

FIRST MERCHANTS CORP  
Form 10-Q  
November 09, 2011

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FORM 10-Q  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

For the quarterly period ended September 30, 2011

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<br>(State or other jurisdiction of<br>incorporation or organization) | 35-1544218<br>(I.R.S. Employer<br>Identification No.) |
|------------------------------------------------------------------------------|-------------------------------------------------------|

|                                                                                 |                          |
|---------------------------------------------------------------------------------|--------------------------|
| 200 East Jackson Street, Muncie, IN<br>(Address of principal executive offices) | 47305-2814<br>(Zip code) |
|---------------------------------------------------------------------------------|--------------------------|

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

Not Applicable  
(Former name, former address and former fiscal year,  
if changed since last report)

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 web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section

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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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer  (Do not check if smaller reporting company) Smaller reporting company

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

As of October 31, 2011, there were 28,539,514 outstanding common shares of the registrant.

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS  
CONSOLIDATED CONDENSED BALANCE SHEETS  
(Dollars in thousands)

|                                                                  | September<br>30,<br>2011 | December<br>31,<br>2010 |
|------------------------------------------------------------------|--------------------------|-------------------------|
|                                                                  | (Unaudited)              |                         |
| <b>ASSETS</b>                                                    |                          |                         |
| Cash and due from banks                                          | \$ 60,166                | \$ 50,844               |
| Federal funds sold                                               |                          | 7,463                   |
| Cash and cash equivalents                                        | 60,166                   | 58,307                  |
| Interest-bearing time deposits                                   | 16,115                   | 65,216                  |
| Investment securities available for sale                         | 496,608                  | 539,370                 |
| Investment securities held to maturity                           | 441,220                  | 287,427                 |
| Mortgage loans held for sale                                     | 12,257                   | 21,469                  |
| Loans, net of allowance for loan losses of \$73,074 and \$82,977 | 2,639,864                | 2,752,706               |
| Premises and equipment                                           | 51,432                   | 52,450                  |
| Federal Reserve and Federal Home Loan Bank stock                 | 31,381                   | 33,884                  |
| Interest receivable                                              | 17,770                   | 18,674                  |
| Core deposit intangibles                                         | 9,705                    | 12,662                  |
| Goodwill                                                         | 141,357                  | 141,357                 |
| Cash surrender value of life insurance                           | 123,524                  | 96,731                  |
| Other real estate owned                                          | 19,425                   | 20,927                  |
| Tax asset, deferred and receivable                               | 35,804                   | 45,623                  |
| Other assets                                                     | 21,881                   | 24,045                  |
| <b>TOTAL ASSETS</b>                                              | <b>\$ 4,118,509</b>      | <b>\$ 4,170,848</b>     |
| <b>LIABILITIES</b>                                               |                          |                         |
| Deposits:                                                        |                          |                         |
| Noninterest-bearing                                              | \$ 598,139               | \$ 583,696              |
| Interest-bearing                                                 | 2,466,111                | 2,685,184               |
| <b>Total Deposits</b>                                            | <b>3,064,250</b>         | <b>3,268,880</b>        |
| Borrowings:                                                      |                          |                         |
| Federal funds purchased                                          | 27,946                   |                         |
| Securities sold under repurchase agreements                      | 117,097                  | 109,871                 |
| Federal Home Loan Bank advances                                  | 168,764                  | 82,684                  |
| Subordinated debentures, revolving credit lines and term loans   | 194,961                  | 226,440                 |
| <b>Total Borrowings</b>                                          | <b>508,768</b>           | <b>418,995</b>          |
| Interest payable                                                 | 2,186                    | 4,262                   |
| Other liabilities                                                | 30,760                   | 24,303                  |
| <b>Total Liabilities</b>                                         | <b>3,605,964</b>         | <b>3,716,440</b>        |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES</b>                    |                          |                         |
| <b>STOCKHOLDERS' EQUITY</b>                                      |                          |                         |
| Preferred Stock, no-par value:                                   |                          |                         |
| Authorized -- 500,000 shares                                     |                          |                         |

