SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

February 09, 2011

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The Farmers and Merchants National Bank of Nashville
Charter Number 8221

120 W. St. Louis
Nashville, IL 62263

Office of the Comptroller of the Currency

St. Louis Field Office
2350 Market Street, Room 100
St. Louis, MO 63103

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.

All of the lending performance criteria meet the standards for satisfactory performance.

- The borrower distribution of residential real estate loans reflects reasonable penetration amongst borrowers of different incomes.
- The bank's loan-to-deposit ratio is reasonable.
- A majority of the bank's loans originated during this evaluation period were made within the bank's assessment areas (AAs).

SCOPE OF EXAMINATION

We used small bank procedures to evaluate the performance of The Farmers and Merchants National Bank of Nashville (F&MNB) under the Community Reinvestment Act. F&MNB has two distinct AAs; both received a full-scope review.

Bank management identified residential real estate loans as their primary product for both AAs. Small business loans were identified as an additional primary product for the newer AA, but the number of small business loans originated was insufficient for our analysis. Therefore, we focused on residential real estate loans originated during 2009 and 2010 for our analysis of the bank's lending activity.

F&MNB became a Home Mortgage Disclosure Act (HMDA) reporter in 2009. We reviewed a sample of 60 HMDA-reported loans and determined that the data reported was reliable for our analysis of residential real estate loans. All HMDA-reportable loans are included in our analysis.

DESCRIPTION OF INSTITUTION

The Farmers and Merchants National Bank of Nashville is an intrastate bank, wholly owned by Farmers and Merchants Bancshares, a one-bank holding company located in Nashville, Illinois. As of December 31, 2010, F&MNB had total assets of $151 million, total loans of $79 million, total deposits of $126 million, and total risk-based capital of $19 million. The loan portfolio consisted of 50% residential real estate loans, 23% farm loans, 22% commercial loans, 4% consumer loans, and 1% municipal loans.

F&MNB offers a full range of retail and commercial banking products and services associated with a community bank. F&MNB is primarily a residential real estate, farm and commercial lender. Since the prior evaluation, F&MNB has expanded its footprint in Washington County with the opening of the Ashley branch in November 2005. The other Washington County offices are in Nashville (main office and drive-up facility), Hoyleton and Dubois. Cash-dispensing Automated Teller Machines (ATMs) are located at each of these offices, and three non-proprietary cash-dispensing ATMs are accessible at businesses in or near Nashville.

Two branches were also opened in St. Clair County, which is part of the St. Louis MO-IL Metropolitan Statistical Area (MSA): the Lebanon branch in August 2008, and the Mascoutah branch in January 2009. Cash-dispensing ATMs are located at the Mascoutah branch and at Ron's Lounge in Lebanon.

There are no legal or financial impediments to the bank's ability to meet its community credit needs. The bank has adequate resources to provide for the credit needs of its AA. The type and amount of CRA activities are consistent with the bank's size, its financial capacity, local economic conditions, and the credit needs of the community.

F&MNB's last CRA evaluation was July 19, 2004, when we rated the bank Satisfactory.

DESCRIPTION OF ASSESSMENT AREAS

Washington County

Management has identified all of Washington County, Illinois, as its traditional AA. Washington County consists of four middle-income census tracts (CTs 9501, 9502, 9503, and 9504) and is a non-MSA AA, just east of the St. Louis MO-IL MSA. This is a contiguous area, meets the requirements of the regulation, and does not arbitrarily exclude any low- or moderate-income geographies.

Based on 2000 Census data, Washington County had a total population of 15,148. About 17% of the population is over age 65, and one-third of the households (33%) receive social security. Of the 4,305 families in this county, 567 (13%) were classified as low-income, 747 (17%) as moderate-income, 1,075 (25%) as middle-income, and 1,916 (45%) as upper-income. Nearly 4% of families had income below the poverty level. The non-MSA median family income as of the 2000 Census was $43,613. The 2010 updated figure, adjusted for inflation by the Department of Housing and Urban Development (HUD), is $54,600. This HUD-updated figure is used to determine borrower income levels in our analysis of residential real estate lending for this AA.

Competition is moderate in Washington County and comes primarily from six other community banks and one large bank with a nationwide presence. As of June 30, 2010, F&MNB ranked first among these banks with a 33% deposit market share. The bank has a dominant presence in the county as 5 of the 13 offices are F&MNB branches. About 95% of the bank's deposits come from this AA.

