

OFFICE OF THRIFT SUPERVISION

Approval of Application for Permission to Organize a Federal Savings Bank, Merger Application, and Branch Application

Order No.: 2007-05

Date: February 16, 2007

OTS No. 18033

Appalachian Bancshares, Inc., Ellijay, Georgia (Applicant), a bank holding company that holds all of the stock of Appalachian Community Bank, Ellijay, Georgia (Bank), has applied for approval of the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. § 1464(e) and 12 C.F.R. § 552.2-1, for permission to organize Appalachian Community Bank, F.S.B., McCaysville, Georgia (Savings Bank). The Savings Bank has applied under the Bank Merger Act (BMA), 12 U.S.C. § 1828(c), and 12 C.F.R. § 563.22, to acquire certain assets and assume certain liabilities of the Bank's McCaysville, Georgia branch office, and has applied under 12 C.F.R. § 545.95 to establish branch offices in Ducktown, Tennessee, and Murphy, North Carolina.

In the proposed transaction, the Applicant will form the Savings Bank as a wholly owned direct subsidiary. The Applicant will capitalize the Savings Bank with \$8 million. The Savings Bank will acquire for its home office the McCaysville, Georgia branch of the Bank. Simultaneously with the opening of the Savings Bank's home office in McCaysville, the Savings Bank will acquire the existing loan production offices of the Bank in Ducktown, Tennessee, and Murphy, North Carolina, and convert them to full service branch offices of the Savings Bank. The Savings Bank plans to offer its products and services in the tri-state market, which includes Fannin County, Georgia; Polk County, Tennessee; and Cherokee County, North Carolina (the Tri-State Market). The Applicant has received approval from the Federal Deposit Insurance Corporation (FDIC) for insurance of the Savings Bank's deposits.

Permission to Organize Application

OTS has considered the application under the standards set forth in 12 U.S.C. § 1464(e) and 12 C.F.R. §§ 543.3 and 552.2-1. OTS also has considered the application under the Community Reinvestment Act (CRA), 12 U.S.C. §§ 2901 *et seq.*, and the OTS regulations thereunder, 12 C.F.R. Part 563e. In addition, OTS has considered the submissions made by the Applicant and the Savings Bank, and the results of examinations conducted by other banking agencies.

OTS may grant a federal savings association charter only: (1) to persons of good character and responsibility; (2) if, in OTS's judgment, a necessity exists for such association in the community to be served; (3) if there is a reasonable probability for the

association's usefulness and success; and (4) if the association can be established without undue injury to properly conducted existing local thrift and home financing institutions. In addition, OTS must consider whether the association will promote credit for housing consistent with the safe and sound operation of a federal savings association. OTS also takes into account an applicant's description of how it will meet CRA objectives when considering the application. Furthermore, OTS considers the amount of initial capital and the residence and composition of the savings association's board of directors.

With respect to the character and responsibility of the organizers, materials available to OTS indicate that the Applicant's character and responsibility are consistent with approval. OTS conducted background investigations of the Applicant's directors and senior executive officers and the proposed directors and senior executive officers of the Savings Bank. OTS review of the information received did not disclose any information that is inconsistent with approval. Also, the application indicates that the members of the Savings Bank's proposed board of directors possess varied business experience and expertise. Accordingly, we conclude that the character and responsibility of the organizers of the Savings Bank are consistent with approval of the application.

With respect to the necessity for the Savings Bank, the Savings Bank will conduct its operations in the Tri-State Market. As of 2005, the Tri-State Market had a population of 63,621. This represented a 20 percent increase from 1990, and a 5.8 percent increase from 2000. In addition, the deposit markets in Fannin County, Georgia, and Cherokee County, North Carolina, have grown significantly in the past two years. Between June 30, 2004, and June 30, 2006, deposits of banks and savings associations in Fannin County increased from approximately \$326 million to \$472 million, an increase of 44.8 percent, and deposits in Cherokee County increased from \$357 million to \$470 million, an increase of 31.7 percent. During the same period, deposits in Polk County, Tennessee decreased slightly, from approximately \$196 million to \$191 million. Therefore, we conclude that there is a necessity in the community for the Savings Bank.

With respect to undue injury to local thrift and home financing institutions, the Savings Bank may take some business from existing institutions. However, as of June 30, 2006, there were 12 state and federally chartered banks and savings institutions, with approximately 31 offices, operating inside the Tri-State Market. At the end of the third year of operations, the Savings Bank's projected market share would represent only approximately 4.1 percent of the Tri-State Market's 2006 deposits. In addition, no one opposed the application in response to the public notice. Therefore, we conclude that the Savings Bank will not cause undue injury to local thrift and home financing institutions in the geographic area where its customers will be located.

