

FIRST MERCHANTS CORP
Form 10-K
February 27, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

[Mark One]

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-17071

FIRST MERCHANTS CORPORATION

(Exact name of registrant as specified in its charter)

Indiana

35-1544218

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

200 East Jackson

Muncie, Indiana

47305-2814

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (765)747-1500

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of each exchange on which registered

Common Stock, \$0.125 stated value per share

The NASDAQ Stock Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant(1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best

of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of

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this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer Accelerated filer Non-accelerated filer Small Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value (not necessarily a reliable indication of the price at which more than a limited number of shares would trade) of the voting stock held by non-affiliates of the registrant was \$762,144,000 as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2014).

As of February 20, 2015 there were 37,680,604 outstanding common shares, without par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Documents	Part of Form 10-K into which incorporated
Portions of the Registrant's Definitive	Part III (Items 10 through 14)
Proxy Statement for Annual Meeting of	
Shareholders to be held May 4, 2015	

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FORWARD-LOOKING STATEMENTS

First Merchants Corporation (the “Corporation”) from time to time includes forward-looking statements in its oral and written communication. The Corporation may include forward-looking statements in filings with The Securities and Exchange Commission (“SEC”), such as Form 10-K and Form 10-Q, in other written materials and oral statements made by senior management to analysts, investors, representatives of the media and others. The Corporation intends these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and the Corporation is including this statement for purposes of these safe harbor provisions. Forward-looking statements can often be identified by the use of words like “believe”, “continue”, “pattern”, “estimate”, “project”, “intend”, “anticipate”, “expect” and similar expressions or future or conditional verbs such as “will”, “would”, “should”, “could”, “might”, “can”, “may” or similar expressions. These forward-looking statements include:

- statements of the Corporation’s goals, intentions and expectations;
- statements regarding the Corporation’s business plan and growth strategies;
- statements regarding the asset quality of the Corporation’s loan and investment portfolios;
- and
- estimates of the Corporation’s risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, those discussed in Item 1A, “RISK FACTORS”.

Because of these and other uncertainties, the Corporation’s actual future results may be materially different from the results indicated by these forward-looking statements. In addition, the Corporation’s past results of operations do not necessarily indicate its future results.

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PART I: ITEM 1. BUSINESS

PART I

ITEM 1. BUSINESS

GENERAL

First Merchants Corporation (the “Corporation”) is a financial holding company headquartered in Muncie, Indiana and was organized in September 1982. The Corporation’s Common Stock is traded on NASDAQ’s Global Select Market System under the symbol FRME. The Corporation has one full-service bank charter, First Merchants Bank, National Association (the “Bank”), which opened for business in Muncie, Indiana, in March 1893. The Bank also operates Lafayette Bank and Trust, Commerce National Bank, Community Bank of Noblesville and First Merchants Trust Company as divisions of First Merchants Bank, N.A. The Bank includes 106 banking locations in twenty-six Indiana, two Illinois and two Ohio counties. In addition to its branch network, the Corporation’s delivery channels include ATMs, check cards, remote deposit capture, interactive voice response systems and internet technology. The Corporation’s business activities are currently limited to one significant business segment, which is community banking.

Through the Bank, the Corporation offers a broad range of financial services, including accepting time deposits, savings and demand deposits; making consumer, commercial, agri-business and real estate mortgage loans; renting safe deposit facilities; providing personal and corporate trust services; providing full-service brokerage; and providing other corporate services, letters of credit and repurchase agreements.

The Corporation also operates First Merchants Insurance Services, Inc., operating as First Merchants Insurance Group, a full-service property, casualty, personal lines, and employee benefit insurance agency headquartered in Muncie, Indiana.

All inter-company transactions are eliminated during the preparation of consolidated financial statements.

As of December 31, 2014, the Corporation had consolidated assets of \$5.8 billion, consolidated deposits of \$4.6 billion and stockholders’ equity of \$727 million. As of December 31, 2014, the Corporation and its subsidiaries had 1,415 full-time equivalent employees.

AVAILABLE INFORMATION

The Corporation makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, available on its website at www.firstmerchants.com without charge, as soon as reasonably practicable, after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. These documents can also be read and copied at the Securities and Exchange Commission’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. SEC filings are also available to the public at the Securities and Exchange Commission’s website at www.sec.gov. Additionally, the Corporation will also provide without charge, a copy of its Annual Report on Form 10-K to any shareholder by mail. Requests should be sent to Cynthia Holaday, Shareholder Relations, First Merchants Corporation, P.O. Box 792, Muncie, IN 47308-0792.