The economic turmoil of the last few years has also affected Washington County, although conditions have improved slightly in 2010. Local unemployment rates have increased steadily since 2007, when the average unemployment rate in the county and the nation was below 5%. In January 2010, the local unemployment rate was 9.8%, lower than the national (10.6%) and Illinois (12.1%) unemployment rate. As of

January 2011, the unemployment rate in Washington County had improved to 7.3%, still lower than the national (9.8%) and Illinois (9.6%) unemployment rate for that month.

Major employers in the AA include Nascote Industries (790 employees), Norrenberns Trucking (300), and Inner-Tech Nashville (296). The economy in the county is further supported by service- and agriculture-related businesses.

To further our understanding of the community's credit needs, we contacted a community services organization. Our contacts did not identify specific unmet opportunities in the AA, but they indicated that F&MNB was responsive to existing needs in the community.

Northeast St. Clair County

Management has identified the northeast corner of St. Clair County, Illinois, as its second AA. This new AA consists of four middle-income CTs (5038, 5039.01, 5043.02 and 5043.03) encompassing the Mascoutah and Lebanon branches of the bank. St. Clair County is at the eastern edge of the St. Louis MO-IL MSA. The bank's designated AA is a contiguous area, meets the requirements of the regulation, and does not arbitrarily exclude any low- or moderate-income geographies.

Based on 2000 Census data, Northeast St. Clair County had a total population of 24,263. About 10% of the population is over age 65, and 21% of the households receive social security. Of the 6,438 families in this AA, 1,016 (16%) were classified as low-income, 1,368 (21%) as moderate-income, 1,556 (24%) as middle-income, and 2,498 (39%) as upper-income. Nearly 5.5% of families had income below the poverty level. The MSA median family income as of the 2000 Census was $53,435. The 2010 updated figure, adjusted for inflation by HUD, is $68,300. This HUD-updated figure is used to determine borrower income levels in our analysis of residential real estate lending for this AA.

Competition in the northeast corner of St. Clair County is strong. As of June 30, 2010, 28 banks operated 97 branches in all of St. Clair County. Four of these competitors have a nationwide presence, five are large regional banks, and the rest are community banks. F&MNB entered this market in August 2008 with a branch in Lebanon, followed by a branch in Mascoutah in January 2009. Both locations are at the extreme northeast end of St. Clair County. As of June 30, 2010, F&MNB ranked 26th in the county with a 0.17% deposit market share. Only 5% of the bank's deposits come from this AA.

The economic stress experienced around the country also impacted St. Clair County, but conditions appear to have eased somewhat since the first quarter in 2010. Local unemployment rates have increased steadily since 2007, when the average unemployment rate in St. Clair County was 6.4%, higher than the Illinois average of 5.1% and the national average of 4.8%. In January 2010, the local unemployment rate was 12.9%, above the national (10.6%) and Illinois (12.1%) unemployment rate. As of January 2011, the unemployment rate in St. Clair County improved to 10.5%, but was still higher than the national (9.8%) and Illinois (9.6%) unemployment rate for that month.

Major employers in St. Clair County include Scott Air Force Base (14,150 employees); Memorial Hospital (2,400), St. Elizabeth Hospital (1,660), Southwestern Illinois College (1,475), Southern Illinois Healthcare Foundation (1,400), Midcoast Aviation Inc. (1,200), and St. Clair County (1,000). Also, many residents of the AA commute to St. Louis for employment.

To further our understanding of the community's credit needs, we contacted a local government agency. Our contact identified a general need for more outreach to the community, more counseling for home owners in difficulty, and seed money to grow and expand businesses.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

F&MNB's performance is reasonable in meeting the credit needs of its AAs, including those of low- and moderate-income borrowers, given the performance context, demographics, economic factors, and competitive pressures faced by the bank.

Loan-to-Deposit Ratio

F&MNB's loan-to-deposit (LTD) ratio is reasonable. As of December 31, 2010, the bank's LTD ratio was 62%. The bank's average quarterly LTD since the 2004 examination was 53%. This is below the average quarterly ratios of five similarly situated banks (four in Washington County and one in St. Clair County) whose average ratios ranged from 61% to 72%. However, F&MNB sells over half of its originated residential real estate loans into the secondary market; without this strategic decision, the bank's LTD ratio would be more in line with its competitors' LTD averages.