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|                                                                           |              |              |  |
|---------------------------------------------------------------------------|--------------|--------------|--|
| Series A, Issued and outstanding - 0 and 69,600 shares                    |              | 67,880       |  |
| Preferred Stock, no-par value, \$1,000 liquidation value:                 |              |              |  |
| Authorized -- 500,000 shares                                              |              |              |  |
| Senior Non-Cumulative Perpetual Preferred Stock, Series B                 |              |              |  |
| Issued and outstanding - 90,782.94 and 0 shares                           | 90,783       |              |  |
| Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value: |              |              |  |
| Authorized -- 600 shares                                                  |              |              |  |
| Issued and outstanding -- 125 shares                                      | 125          | 125          |  |
| Common Stock, \$.125 stated value:                                        |              |              |  |
| Authorized -- 50,000,000 shares                                           |              |              |  |
| Issued and outstanding - 28,538,164 and 25,574,251 shares                 | 3,567        | 3,197        |  |
| Additional paid-in capital                                                | 254,801      | 232,503      |  |
| Retained earnings                                                         | 162,669      | 160,860      |  |
| Accumulated other comprehensive income (loss)                             | 600          | (10,157)     |  |
| Total Stockholders' Equity                                                | 512,545      | 454,408      |  |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY                                | \$ 4,118,509 | \$ 4,170,848 |  |

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF INCOME  
(Dollars in thousands, except per share amounts)  
(Unaudited)

|                                                                       | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|-----------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                                                                       | 2011                                | 2010      | 2011                               | 2010       |
| <b>INTEREST INCOME</b>                                                |                                     |           |                                    |            |
| Loans receivable:                                                     |                                     |           |                                    |            |
| Taxable                                                               | \$ 37,024                           | \$ 43,148 | \$ 113,219                         | \$ 132,573 |
| Tax exempt                                                            | 86                                  | 236       | 435                                | 765        |
| Investment securities:                                                |                                     |           |                                    |            |
| Taxable                                                               | 5,078                               | 3,100     | 14,665                             | 9,277      |
| Tax exempt                                                            | 2,529                               | 2,610     | 7,617                              | 7,804      |
| Federal funds sold                                                    |                                     | 3         | 3                                  | 23         |
| Deposits with financial institutions                                  | 45                                  | 84        | 228                                | 239        |
| Federal Reserve and Federal Home Loan Bank stock                      | 323                                 | 250       | 1,005                              | 940        |
| Total Interest Income                                                 | 45,085                              | 49,431    | 137,172                            | 151,621    |
| <b>INTEREST EXPENSE</b>                                               |                                     |           |                                    |            |
| Deposits                                                              | 5,046                               | 9,434     | 17,776                             | 31,449     |
| Federal funds purchased                                               | 16                                  | 1         | 22                                 | 5          |
| Securities sold under repurchase agreements                           | 384                                 | 401       | 1,148                              | 1,329      |
| Federal Home Loan Bank advances                                       | 1,089                               | 1,218     | 3,067                              | 4,222      |
| Subordinated debentures, revolving credit lines and term loans        | 2,699                               | 2,695     | 7,984                              | 6,540      |
| Total Interest Expense                                                | 9,234                               | 13,749    | 29,997                             | 43,545     |
| NET INTEREST INCOME                                                   | 35,851                              | 35,682    | 107,175                            | 108,076    |
| Provision for loan losses                                             | 5,556                               | 10,521    | 16,775                             | 39,405     |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES                   | 30,295                              | 25,161    | 90,400                             | 68,671     |
| <b>OTHER INCOME</b>                                                   |                                     |           |                                    |            |
| Service charges on deposit accounts                                   | 3,169                               | 3,404     | 8,945                              | 10,172     |
| Fiduciary activities                                                  | 1,881                               | 1,773     | 5,846                              | 5,811      |
| Other customer fees                                                   | 2,583                               | 2,080     | 7,452                              | 6,773      |
| Commission income                                                     | 1,528                               | 1,482     | 4,440                              | 4,958      |
| Earnings on cash surrender value of life insurance                    | 644                                 | 540       | 1,793                              | 1,574      |
| Net gains and fees on sales of loans                                  | 1,768                               | 2,088     | 4,671                              | 4,422      |
| Net realized gains on sales of available for sale securities          | 861                                 | 2         | 2,149                              | 2,101      |
| Other-than-temporary impairment on available for sale securities      |                                     | (1,085)   | (2,780)                            | (2,849)    |
| Portion of loss recognized in other comprehensive income before taxes |                                     | 429       | 2,380                              | 1,305      |
| Net impairment losses recognized in earnings                          |                                     | (656)     | (400)                              | (1,544)    |
| Other income                                                          | 796                                 | 332       | 1,253                              | 684        |
| Total Other Income                                                    | 13,230                              | 11,045    | 36,149                             | 34,951     |
| <b>OTHER EXPENSES</b>                                                 |                                     |           |                                    |            |