ACQUISITION POLICY

The Corporation anticipates that it will continue its policy of geographic expansion of its banking business through the acquisition of banks whose operations are consistent with its banking philosophy. Management routinely explores opportunities to acquire financial institutions and other financial services-related businesses and to enter into strategic alliances to expand the scope of its services and its customer base.

On November 7, 2014, the Corporation acquired 100 percent of Community Bancshares, Inc. ("Community"). Community was headquartered in Noblesville, Indiana and had 10 full-service banking centers serving central Indiana. Pursuant to the merger agreement, each outstanding share of common stock of Community was converted into the right to receive either (a) 4.0926 shares of the Corporation's common stock, plus cash in lieu of fractional shares; or (b) \$85.94 in cash, based upon shareholder elections. The Corporation paid \$14.2 million in cash and issued approximately 1.6 million shares of common stock, valued at approximately \$35.0 million, for a total purchase price of approximately \$49.2 million.

Effective November 12, 2013, the Corporation acquired 100 percent of CFS Bancorp ("CFS") in an all stock transaction. CFS was headquartered in Munster, Indiana and had 20 banking centers in northwestern Indiana and northeastern Illinois. Pursuant to the merger agreement, the shareholders of CFS received 0.65 percent of a share of the Corporation's common stock for each share of CFS Bancorp common stock held. The Corporation issued approximately 7.1 million shares of common stock, which was valued at approximately \$135.6 million.

The details of the Community and CFS acquisitions can be found in Note 3. BUSINESS COMBINATIONS, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

Effective February 10, 2012, the Bank assumed substantially all of the deposits and certain other liabilities and acquired certain assets of SCB Bank ("SCB"), a federal savings bank headquartered in Shelbyville, Indiana, from the Federal Deposit Insurance Corporation ("FDIC"), as receiver for SCB, pursuant to the terms of the Purchase and Assumption Agreement - Modified Whole Bank; All Deposits, entered into by the Bank, the FDIC as receiver of SCB and the FDIC. Additional details of this transaction can be found in Note 2. PURCHASE AND ASSUMPTION, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

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On January 5, 2015, the Corporation and C Financial Corporation, an Ohio corporation (“C Financial”), entered into an Agreement and Plan of Reorganization and Merger (the “Merger Agreement”), pursuant to which, C Financial will, subject to the terms and conditions of the Merger Agreement, merge with and into First Merchants (the “Merger,”) whereupon the separate corporate existence of C Financial will cease and First Merchants will survive. Immediately following the Merger, Cooper State Bank, an Ohio state bank and wholly-owned subsidiary of C Financial, will be merged with and into First Merchants Bank, National Association, a national bank and wholly-owned subsidiary of First Merchants, with First Merchants Bank, National Association continuing as the surviving bank. The Merger Agreement has been approved by the Boards of Directors of each of First Merchants and C Financial, but the consummation of the Merger is conditioned upon the approval of the C Financial shareholders and certain regulatory authorities as well as satisfaction of customary closing conditions. The Merger Agreement provides that upon the effective date of the Merger (the “Effective Date”), the shareholders of C Financial shall be entitled to receive an aggregate of \$14,500,000 in cash in exchange for all of the outstanding shares of C Financial common stock, \$1.00 par value. Subject to C Financial common shareholders’ approval of the Merger Agreement, regulatory approvals and other customary closing conditions, the parties anticipate completing the Merger in the second quarter of 2015. Additional details of this transaction can be found in Note 28. SUBSEQUENT EVENTS, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

COMPETITION

The Bank is located in Indiana, Ohio and Illinois counties where other financial services companies provide similar banking services. In addition to the competition provided by the lending and deposit gathering subsidiaries of national manufacturers, retailers, insurance companies and investment brokers, the Bank competes vigorously with other banks, thrift institutions, credit unions and finance companies located within its service areas.