Lending in Assessment Area

Lending in the AA meets the standard for satisfactory performance. A majority of the bank's residential real estate (RRE) loans originated during the evaluation period were made inside the bank's AA. Based on all RRE loans reported under HMDA in 2009 and 2010, 62% by number and 61% by dollar volume were made within the bank's two AAs.

Lending in Washington County and Northeast St. Clair County

	Number of Loans					Dollars of Loans				
Loan Type	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		$	%	$	%	
Home Purchase	56	57%	42	43%	98	4,227	51%	4,111	49%	8,338
Home Improvement	31	78%	9	22%	40	926	73%	343	27%	1,269
Home Refinance	168	62%	105	38%	273	24,006	63%	14,351	37%	38,357
Totals	255	62%	156	38%	411	29,159	61%	18,805	39%	47,964

Source: 2009 and 2010 RRE loan data reported under HMDA.

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

F&MNB's lending distribution to borrowers of different income levels meets the standard for satisfactory performance. To reach this conclusion, we placed more weight on the results of our analysis in the Washington County AA where 71% of the branches (5 out of 7) and 95% of the deposits are.

Washington County

Residential real estate loans

The borrower distribution of RRE loans originated during the evaluation period in Washington County reflects reasonable penetration among borrowers of different incomes.

The percentage of home purchase loans (31%) made to moderate-income borrowers exceeds the percentage of moderate-income families in the AA (17%). The percentage of home improvement loans (15%) is near the percentage of moderate-income families in the AA (17%). The percentage of home refinance loans (8%) made to moderate-income borrowers is lower than the percentage of moderate-income families in the AA (17%).

The percentage of home purchase loans (6%), home improvement loans (4%), and home refinance loans (2%) made to low-income borrowers is lower than the percentage of low-income families in the AA (13%). In evaluating this borrower distribution, we considered the percentage of families who live below the poverty level (4%) and the barriers this may have on home ownership.

Borrower Distribution of Residential Real Estate Loans in Washington County								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% 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
Home Purchase	13%	6%	17%	31%	25%	22%	45%	41%
Home Improvement	13%	4%	17%	15%	25%	22%	45%	59%
Home Refinance	13%	2%	17%	8%	25%	19%	45%	71%

Source: 2009 and 2010 RRE loan data reported under HMDA; 2000 U.S. Census data.

Northeast St. Clair County

Residential real estate loans

The borrower distribution of RRE loans originated during the evaluation period in Northeast St. Clair County reflects reasonable penetration among borrowers of different incomes. Even though the penetration level appears to be low based on the percentages in the table, there are mitigating factors:

- This AA is a new market for F&MNB, which they entered at a time when the economy was severely stressed especially in the housing market.
- Established banks in and around the AA provide strong competition.
- Only 5% of the bank's deposits come from this AA; therefore, we placed little weight on this assessment.

F&MNB originated only 7 home purchase and 4 home improvement loans within this AA. Based on this small number, the percentage of home purchase loans (57%) and home improvement loans (25%) made to moderate-income borrowers exceeds the percentage of moderate-income families in the AA (21%). There were no home purchase and home improvement loans made to low-income borrowers.

F&MNB originated 30 home refinance loans in this AA since January 2009. Two of these refinance loans were related to multi-family housing units for which no income information is available. Based on the 28 remaining loans, the percentage of home refinance loans (0%) made to moderate-income borrowers is well below the percentage of moderate-income families in the AA (21%). The percentage of home refinance loans (4%) made to low-income borrowers is also lower than the percentage of low-income families in the AA (16%). In evaluating this particular borrower distribution, we considered the financial burden associated with refinancing, which may be a deterrent for low- and moderate-income borrowers.

Borrower Distribution of Residential Real Estate Loans in Northeast St. Clair County								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% 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
Home Purchase	16%	0%	21%	57%	24%	0%	39%	43%
Home Improvement	16%	0%	21%	25%	24%	50%	39%	25%
Home Refinance	16%	4%	21%	0%	24%	46%	39%	50%

Source: 2009 and 2010 RRE loan data reported under HMDA; 2000 U.S. Census data.

Geographic Distribution of Loans

An analysis of the geographic distribution of loans within the AAs would not be meaningful. There are no low- or moderate-income CTs in either AA.

Responses to Complaints

No CRA-related complaints have been received by the bank or the OCC since the prior CRA evaluation.

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.