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|                                                              |            |         |          |          |
|--------------------------------------------------------------|------------|---------|----------|----------|
| Salaries and employee benefits                               | 19,964     | 18,094  | 55,700   | 53,598   |
| Net occupancy                                                | 2,530      | 2,574   | 7,690    | 7,483    |
| Equipment                                                    | 1,662      | 1,797   | 5,122    | 5,511    |
| Marketing                                                    | 534        | 519     | 1,352    | 1,443    |
| Outside data processing fees                                 | 1,391      | 1,348   | 4,294    | 3,939    |
| Printing and office supplies                                 | 301        | 303     | 902      | 942      |
| Core deposit amortization                                    | 755        | 1,161   | 2,957    | 3,560    |
| FDIC assessments                                             | 1,201      | 2,112   | 4,756    | 6,077    |
| Other real estate owned and credit-related expenses          | 2,007      | 2,991   | 8,045    | 7,179    |
| Other expenses                                               | 3,877      | 4,236   | 11,684   | 14,386   |
| Total Other Expenses                                         | 34,222     | 35,135  | 102,502  | 104,118  |
| INCOME (LOSS) BEFORE INCOME TAX                              | 9,303      | 1,071   | 24,047   | (496)    |
| Income tax expense (benefit)                                 | 2,561      | (564)   | 6,356    | (3,374)  |
| NET INCOME                                                   | 6,742      | 1,635   | 17,691   | 2,878    |
| Gain on exchange of preferred stock for trust preferred debt |            |         |          | 11,353   |
| Loss on retirement of CPP preferred stock                    | (1,401)    |         | (1,401)  | (1,301)  |
| Loss on extinguishment of trust preferred securities         | (10,857)   |         | (10,857) |          |
| Preferred stock dividends and discount accretion             | (868)      | (870)   | (2,846)  | (3,763)  |
| NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS           | \$ (6,384) | \$ 765  | \$ 2,587 | \$ 9,167 |
| Per Share Data:                                              |            |         |          |          |
| Basic Net Income (Loss) Available to Common Stockholders     | \$ (0.25)  | \$ 0.02 | \$ 0.10  | \$ 0.38  |
| Diluted Net Income (Loss) Available to Common Stockholders   | \$ (0.25)  | \$ 0.02 | \$ 0.10  | \$ 0.38  |
| Cash Dividends Paid                                          | \$ 0.01    | \$ 0.01 | \$ 0.03  | \$ 0.03  |
| Average Diluted Shares Outstanding (in thousands)            | 26,367     | 25,686  | 26,019   | 24,273   |

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(Dollars in thousands)  
(Unaudited)