REGULATION AND SUPERVISION OF FIRST MERCHANTS CORPORATION AND SUBSIDIARIES

Bank Holding Company Regulation

The Corporation is registered as a bank holding company and has elected to be a financial holding company. It is subject to the supervision of, and regulation by the Board of Governors of the Federal Reserve System (“Federal Reserve”) under the Bank Holding Company Act of 1956 (the “BHC Act”), as amended. Bank holding companies are required to file periodic reports with and are subject to periodic examination by the Federal Reserve. The Federal Reserve has issued regulations under the BHC Act requiring a bank holding company to serve as a source of financial and managerial strength to the Bank. Thus, it is the policy of the Federal Reserve that a bank holding company should stand ready to use its resources to provide adequate capital funds to the Bank during periods of financial stress or adversity. Additionally, under the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), a bank holding company is required to guarantee the compliance of any subsidiary bank that may become “undercapitalized” (as defined in the FDICIA section of this Form 10-K) with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency. Under the BHC Act, the Federal Reserve has the authority to require a bank holding company to terminate any activity or relinquish control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the determination that such activity constitutes a serious risk to the financial stability of any bank subsidiary.

The BHC Act requires the Corporation to obtain the prior approval of the Federal Reserve before:

acquiring direct or indirect control or ownership of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company will directly or indirectly own or control more than 5 percent of the

voting shares of the bank or bank holding company;
merging or consolidating with another bank holding company; or
acquiring substantially all of the assets of any bank.

The BHC Act generally prohibits bank holding companies that have not become financial holding companies from (i) engaging in activities other than banking or managing or controlling banks or other permissible subsidiaries, and (ii) acquiring or retaining direct or indirect control of any company engaged in the activities other than those activities determined by the Federal Reserve to be closely related to banking or managing or controlling banks.

Capital Adequacy Guidelines for Bank Holding Companies

The BHC Act does not place territorial restrictions on such non-banking related activities. The Corporation is required to comply with the Federal Reserve's risk-based capital guidelines. These guidelines require a minimum ratio of capital to risk-weighted assets of 8 percent (including certain off-balance sheet activities such as standby letters of credit). At least half of the total required capital must be "Tier 1 capital," consisting principally of stockholders' equity, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interest in the equity accounts of consolidated subsidiaries, less certain goodwill items. The remainder may consist of a limited amount of subordinate debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, cumulative perpetual preferred stock, and a limited amount of the general loan loss allowance.

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In addition to the risk-based capital guidelines, the Federal Reserve has adopted a Tier 1 (leverage) capital ratio under which the Corporation must maintain a minimum level of Tier 1 capital to average total consolidated assets.

The following are the Corporation's regulatory capital ratios as of December 31, 2014:

	Corporation	Regulatory Minimum Requirement	
Tier 1 risk-based capital ratio	12.63	% 4.00	%
Total risk-based capital ratio	15.34	% 8.00	%

In July 2013, the United States banking regulators adopted new capital rules which modified the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions. These rules are commonly known as "Basel III". These new rules will be phased in for the Corporation and the Bank beginning on January 1, 2015. The following is a summary of the major changes related to risk based capital:

- higher minimum capital requirements, including a new "common equity tier 1 capital" ratio of 4.5 percent, a tier 1 capital ratio of 6 percent, a total capital ratio of 8 percent and a minimum leverage ratio of 4 percent;
- stricter eligibility for regulatory capital instruments;
- restrictions on the payment of capital distributions (including dividends) and certain discretionary bonus payments to executive officers if certain thresholds are not met under a new "capital conservation buffer" as defined in the rules;
- replacement of the external credit ratings approach to standards of creditworthiness with a simplified supervisory formula approach;
- stricter limitations on the extent to which certain mortgage servicing assets, deferred tax assets and investments in unconsolidated financial institutions may be included in common equity tier 1 capital;
- increased risk weights for past due loans, certain commercial real estate loans and certain equity exposures.

The implementation of the new Basel III standards is not expected to have a material impact on the Corporation or the Bank.

Bank Regulation

The Bank is supervised, regulated and examined by the Office of the Comptroller of the Currency (the "OCC"). The OCC has the authority to issue cease-and-desist orders if it determines that activities of the Bank regularly represent an unsafe and unsound banking practice or a violation of law. Federal law extensively regulates various aspects of the banking business such as reserve requirements, truth-in-lending and truth-in-savings disclosures, equal credit opportunity, fair credit reporting, trading in securities and other aspects of banking operations. Current federal law also requires banks, among other things, to make deposited funds available within specified time periods.

Bank Capital Requirements

The OCC has adopted risk-based capital ratio guidelines to which national banks are subject. The guidelines establish a framework that makes regulatory capital requirements more sensitive to differences in risk profiles. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk-weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk.