With respect to the probability of the Savings Bank's usefulness and success, the Savings Bank will be well-capitalized. The Savings Bank's business plan projects that it will remain well-capitalized throughout the duration of the business plan. The Applicant's and the Savings Bank's managerial resources are consistent with approval. Conditions five, six, seven and nine, below, are intended to ensure that the Savings Bank

maintains safe and sound operations by requiring compliance with the business plan submitted with the application, requiring reports that will be used for appropriate monitoring of the Savings Bank's progress and condition, and by ensuring that changes in the Savings Bank's management are appropriate. In addition, because the Applicant and the Bank plan to provide certain services to the Savings Bank and the Bank may sell certain loans to the Savings Bank, OTS is imposing condition eight, below, to address concerns regarding potential conflicts and to ensure that the Savings Bank's probability of usefulness and success is consistent with approval. We conclude that there is a reasonable probability of the Savings Bank's usefulness and success, provided that the Savings Bank (and the Applicant, to the extent applicable) comply with the conditions set forth below.

With respect to the provision of credit for housing consistent with the safe and sound operation of a federal savings association, the Savings Bank plans to extend credit for housing within its proposed market area. In addition, the Savings Bank is projected to meet its Qualified Thrift Lender (QTL) requirements. As discussed above, the Savings Bank's management is competent and should be able to conduct lending appropriately. Accordingly, we conclude that this approval criterion has been satisfied.

With respect to the CRA and OTS's CRA regulations, OTS received no public comments objecting to the application. OTS has reviewed the Savings Bank's CRA Plan. Consistent with OTS's CRA regulations, the Savings Bank's CRA assessment area will be the Tri-State Market. The Savings Bank plans to provide credit to all segments of its community. Accordingly, we conclude that the Savings Bank has satisfactorily demonstrated how it will meet its CRA objectives.

The Savings Bank intends to adopt a charter and bylaws that are consistent with OTS regulations. In addition, the Savings Bank's initial capitalization will exceed the minimum regulatory requirement.

A majority of the Savings Bank's board members will live and/or work in Georgia. The Savings Bank's board of directors will be made up of persons with varied backgrounds. The Savings Bank and the Applicant are not subject to the provisions of 12 C.F.R. § 543.3(d)(2), regarding the participation of directors in closely related businesses. Accordingly, we conclude that the application complies with 12 C.F.R. § 543.3(d).

BMA Application

The BMA application seeks OTS approval for the Savings Bank to acquire certain assets and assume certain liabilities of the Bank's McCaysville, Georgia branch office, pursuant to 12 U.S.C. § 1828(c), and 12 C.F.R. § 563.22 (Merger Regulations).

In evaluating a BMA application, OTS is required to consider the effect on the capital of the resulting association; the financial and managerial resources of the constituent institutions; the future prospects of the constituent institutions; the effect of

the transaction on competition; the convenience and needs of the community; conformance to applicable law, regulation, and supervisory policy; factors relating to fairness of and disclosure concerning the transaction; the effect on competition; and the effectiveness of any insured depository institution in combating money laundering activities. Under 12 C.F.R. § 563e.29, OTS must consider the constituent savings associations' record of performance under the CRA.

The Savings Bank will be well-capitalized, with initial capital of \$8.0 million, and it is projected to remain well-capitalized throughout its three-year business plan. Therefore, we conclude that this criterion for approval has been satisfied.

As discussed above, we conclude that the managerial and financial resources of the Savings Bank are adequate. The transfer of the McCaysville, Georgia branch to the Savings Bank will enhance the future prospects of the Savings Bank by enabling the Savings Bank to commence its banking operations from an existing office with an existing customer base in the Tri-State Market. Accordingly, we conclude that financial and managerial resources and future prospects of the Savings Bank meet the standards for approval of the transaction.

With respect to convenience and needs, the Savings Bank will be assuming the operations of an existing bank branch office and will continue to provide comparable service to the branch's customers and communities. In addition, the acquisition is not objectionable on CRA grounds. The Bank received a "Satisfactory" CRA rating in its last examination in October 2005. The Savings Bank is newly organized and, while it has no CRA history, it has provided an adequate plan for CRA compliance. As previously noted, the OTS received no adverse comments regarding the subject application.

Accordingly, we conclude that approval of the BMA application is consistent with the convenience and needs of the community and that approval of the BMA application is consistent with the CRA.

We are not aware of any violation of law or regulations, or non-compliance with supervisory policies, in connection with the proposed transaction. OTS has reviewed the compliance records of the Bank, which involves an evaluation of its anti-money laundering practices and compliance with anti-money laundering provisions. On the basis of the foregoing information, we conclude that the transaction will conform with regulatory policies and requirements and anti-money laundering provisions.

The proposed transaction, which will result in the establishment of a new savings association, will not have a negative impact on competition. The transaction replaces one competitor in McCaysville, Georgia with an affiliate and adds a new competitor to other portions of the Tri-State Market. The Department of Justice has not objected to the proposed transaction on competitive grounds. Accordingly, we conclude that there is no basis for objection to the BMA application on competitive grounds.