|                                                                                                                                                                                     | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                                                                                                                                                                     | 2011                                | 2010     | 2011                               | 2010      |
| Net income                                                                                                                                                                          | \$ 6,742                            | \$ 1,635 | \$ 17,691                          | \$ 2,878  |
| Other comprehensive income net of tax:                                                                                                                                              |                                     |          |                                    |           |
| Unrealized holding gain on securities available for sale arising during the period, net of income tax of \$(4,553), \$(2,204), \$(8,212) and \$(6,096)                              | 8,457                               | 4,094    | 15,255                             | 11,321    |
| Unrealized loss on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of \$0, \$155, \$831 and \$470 |                                     | (287)    | (1,546)                            | (872)     |
| Unrealized loss on cash flow hedges: Unrealized loss arising during the period, net of income tax of \$778 \$0, \$949 and \$0                                                       | (1,446)                             |          | (1,762)                            |           |
| Amortization of items previously recorded in accumulated other comprehensive income/(losses), net of income tax of \$10, \$(15), \$29 and \$(45)                                    | (18)                                | 23       | (53)                               | 68        |
| Reclassification adjustment for gains included in net income net of income tax expense of \$301, \$(229), \$612 and \$195                                                           | (560)                               | 425      | (1,137)                            | (362)     |
|                                                                                                                                                                                     | 6,433                               | 4,255    | 10,757                             | 10,155    |
| Comprehensive income                                                                                                                                                                | \$ 13,175                           | \$ 5,890 | \$ 28,448                          | \$ 13,033 |

The components of accumulated other comprehensive loss, net of tax, included in stockholders' equity, are as follows:

|                                                                                                                                              | September<br>30, 2011 | December<br>31, 2010 |
|----------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| Net unrealized gain on securities available for sale                                                                                         | \$ 15,921             | \$ 2,767             |
| Net unrealized loss on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in income | (1,584)               | (1,001)              |
| Net unrealized loss on cash flow hedges                                                                                                      | (1,474)               | 288                  |
| Defined benefit plans                                                                                                                        | (12,263)              | (12,211)             |
|                                                                                                                                              | \$ 600                | \$ (10,157)          |



See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY  
(Dollars in thousands, except per share data)  
(Unaudited)

|                                                                  | Preferred |           | Common Stock |          | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total      |
|------------------------------------------------------------------|-----------|-----------|--------------|----------|----------------------------------|----------------------|-------------------------------------------------|------------|
|                                                                  | Shares    | Amount    | Shares       | Amount   |                                  |                      | (Loss)                                          |            |
| Balances, December 31, 2010                                      | 69,725    | \$ 68,005 | 25,574,251   | \$ 3,197 | \$ 232,503                       | \$ 160,860           | \$ (10,157)                                     | \$ 454,408 |
| Comprehensive Income                                             |           |           |              |          |                                  |                      |                                                 |            |
| Net Income                                                       |           |           |              |          |                                  | 17,691               |                                                 | 17,691     |
| Other Comprehensive Income, net of tax                           |           |           |              |          |                                  |                      | 10,757                                          | 10,757     |
| Cash Dividends on Common Stock (\$0.03 per Share)                |           |           |              |          |                                  | (778)                |                                                 | (778)      |
| Cash Dividends on Preferred Stock under Capital Purchase Program |           |           |              |          |                                  | (2,527)              |                                                 | (2,527)    |
| Accretion of Discount on Preferred Stock                         |           | 319       |              |          |                                  | (319)                |                                                 | -          |
| Loss on Retirement of CPP Preferred Stock                        |           | 1,401     |              |          |                                  | (1,401)              |                                                 | -          |
| Loss on Early Extinguishment of Trust Preferred Securities       |           |           |              |          |                                  | (10,857)             |                                                 | (10,857)   |
| Preferred Stock Redeemed under Capital Purchase Program          | (69,600)  | (69,600)  |              |          |                                  |                      |                                                 | (69,600)   |
| Preferred Stock issued under Small Business Lending Fund         | 90,783    | 90,783    |              |          |                                  |                      |                                                 | 90,783     |
| Private Stock Issuance                                           |           |           | 2,822,000    | 353      | 20,812                           |                      |                                                 | 21,165     |
| Share-based Compensation                                         |           |           | 70,543       | 9        | 1,000                            |                      |                                                 | 1,009      |

|                                                                  |        |           |            |          |            |            |    |     |            |
|------------------------------------------------------------------|--------|-----------|------------|----------|------------|------------|----|-----|------------|
| Stock Issued Under Employee Benefit Plans                        |        |           | 78,102     | 10       | 551        |            |    |     | 561        |
| Stock Issued Under Dividend Reinvestment and Stock Purchase Plan |        |           | 7,506      | 1        | 59         |            |    |     | 60         |
| Stock Redeemed                                                   |        |           | (14,238)   | (3)      | (124)      |            |    |     | (127)      |
| Balances, September 30, 2011                                     | 90,908 | \$ 90,908 | 28,538,164 | \$ 3,567 | \$ 254,801 | \$ 162,669 | \$ | 600 | \$ 512,545 |