Like the capital guidelines established by the Federal Reserve, these guidelines divide a bank's capital into tiers. Banks are required to maintain a total risk-based capital ratio of 8 percent. The OCC may, however, set higher capital

requirements when a bank's particular circumstances warrant. Banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

In addition, the OCC established guidelines prescribing a minimum Tier 1 leverage ratio (Tier 1 capital to adjusted total assets as specified in the guidelines). Currently, these guidelines provide for a minimum Tier 1 leverage ratio of 3 percent for banks that meet specified criteria, including that they have the highest regulatory rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier 1 leverage ratio of 3 percent plus an additional 1 to 2 percent. The Bank exceeded the minimum risk-based capital guidelines of the OCC as of December 31, 2014. The capital standards applicable to the Bank will begin to change on January 1, 2015 in accordance with the Basel III rules discussed above. The implementation of the new Basel III standards is not expected to have a material impact on the Corporation or the Bank.

FDIC Improvement Act of 1991

The FDICIA requires, among other things, federal bank regulatory authorities to take "prompt corrective action" with respect to banks, which do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. The Federal Deposit Insurance Corporation ("FDIC") has adopted regulations to implement the prompt corrective action provisions of FDICIA.

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“Undercapitalized” banks are subject to growth limitations and are required to submit a capital restoration plan. A bank’s compliance with such plan is required to be guaranteed by the bank’s parent holding company. If an “undercapitalized” bank fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. “Significantly undercapitalized” banks are subject to one or more restrictions, including an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cease receipt of deposits from correspondent banks, and restrictions on compensation of executive officers. “Critically undercapitalized” institutions may not, beginning 60 days after becoming “critically undercapitalized,” make any payment of principal or interest on certain subordinated debt or extend credit for a highly leveraged transaction or enter into any transaction outside the ordinary course of business. In addition, “critically undercapitalized” institutions are subject to appointment of a receiver or conservator.

As of December 31, 2014, the Bank was “well capitalized” based on the “prompt corrective action” ratios described above. It should be noted that a bank’s capital category is determined solely for the purpose of applying the OCC’s “prompt corrective action” regulations and that the capital category may not constitute an accurate representation of the bank’s overall financial condition or prospects.

Volcker Rule

In December 2013, United States banking regulators adopted final rules implementing the Volcker Rule under the Dodd-Frank Act. The Volcker Rule places certain limitations on the trading activity of insured depository institutions and their affiliates subject to certain exceptions. The restricted trading activity includes purchasing or selling certain types of securities or instruments in order to benefit from short-term price movements or to realize short-term profits. Exceptions to the Volcker Rule include trading in certain U.S. Government or other municipal securities and trading conducted in certain capacities as a broker or other agent, as a fiduciary on behalf of customers, to satisfy a debt previously contracted, repurchase and securities lending agreements and risk-mitigating hedging activities. The Volcker Rule also prohibits banking institutions from having an ownership interest in a hedge fund or private equity fund. The implementation of the new Volcker Rule did not have a material impact on the Corporation or the Bank.

LEGISLATIVE AND REGULATORY INITIATIVES TO ADDRESS FINANCIAL AND ECONOMIC CRISES

Small Business Lending Program

In 2010, Congress established the Small Business Lending Fund (“SBLF”) under the Small Business Jobs Act of 2010 encouraging lending to small business by providing capital to qualified community banks with assets of less than \$10 billion. On September 22, 2011, the Corporation became a participant in SBLF by entering into a Securities Purchase Agreement (the “Purchase Agreement”) with the U.S. Department of Treasury (“Treasury”), pursuant to which the Corporation issued 90,782.94 shares of the Corporation’s Senior Non-Cumulative Perpetual Preferred Stock, Series B (the “Series B Preferred Stock”), having a liquidation amount per share equal to \$1,000, for a total purchase price of \$90,782,940.

The Series B Preferred Stock was entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate was based on the level of the Bank’s lending to small businesses. The Series B Preferred Stock was non-voting, except in limited circumstances, and was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

On January 3, 2013, the Corporation redeemed 22,695.94 shares of the Series B Preferred Stock held by the Treasury at an aggregate redemption price of \$22,695,940 plus accrued but unpaid dividends. On July 2, 2013, the Corporation redeemed an additional 34,044 shares of the Series B Preferred Stock held by the Treasury at an aggregate redemption price of \$34,044,000 plus accrued but unpaid dividends. On November 22, 2013, the Corporation redeemed the final 34,043 shares of the Series B Preferred Stock held by the Treasury at an aggregate redemption price of \$34,043,000 plus accrued but unpaid dividends. This redemption resulted in all of the outstanding shares of Series B Preferred Stock having been redeemed and the Corporation ending its participation in the SBLF program.