Upon review of the application materials, we conclude that the transaction is equitable to all concerned. The application addressed the accounting and tax consequences of the transaction. Therefore, we conclude that the fairness criterion has been satisfied.

For the reasons discussed above, we conclude that OTS approval of the BMA application is consistent with the BMA, the Merger Regulations, and other relevant statutes and regulations.

Branch Application

The Savings Bank has requested OTS approval, under 12 C.F.R. § 545.95, to establish two branch offices. Section 545.95 provides that OTS shall approve a branching application only if the overall policies, condition and operations of the savings association afford no basis for supervisory objection and the proposed branch will open within twelve months of approval. In addition, where offices are to be opened in other states than the one where the Savings Bank's home office is located, 12 U.S.C. § 1464(r) requires that the total assets of the branches in each new state qualify the branches as a domestic building and loan under 26 U.S.C. § 7701(a)(19) or as a qualified thrift lender, as determined under 12 U.S.C. § 1467a(m).

Pursuant to 12 C.F.R. § 545.95(b), the Savings Bank will exceed the minimum capital requirements. The Savings Bank's proposed CRA plan indicates that it will fulfill its obligation of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods. The Savings Bank has represented that it will meet QTL requirements overall, and that its Tennessee and North Carolina branches will each meet the QTL requirements based on the Savings Bank's Tennessee and North Carolina assets, respectively. Therefore, the Savings Bank will meet the branching requirements set forth in 12 U.S.C. § 1464(r).

As discussed above, the Savings Bank's managerial and financial resources and future prospects are satisfactory. Accordingly, we conclude that the proposed branching is consistent with the applicable branching requirements.

Based on the foregoing analysis, OTS concludes that the permission to organize application, the BMA application, and the branch application meet the applicable approval criteria, and are hereby approved, provided that the following conditions are complied with in a manner satisfactory to the Southeast Regional Director, or his designee (Regional Director):

1. The Savings Bank and the Applicant must receive all required regulatory approvals and submit copies of all such approvals to the Regional Director prior to consummation of the proposed transaction;
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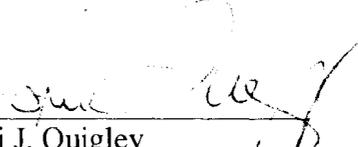
2. The proposed transaction must be consummated within 120 calendar days from the date of this Order;
 3. On the business day prior to the consummation of the proposed transaction, the chief financial officers of the Applicant and the Savings Bank must certify in writing to the Regional Director that no material adverse changes have occurred with respect to the financial condition or operation of the Applicant and the Savings Bank as disclosed in the application. If additional information having a material adverse bearing on any feature of the application is brought to the attention of the Applicant, the Savings Bank or OTS since the date of the financial statements submitted with the application, the transaction must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to consummation of the transaction;
 4. The Applicant and the Savings Bank must advise the Regional Director in writing within 5 calendar days after the effective date of the proposed transaction: (a) of the effective date of the transaction; (b) that the transaction was consummated in accordance with all applicable laws and regulations, the application, and this Order;
 5. The Savings Bank must submit independent audit reports to the Regional Director for its first three years of operations. These reports must be in compliance with the audit rules set forth at 12 C.F.R. § 562.4;
 6. The Savings Bank must operate within the parameters of the business plan submitted with the application. The Savings Bank must submit any proposed major deviations or material changes from the plan (including those initiated by the Applicant) for the prior, written non-objection of the Regional Director. The request for change must be submitted no later than 60 calendar days prior to the desired implementation date with a copy sent to the FDIC Regional Office;
 7. For three years following commencement of operations, the Savings Bank must submit to the Regional Director within 45 calendar days after the end of each calendar quarter, a business plan variance report detailing the Savings Bank's compliance with the business plan and an explanation of any deviations;
 8. Within 6 months of the date of consummation and continuously thereafter, at least 40 percent of the Savings Bank's board of directors must be individuals who are not officers or employees of the Applicant or its affiliates and who have not otherwise been determined by the Regional Director to lack sufficient independence; and at least one member of the Savings Bank's board of directors must be an individual who is not an officer, director or employee of the Applicant or its affiliates and who is not an officer or employee of the Savings Bank, and has not otherwise been determined by the Regional Director to lack sufficient independence. At least 50 percent of any audit or investment committees established by the Savings Bank must be directors who are not officers or employees of the Savings Bank, the Applicant or
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its affiliates and have not otherwise been determined by the Regional Director to lack sufficient independence; and

9. For two years following the consummation of the transaction, the Savings Bank must receive the prior written non-objection of the Regional Director for any proposed new directors or senior executive officers or any significant change in responsibilities of any senior executive officer.

The Regional Director may, for good cause, extend any time period set forth herein for up to 120 calendar days.

By order of the Director of the Office of Thrift Supervision, or his designee, effective 2-16-07.



Lori J. Quigley
Assistant Managing Director
Examinations and Supervision-
Operations