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)  
(Unaudited)

|                                                                                          | September 30, |             |
|------------------------------------------------------------------------------------------|---------------|-------------|
|                                                                                          | 2011          | 2010        |
| <b>Cash Flow From Operating Activities:</b>                                              |               |             |
| Net income                                                                               | \$ 17,691     | \$ 2,878    |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |               |             |
| Provision for loan losses                                                                | 16,775        | 39,405      |
| Depreciation and amortization                                                            | 3,998         | 4,289       |
| Share-based compensation                                                                 | 1,009         | 1,369       |
| Tax expense from stock compensation                                                      |               | 48          |
| Mortgage loans originated for sale                                                       | (185,658)     | (163,235)   |
| Proceeds from sales of mortgage loans                                                    | 194,870       | 155,881     |
| Gains on sales of securities available for sale                                          | (2,149)       | (2,101)     |
| Recognized loss on other-than-temporary-impairment                                       | 400           | 1,544       |
| Change in interest receivable                                                            | 904           | 508         |
| Change in interest payable                                                               | (2,076)       | (1,700)     |
| Other adjustments                                                                        | 21,382        | 21,532      |
| Net cash provided by operating activities                                                | \$ 67,146     | \$ 60,418   |
| <b>Cash Flows from Investing Activities:</b>                                             |               |             |
| Net change in interest-bearing deposits                                                  | \$ 49,101     | \$ (40,376) |
| <b>Purchases of:</b>                                                                     |               |             |
| Securities available for sale                                                            | (133,526)     | (201,560)   |
| Securities held to maturity                                                              | (77,678)      | (58,076)    |
| Proceeds from sales of securities available for sale                                     | 54,606        | 64,314      |
| <b>Proceeds from maturities of:</b>                                                      |               |             |
| Securities available for sale                                                            | 37,894        | 50,929      |
| Securities held to maturity                                                              | 28,120        | 22,191      |
| Proceeds from redemptions of Federal Reserve and Federal Home Loan Bank stock            | 2,503         | 2,305       |
| Purchase of bank owned life insurance                                                    | (25,000)      |             |
| Net change in loans                                                                      | 73,520        | 285,024     |
| Proceeds from the sale of other real estate owned                                        | 9,916         | 14,080      |
| Other adjustments                                                                        | 6,921         | (1,259)     |
| Net cash provided by investing activities                                                | \$ 26,377     | \$ 137,572  |
| <b>Cash Flows from Financing Activities:</b>                                             |               |             |
| <b>Net change in :</b>                                                                   |               |             |
| Demand and savings deposits                                                              | \$ (54,157)   | \$ 8,273    |
| Certificates of deposit and other time deposits                                          | (150,473)     | (290,458)   |
| Borrowings                                                                               | 242,323       | 2,154       |
| Repayment of borrowings                                                                  | (168,894)     | (55,303)    |
| Cash dividends on common stock                                                           | (778)         | (731)       |
| Cash dividends on preferred stock                                                        | (2,527)       | (4,495)     |
| Stock issued in private equity placement                                                 | 21,165        | 24,150      |
| Stock issued under dividend reinvestment and stock purchase plans                        | 621           | 526         |