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) into law. The Dodd-Frank Act is likely to have a broad impact on the financial services industry, including significant regulatory and compliance changes. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to various federal agencies implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies through regulatory guidance, the full extent of the impact such requirements will have on the financial services industry, and on operations specifically, is currently unclear. The changes resulting from the Dodd-Frank Act may materially impact the profitability of the Corporation’s business activities, require changes to certain business practices, impose more stringent capital, liquidity and leverage requirements or otherwise adversely affect the business. At a minimum, the Dodd-Frank Act is likely to:

- increase the cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, including higher deposit insurance premiums;
- limit the Corporation’s ability to raise additional capital through the use of trust preferred securities as new issuances of these securities may no longer be included as Tier 1 capital;
- reduce the flexibility to generate or originate certain revenue-producing assets based on increased regulatory capital standards; and
- limit the ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations.

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PART I: ITEM 1. BUSINESS

The timing and extent of these increases and limitations will remain unclear until the underlying implementing regulations are promulgated by the applicable federal agencies. In the interim, the Corporation's management is currently taking steps to best prepare for the implementation and to minimize the adverse impact on the business, financial condition and results of operation.

On February 7, 2011, the FDIC adopted final rules implementing a portion of the Dodd-Frank Act relating to deposit insurance assessments. The rules modify the base amount for a financial institution's insurance assessments from an institution's insured deposits to the difference between an institution's daily average consolidated assets and its daily average tangible equity. The rules also eliminated the requirement that the FDIC provide rebates to institutions on their deposit premiums once the reserve ratio exceeded 1.5 percent. These new rules became effective on April 1, 2011.

Deposit Insurance

The Bank is insured up to regulatory limits by the FDIC; and, accordingly, is subject to deposit insurance assessments to maintain the Deposit Insurance Fund administered by the FDIC. The FDIC has adopted regulations establishing a permanent risk-related deposit insurance assessment system. Under this system, the FDIC places each insured bank in one of four risk categories based on (i) the bank's capital evaluation, and (ii) supervisory evaluations provided to the FDIC by the bank's primary federal regulator. Each insured bank's annual assessment rate is then determined by the risk category in which it is classified by the FDIC.

When Dodd-Frank became effective, it permanently raised the previous Standard Maximum Deposit Insurance Amount ("SMDIA") to \$250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. This provision became effective for depositors December 31, 2010.

On November 9, 2010, the FDIC implemented section 343 of the Dodd-Frank Act providing unlimited insurance coverage on noninterest-bearing transaction accounts. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. As of January 1, 2013, noninterest-bearing transaction deposit accounts are no longer insured separately from other accounts at the same FDIC-insured institution. Instead, noninterest-bearing transaction accounts will be added to other accounts, and the aggregate balance insured up to at least the Standard Maximum Deposit Insurance Amount of \$250,000, at each institution.

DIVIDEND LIMITATIONS

National banking laws restrict the amount of dividends that an affiliate bank may declare in a year without obtaining prior regulatory approval. National banks are limited to the bank's retained net income (as defined) for the current year plus those for the previous two years. At December 31, 2014, the Corporation's affiliates (including the Bank and other affiliates) had a total of \$23,340,000 retained net profits available for 2015 dividends to the Corporation without prior regulatory approval.

BROKERED DEPOSITS

Under FDIC regulations, no FDIC-insured depository institution can accept brokered deposits unless it (i) is well capitalized, or (ii) is adequately capitalized and received a waiver from the FDIC. In addition, these regulations prohibit any depository institution that is not well capitalized from (a) paying an interest rate on deposits in excess of 76 basis points over certain prevailing market rates or (b) offering "pass through" deposit insurance on certain employee

benefit plan accounts unless it provides certain notice to affected depositors.

INTERSTATE BANKING AND BRANCHING

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (“Riegle-Neal”), subject to certain concentration limits, required regulatory approvals and other requirements, (i) financial holding companies such as the Corporation are permitted to acquire banks and bank holding companies located in any state; (ii) any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans and receive loan payments as an agent for any other bank subsidiary of that holding company; and (iii) banks are permitted to acquire branch offices outside their home states by merging with out-of-state banks, purchasing branches in other states, and establishing de novo branch offices in other states.

