS regulations (12 C.F.R. Part 572).

6. Truth-in-Lending Act.

A. The Association shall comply with the requirements set forth in the Truth-in-Lending Act (15 U.S.C. § 1601 et seq.) and the Federal Reserve Board's Regulation Z (12 C.F.R. Part 226).

B. Within sixty (60) days of the Effective Date the Association shall identify, notify, and reimburse consumers, in order to correct the effects of understatements of the disclosed cost of credit that are subject to reimbursement under Section 108(e) of the Truth in Lending Act. Such identification, notification, and reimbursement, shall include a review of all loans originated on or after July 11, 2001, for violations involving incomplete credit insurance disclosures, understated construction-period-interest calculations, or lack of Truth in Lending disclosures.

C. Within sixty (60) days of the Effective Date First State shall review its loan portfolio and make monetary adjustments for violations of the Federal Reserve Board's Regulation Z

that involve overcharges of consumers either in interest accrual/application or in adjustments made to variable rate loans.

D. The Association will maintain a complete record of the reviews, notices, reimbursements, and other adjustments completed under this provision for review at OTS's next compliance examination.

7. Home Mortgage Disclosure Act.

The Association shall comply with the requirements set forth in the Home Mortgage Disclosure Act (12 U.S.C. § 2801 et seq.) and the Federal Reserve Board's Regulation C (12 C.F.R. Part 203).

8. Real Estate Settlement Procedures Act.

The Association shall comply with the requirements and prohibitions set forth in the Real Estate Settlement Procedures Act (12 U.S.C. § 2601 et seq.) and the U.S. Department of Housing and Urban Development's Regulation X (24 C.F.R. Part 3500).

9. Community Reinvestment Act.

The Association shall comply with the Community Reinvestment Act (12 U.S.C. § 2901 et seq.) and the corresponding OTS regulation (12 C.F.R. § 563e).

10. Representation of Contracts and Services.

The Association shall comply with OTS's advertising regulation (12 C.F.R. § 563.27), which sets forth the Association's general obligation to accurately represent the Association's contracts and services to First State's customers and to the general public.

GENERAL

11. Corrections and Notice Regarding Violations of Law.

Within ninety (90) days after the Effective Date, the Board shall address each regulatory exception and each violation of law, rule or regulation cited in the Compliance ROE and shall take all corrective actions required by OTS in the Compliance ROE. The Board shall provide a comprehensive written notice to the OTS within the ninety- (90-) day timeframe, describing the date and manner in which each correction has been effected.

12. 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 the Association at all times, including compliance with the determinations of the OTS as required by this Agreement.

13. Compliance with Agreement.

A. The Board and officers of First State 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 First State 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, First State 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

14. 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.

15. Successor Statutes, Regulations, Guidance, Amendments.

Reference in this Agreement to provisions of statutes, regulations, and OTS Publications will 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.

16. 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. OTS, by First State, will 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 the Regional Director, Office of Thrift Supervision, Department of the Treasury, 1475 Peachtree Street, N.E., Atlanta, Georgia 30309, or by facsimile transmission to (404) 897-1861 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, will 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 Board of Directors, First State, F.S.B, 386 Waller Avenue, Suite 10, Lexington, Kentucky 40504, or by facsimile transmission to (859) 278-5959 and confirmed by first class mail, postage prepaid, overnight delivery service or physically delivered, in each case to the above address.

B. Notices hereunder will 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 will 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.

17. Duration, Termination, or Suspension of Agreement.

A. This Agreement will become effective upon its execution by the OTS, through its authorized representative whose signature appears below. The Agreement will 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.

18. Time Limits.

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

19. Effect of Headings.

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

20. 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 will not in any way be affected or impaired thereby, unless the Regional Director in his sole discretion determines otherwise.

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

Nothing in this Agreement will 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.

22. 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.

23. 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.

24. Enforceability of Agreement.

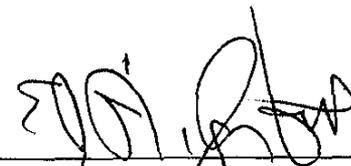
First State represents and warrants that this Agreement has been duly authorized, executed, and delivered, and constitutes, in accordance with its terms, a valid and binding obligation of the Association. First State acknowledges that this Agreement is a "written agreement" entered into with the OTS 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 First State hereby execute this Agreement as of the Effective Date.

OFFICE OF THRIFT SUPERVISION

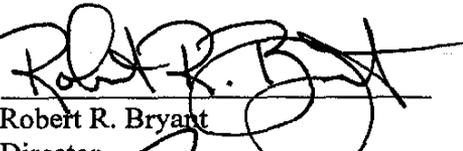
By: 
John E. Ryan
Regional Director

FIRST STATE, F.S.B.

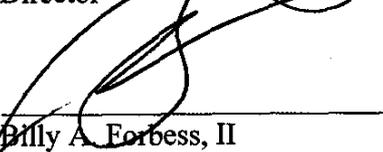
By: 
Edwin J. Nighbert
Director and Board Chairman

By: 
H. Aubrey Bailey
Director

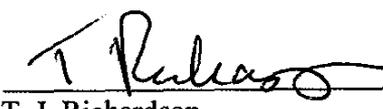
By: 
Ronald C. Tritschler
Director

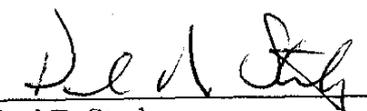
By: 
Robert R. Bryant
Director

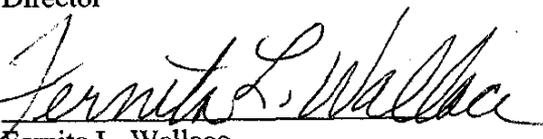
By: 
Russell E. Davis
Director

By: 
Billy A. Forbess, II
Director

By: 
George H. Reese, III
Director

By: 
T. J. Richardson
Director

By: 
Paul D. Steely
Director

By: 
Fernita L. Wallace
Director