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|                                                           |             |              |
|-----------------------------------------------------------|-------------|--------------|
| Stock redeemed                                            | (127)       | (77)         |
| Cumulative preferred stock issued (SBLF)                  | 90,783      |              |
| Cumulative preferred stock redeemed (CPP)                 | (69,600)    |              |
| Tax (expense) benefit from stock options exercised        |             | (48)         |
| Net cash used in financing activities                     | \$ (91,664) | \$ (316,009) |
| Net Change in Cash and Cash Equivalents                   | 1,859       | (118,019)    |
| Cash and Cash Equivalents, January 1                      | 58,307      | 179,147      |
| Cash and Cash Equivalents, September 30                   | \$ 60,166   | \$ 61,128    |
| Additional cash flow information:                         |             |              |
| Interest paid                                             | \$ 32,073   | \$ 45,245    |
| Income tax refunded                                       | \$ (2,977)  | \$ (6,035)   |
| Exchange of preferred stock for trust preferred debt      | \$          | \$ 46,400    |
| Loans transferred to other real estate owned              | \$ 12,646   | \$ 23,524    |
| Non-cash investing activities using trade date accounting | \$ (2,298)  | \$ 1,305     |

See notes to consolidated condensed financial statements.

FIRST MERCHANTS CORPORATION  
FORM 10Q

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

NOTE 1. General

Financial Statement Preparation

The significant accounting policies followed by First Merchants Corporation (the "Corporation") and its wholly owned subsidiaries for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments, which are of a normal recurring nature and are in the opinion of management necessary for a fair statement of the results for the periods reported, have been included in the accompanying consolidated condensed financial statements.

The consolidated condensed balance sheet of the Corporation as of December 31, 2010, has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation's annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation's Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the nine months ended September 30, 2011, are not necessarily indicative of the results to be expected for the year.

NOTE 2. Investment Securities

The amortized cost and approximate fair values of securities are as follows:

|                                                 | Amortized<br>Cost | Gross Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value        |
|-------------------------------------------------|-------------------|---------------------------|-------------------------------|-------------------|
| <b>Available for sale at September 30, 2011</b> |                   |                           |                               |                   |
| U.S. Government-sponsored agency securities     | \$ 100            | \$ 17                     |                               | \$ 117            |
| State and municipal                             | 133,273           | 6,729                     | \$ 2                          | 140,000           |
| Mortgage-backed securities                      | 342,083           | 12,415                    | 33                            | 354,465           |
| Corporate obligations                           | 5,675             |                           | 5,479                         | 196               |
| Equity securities                               | 1,830             |                           |                               | 1,830             |
| <b>Total available for sale</b>                 | <b>482,961</b>    | <b>19,161</b>             | <b>5,514</b>                  | <b>496,608</b>    |
| <b>Held to maturity at September 30, 2011</b>   |                   |                           |                               |                   |
| State and municipal                             | 117,346           | 113                       | 111                           | 117,348           |
| Mortgage-backed securities                      | 323,874           | 11,726                    |                               | 335,600           |
| <b>Total held to maturity</b>                   | <b>441,220</b>    | <b>11,839</b>             | <b>111</b>                    | <b>452,948</b>    |
| <b>Total Investment Securities</b>              | <b>\$ 924,181</b> | <b>\$ 31,000</b>          | <b>\$ 5,625</b>               | <b>\$ 949,556</b> |

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|                                             | Amortized<br>Cost | Gross Unrealized<br>Gains | Gross Unrealized<br>Losses | Fair Value |
|---------------------------------------------|-------------------|---------------------------|----------------------------|------------|
| Available for sale at December 31, 2010     |                   |                           |                            |            |
| U.S. Government-sponsored agency securities | \$ 600            | \$ 16                     |                            | \$ 616     |
| State and municipal                         | 233,622           | 7,108                     | \$ 740                     | 239,990    |
| Mortgage-backed securities                  | 293,311           | 4,293                     | 2,287                      | 295,317    |
| Corporate obligations                       | 5,856             |                           | 5,674                      | 182        |
| Equity securities                           | 3,265             |                           |                            | 3,265      |
| Total available for sale                    | 536,654           | 11,417                    | 8,701                      | 539,370    |
| Held to maturity at December 31, 2010       |                   |                           |                            |            |
| State and municipal                         | 10,070            | 389                       | 5                          | 10,454     |
| Mortgage-backed securities                  | 277,357           | 2,064                     | 3,605                      | 275,816    |
| Total held to maturity                      | 287,427           | 2,453                     | 3,610                      | 286,270    |
| Total Investment Securities                 | \$ 824,081        | \$ 13,870                 | \$ 12,311                  | \$ 825,640 |

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
(Unaudited)

## NOTE 2. Investment Securities continued

In August of 2011, the Corporation transferred selected state and municipal securities from available for sale to held to maturity. The cost basis of the securities was \$97.3 million prior to the transfer and was increased by the \$8.5 million in unrealized gains to \$105.8 million.