FINANCIAL SERVICES MODERNIZATION ACT

The Gramm-Leach-Bliley Act of 1999 (the “Financial Services Modernization Act”) establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the existing BHC Act. Under this legislation, bank holding companies would be permitted to conduct essentially unlimited securities and insurance activities as well as other activities determined by the Federal Reserve Board to be financial in nature or related to financial services. As a result, the Corporation is able to provide securities and insurance services. Furthermore, under this legislation, the Corporation is able to acquire, or be acquired, by brokerage and securities firms and insurance underwriters. In addition, the Financial Services Modernization Act broadens the activities that may be conducted by national banks through the formation of financial subsidiaries. Finally, the Financial Services Modernization Act modifies the laws governing the implementation of the Community Reinvestment Act and addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

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A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, is well managed and has at least a satisfactory rating under the Community Reinvestment Act, by filing a declaration that the bank holding company wishes to become a financial holding company. Also effective March 11, 2000, no regulatory approval is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. The Federal Reserve Bank of Chicago approved the Corporation's application to become a Financial Holding Company effective September 13, 2000.

USA PATRIOT ACT

As part of the USA Patriot Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Act"). The Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Treasury regulations implementing the due diligence requirements were issued in 2002. These regulations required minimum standards to verify customer identity, encouraged cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibited the anonymous use of "concentration accounts," and required all covered financial institutions to have in place an anti-money laundering compliance program.

The Act also amended the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act"), which became law on July 30, 2002, added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting. The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);
- independence requirements for audit committee members;
- independence requirements for company auditors;
- certification of financial statements on Forms 10-K and 10-Q reports by the chief executive officer and the chief financial officer;
- the forfeiture by the chief executive officer and chief financial officer of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by such officers in the twelve-month period following

initial publication of any financial statements that later require restatement due to corporate misconduct;

- disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing Form 4s;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change in or waiver of such code;
- the reporting of securities violations “up the ladder” by both in-house and outside attorneys;
- restrictions on the use of non-GAAP financial measures in press releases and SEC filings;
- the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

The Sarbanes-Oxley Act contains provisions, which became effective upon enactment on July 30, 2002, including provisions, which became effective from within 30 days to one year from enactment. The SEC has been delegated the task of enacting rules to implement various provisions. In addition, each of the national stock exchanges developed new corporate governance rules, including rules strengthening director independence requirements for boards, the adoption of corporate governance codes and charters for the nominating, corporate governance and audit committees.

ADDITIONAL MATTERS

The Corporation and the Bank are subject to the Federal Reserve Act, which restricts financial transactions between banks and affiliated companies. The statute limits credit transactions between banks, affiliated companies and its executive officers and its affiliates. The statute prescribes terms and conditions for bank affiliate transactions deemed to be consistent with safe and sound banking practices. It also restricts the types of collateral security permitted in connection with the bank’s extension of credit to an affiliate. Additionally, all transactions with an affiliate must be on terms substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated parties.

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In addition to the matters discussed above, the Bank is subject to additional regulation of its activities, including a variety of consumer protection regulations affecting its lending, deposit and collection activities and regulations affecting secondary mortgage market activities.

The earnings of financial institutions are also affected by general economic conditions and prevailing interest rates, both domestic and foreign, and by the monetary and fiscal policies of the United States Government and its various agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of credit in order to influence general economic conditions, primarily through open market operations in United States Government obligations, varying the discount rate on financial institution borrowings, varying reserve requirements against financial institution deposits, and restricting certain borrowings by financial institutions and their subsidiaries. The monetary policies of the Federal Reserve have had a significant effect on the operating results of the Bank in the past and are expected to continue to do so in the future.

Additional legislation and administrative actions affecting the banking industry may be considered by the United States Congress, state legislatures and various regulatory agencies, including those referred to above. It cannot be predicted with certainty whether such legislation or administrative action will be enacted or the extent to which the banking industry, the Corporation or the Bank would be affected.

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STATISTICAL DATA

The following tables set forth statistical data on the Corporation and its subsidiaries.

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

The daily average balance sheet amounts, the related interest income or interest expense, and average rates earned or paid are presented in the following table:

	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
(Dollars in Thousands)	2014			2013			2012		
Assets:									
Interest-bearing deposits	\$53,231	\$124	0.2 %	\$74,964	\$158	0.2 %	\$57,842	\$100	0.2 %
Federal reserve and federal home loan bank stock	42,142	2,124	5.0	33,620	1,488	4.4	32,819	1,408	4.3
Securities: ⁽¹⁾									
Taxable	763,450	19,882	2.6	617,524	15,214	2.5	670,973	17,027	2.5
Tax-Exempt ⁽²⁾	396,435	22,127	5.6	282,584	16,660	5.9	251,724	15,675	6.2
Total securities	1,159,885	42,009	3.6	900,108	31,874	3.5	922,697	32,702	3.5
Loans held for sale	6,681	485	7.3	16,137	770	4.8	20,648	1,024	5.0
Loans: ⁽³⁾									
Commercial	2,919,020	133,567	4.6	2,391,221	113,613	4.8	2,166,238	114,078	5.3
Real estate mortgage	429,384	19,812	4.6	277,520	12,375	4.5	293,384	13,848	4.7
Installment	361,484	18,175	5.0	308,233	15,994	5.2	324,553	17,795	5.5
Tax-Exempt ⁽²⁾	13,511	504	3.7	15,444	605	3.9	14,993	739	4.9
Total loans	3,730,080	172,543	4.6	3,008,555	143,357	4.8	2,819,816	147,484	5.2
Total earning assets	4,985,338	216,800	4.3 %	4,017,247	176,877	4.4 %	3,833,174	181,694	4.7 %
Net unrealized gain on securities available for sale	8,921			4,521			16,116		
Allowance for loan losses	(67,969)			(68,806)			(71,038)		
Cash and due from banks	87,068			73,161			66,109		
Premises and equipment	75,202			57,228			51,692		
Other assets	482,794			372,060			349,943		
Total assets	\$5,571,354			\$4,455,411			\$4,245,996		
Liabilities:									
Interest-bearing deposits:									
NOW accounts	\$1,066,402	\$1,110	0.1 %	\$880,323	\$941	0.1 %	\$814,831	\$1,007	0.1 %

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Money market deposit accounts	776,712	1,572	0.2	603,012	1,287	0.2	501,537	1,370	0.3
Savings deposits	533,080	619	0.1	377,106	421	0.1	327,644	528	0.2
Certificates and other time deposits	1,042,539	8,377	0.8	807,764	7,404	0.9	935,713	11,895	1.3
Total interest-bearing deposits	3,418,733	11,678	0.3	2,668,205	10,053	0.4	2,579,725	14,800	0.6
Borrowings	492,128	10,164	2.1	400,580	6,516	1.6	411,915	8,813	2.1
Total interest-bearing liabilities	3,910,861	21,842	0.6	3,068,785	16,569	0.5	2,991,640	23,613	0.8
Noninterest-bearing deposits	945,222			797,435			683,295		
Other liabilities	39,976			48,936			35,564		
Total liabilities	4,896,059			3,915,156			3,710,499		
Stockholders' Equity	675,295			540,255			535,497		
Total Liabilities and Stockholders' Equity	\$5,571,354	21,842	0.4	\$4,455,411	16,569	0.4	\$4,245,996	23,613	0.6
Net Interest Income		\$194,958			\$160,308			\$158,081	
Net Interest Margin			3.9 %			4.0 %			4.1 %

(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35 percent for 2014, 2013 and 2012. These totals equal \$7,921, \$6,043 and \$5,745, respectively.

(3) Non-accruing loans have been included in the average balances.

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ANALYSIS OF CHANGES IN NET INTEREST INCOME

The following table presents net interest income components on a tax-equivalent basis and reflects changes between periods attributable to movement in either the average balance or average interest rate for both earning assets and interest-bearing liabilities. The volume differences were computed as the difference in volume between the current and prior year multiplied by the interest rate from the prior year. The interest rate changes were computed as the difference in rate between the current and prior year multiplied by the volume from the prior year. Volume/rate variances have been allocated on the basis of the absolute relationship between volume variances and rate variances.

(Dollars in Thousands, Fully Taxable Equivalent Basis)	2014 Compared to 2013 Increase (Decrease) Due To			2013 Compared to 2012 Increase (Decrease) Due To			2012 Compared to 2011 Increase (Decrease) Due To		
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
Interest Income:									
Federal funds sold									
Interest-bearing deposits	\$(49)	\$15	\$(34)	\$33	\$25	\$58	\$(3)		\$(3)
Federal Reserve and Federal Home Loan Bank stock	411	225	636	35	45	80	17	72	89
Securities	9,393	742	10,135	(800)	(28)	(828)	1,222	(3,392)	(2,170)
Mortgage loans held for sale	(576)	291	(285)	(216)	(38)	(254)	575	(105)	470
Loans	33,894	(4,423)	29,471	9,718	(13,591)	(3,873)	3,226	(6,740)	(3,514)
Totals	43,073	(3,150)	39,923	8,770	(13,587)	(4,817)	4,997	(10,307)	(5,310)
Interest Expense:									
NOW accounts	194	(25)	169	77	(143)	(66)	72	(518)	(446)
Money market deposit accounts	354	(69)	285	248	(331)	(83)	101	(288)	(187)
Savings deposits	180	18	198	72	(179)	(107)	64	(204)	(140)
Certificates and other time deposits	1,966	(993)	973	(1,477)	(3,014)	(4,491)	(1,624)	(5,084)	(6,708)
Borrowings	1,673	1,975	3,648	(237)	(2,060)	(2,297)	(1,370)	(5,426)	(6,796)
Totals	4,367	906	5,273	(1,317)	(5,727)	(7,044)	(2,757)	(11,520)	(14,277)
Change in net interest income (fully taxable equivalent basis)	\$38,706	\$(4,056)	34,650	\$10,087	\$(7,860)	2,227	\$7,754	\$1,213	8,967
Tax equivalent adjustment using marginal rate of 35% for 2014, 2013, and 2012			(1,878)			(298)			14
Change in net interest income			\$32,772			\$1,929			\$8,981

INVESTMENT SECURITIES

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities are generally evaluated for OTTI under Accounting Standards Codification (“ASC”) 320,

Investments – Debt and Equity Securities. However, certain purchased beneficial interest, including certain non-agency government-sponsored mortgage-backed securities, asset-backed securities and collateralized debt obligations are evaluated using the model outlined in ASC 325-10, Investments - Other.

In determining OTTI under ASC 320, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Corporation has the intent to sell the debt security or more likely than not, will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of OTTI recognized in the income statement depends on whether the Corporation intends to sell the security or it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, less any recognized credit loss. If the intent is to sell, or it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, less any recognized credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis, less any recognized credit loss, and its fair value at the balance sheet date. If the intent is not to sell the security and it is not more likely than not that the Corporation will be required to sell the security before the recovery of its amortized cost basis less any recognized credit loss, the OTTI has been separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors has been recognized in other comprehensive income, net of applicable income taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

The Corporation's management has evaluated all securities with unrealized losses for OTTI as of December 31, 2014. The evaluations are based on the nature of the securities, the extent and duration of the loss and the intent and ability of the Corporation to hold these securities either to maturity or through the expected recovery period.

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In determining the fair value of the investment securities portfolio, the Corporation utilizes a third party for portfolio accounting services, including market value input, for those securities classified as Level I and Level II in the fair value hierarchy. The Corporation has obtained an understanding of what inputs are being used by the vendor in pricing the portfolio and how the vendor classified these securities based upon these inputs. From these discussions, the Corporation's management is comfortable that the classifications are proper. The Corporation has gained trust in the data for two reasons: (a) independent spot testing of the data is conducted by the Corporation through obtaining market quotes from various brokers on a periodic basis; and (b) actual gains or loss resulting from the sale of certain securities has proven the data to be accurate over time. Fair value of securities classified as Level 3 in the valuation hierarchy were determined using a discounted cash flow model that incorporated market estimates of interest rates and volatility in markets that have not been active.

The Corporation continues to evaluate the portfolio for OTTI on an ongoing basis. In 2014, the Corporation sold all but one of its trust preferred securities, which resulted in gains of \$1.9 million. These securities had previous OTTI of \$9.4 million. The one remaining trust preferred security has no remaining book value as a result of OTTI of approximately \$500,000 taken in 2009.

The amortized cost, gross unrealized gains, gross unrealized losses and approximate market value of the investment securities at the dates indicated were:

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2014				
U.S. Government-sponsored agency securities	\$ 100	\$9		\$ 109
State and municipal	216,915	11,801	\$123	228,593
U.S. Government-sponsored mortgage-backed securities	310,460	8,771	127	319,104
Corporate obligations	31			31
Equity securities	1,706			1,706
Total available for sale	529,212	20,581	250	549,543
Held to maturity at December 31, 2014				
State and municipal	204,443	5,716	96	210,063
U.S. Government-sponsored mortgage-backed securities	426,645	11,527	512	437,660
Total held to maturity	631,088	17,243	608	647,723
Total Investment Securities	\$ 1,160,300	\$37,824	\$ 858	\$ 1,197,266
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2013				
U.S. Treasury	\$ 15,914	\$80	\$21	\$ 15,973
U.S. Government-sponsored agency securities	3,550	12	17	3,545
State and municipal	231,005	3,878	3,896	230,987
U.S. Government-sponsored mortgage-backed securities	279,299	3,926		