The amortized cost and fair value of available for sale securities and held to maturity securities at September 30, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                              | Available for Sale |                   | Held to Maturity  |                   |
|----------------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                              | Amortized Cost     | Fair Value        | Amortized Cost    | Fair Value        |
| Maturity Distribution at September 30, 2011: |                    |                   |                   |                   |
| Due in one year or less                      | \$ 3,225           | \$ 3,242          | \$ 2,010          | \$ 2,010          |
| Due after one through five years             | 13,929             | 14,327            | 1,435             | 1,444             |
| Due after five through ten years             | 26,874             | 28,345            | 37,177            | 37,041            |
| Due after ten years                          | 95,020             | 94,399            | 76,724            | 76,853            |
|                                              | \$ 139,048         | \$ 140,313        | \$ 117,346        | \$ 117,348        |
| Mortgage-backed securities                   | 342,083            | 354,465           | 323,874           | 335,600           |
| Equity securities                            | 1,830              | 1,830             |                   |                   |
| <b>Total Investment Securities</b>           | <b>\$ 482,961</b>  | <b>\$ 496,608</b> | <b>\$ 441,220</b> | <b>\$ 452,948</b> |

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was \$272,560,000 at September 30, 2011, and \$271,091,000 at December 31, 2010.

The book value of securities sold under agreements to repurchase amounted to \$90,171,000 at September 30, 2011, and \$84,965,000 at December 31, 2010.

For the three and nine months ended September 30, 2011, gross gains of \$861,000 and \$2,149,000 were realized from sales and redemptions of available for sale securities. For the three and nine months ended September 30, 2010, gross gains of \$2,000 and \$2,326,000 were realized from sales and redemptions of available for sale securities. There were no gross losses resulting from sales and redemptions of available for sale securities realized for the three and nine months ended September 30, 2011, and 2010. The Corporation did not recognize an other-than-temporary impairment ("OTTI") loss in the three months ended September 30, 2011, but did recognize a loss of \$656,000 in the three months ended September 30, 2010, equal to the credit loss, establishing a new, lower amortized cost basis. The Corporation has recognized OTTI losses of \$400,000 and \$1,544,000 in the nine months ended September 30, 2011, and 2010, equal to the credit loss, establishing a new, lower amortized cost basis.



Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. The historical cost of these investments totaled \$12,423,000 and \$273,853,000 at September 30, 2011, and December 31, 2010, respectively. Total fair value of these investments at September 30, 2011, and December 31, 2010, was \$6,909,000 and \$261,542,000, which is approximately 0.7 percent and 31.6 percent of the Corporation's available for sale and held to maturity investment portfolio at September 30, 2011, and December 31, 2010.

Except as discussed below, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the OTTI is identified.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

NOTE 2. Investment Securities continued

The following table shows the Corporation's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011, and December 31, 2010:

|                                                                         | Less than 12 Months |                         | 12 Months or Longer |                         | Total           |                         |
|-------------------------------------------------------------------------|---------------------|-------------------------|---------------------|-------------------------|-----------------|-------------------------|
|                                                                         | Fair Value          | Gross Unrealized Losses | Fair Value          | Gross Unrealized Losses | Fair Value      | Gross Unrealized Losses |
| <b>Temporarily Impaired Investment Securities at September 30, 2011</b> |                     |                         |                     |                         |                 |                         |
| State and municipal                                                     | \$ 1,548            | \$ (2)                  |                     |                         | \$ 1,548        | \$ (2)                  |
| Mortgage-backed securities                                              | 5,196               | (33)                    |                     |                         | 5,196           | (33)                    |
| Corporate obligations                                                   |                     |                         | \$ 165              | \$ (5,479)              | 165             | (5,479)                 |
| <b>Total Temporarily Impaired Investment Securities</b>                 | <b>\$ 6,744</b>     | <b>\$ (35)</b>          | <b>\$ 165</b>       | <b>\$ (5,479)</b>       | <b>\$ 6,909</b> | <b>\$ (5,514)</b>       |

|                                                                        | Less than 12 Months |                         | 12 Months or Longer |                         | Total             |                         |
|------------------------------------------------------------------------|---------------------|-------------------------|---------------------|-------------------------|-------------------|-------------------------|
|                                                                        | Fair Value          | Gross Unrealized Losses | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses |
| <b>Temporarily Impaired Investment Securities at December 31, 2010</b> |                     |                         |                     |                         |                   |                         |
| State and municipal                                                    | \$ 31,796           | \$ (745)                |                     |                         | \$ 31,796         | \$ (745)                |
| Mortgage-backed securities                                             | 229,441             | (5,892)                 | \$ 154              |                         | 229,595           | (5,892)                 |
| Corporate obligations                                                  |                     |                         | 151                 | \$ (5,674)              | 151               | (5,674)                 |
| <b>Total Temporarily Impaired Investment Securities</b>                | <b>\$ 261,237</b>   | <b>\$ (6,637)</b>       | <b>\$ 305</b>       | <b>\$ (5,674)</b>       | <b>\$ 261,542</b> | <b>\$ (12,311)</b>      |

**Mortgage-backed Securities**

The unrealized losses of \$33,000 on the Corporation's investment in mortgage-backed securities were a result of changes in interest rates. The Corporation expects to recover the amortized cost basis over the term of the securities as the decline in market value is attributable to changes in interest rates and not credit quality. The Corporation does

not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at September 30, 2011.

#### State and Political Subdivisions

The unrealized losses of \$2,000 on the Corporation's investments in securities of state and political subdivisions were caused by changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at September 30, 2011.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
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## NOTE 2. Investment Securities continued

## Corporate Obligations

The Corporation's unrealized losses on Corporate Obligations, primarily pooled trust preferred securities, total \$5.5 million on a book value of \$5.7 million at September 30, 2011. All of the decline in value is related to the pooled trust preferred securities and is attributable to temporary illiquidity and the financial crisis affecting these markets coupled with the potential credit loss resulting from the adverse change in expected cash flows. Due to the illiquidity in the market, it is unlikely that the Corporation would be able to recover its investment in these securities if the Corporation sold the securities at this time. Management has analyzed the cash flow characteristics of the securities and this analysis included utilizing the most recent trustee reports and any other relevant market information including announcements of deferrals or defaults of trust preferred securities. The Corporation did not recognize an OTTI loss in the three months ended September 30, 2011. The Corporation did recognize an OTTI loss of \$400,000 in the nine months ended September 30, 2011, equal to the credit loss, establishing a new, lower amortized cost basis. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the remainder of the investment securities, which are classified as Level 3 inputs in the fair value hierarchy, to be other-than-temporarily impaired at September 30, 2011.

## Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses and other market factors. The following table provides information about debt securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income.

|                                                                            | Accumulated<br>Credit Losses in<br>2011 | Accumulated<br>Credit Losses in<br>2010 |
|----------------------------------------------------------------------------|-----------------------------------------|-----------------------------------------|
| Credit losses on debt securities held:                                     |                                         |                                         |
| Balance, January 1                                                         | \$ 10,955                               | \$ 9,411                                |
| Additions related to other-than-temporary losses not previously recognized | 400                                     | 1,544                                   |
| Balance, September 30                                                      | \$ 11,355                               | \$ 10,955                               |

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(Table dollars in thousands)

(Unaudited)

NOTE 3. Loans and Allowance

The Corporation's primary lending focus is small business and middle market commercial and residential real estate, auto and small consumer lending, which results in portfolio diversification. The following tables show the composition in the loan portfolio, loan grades and the allowance for loan losses excluding loans held for sale. Residential real estate loans held for sale at September 30, 2011, and December 31, 2010, were \$12,257,000 and \$21,469,000, respectively.

The following table shows the composition of the corporation's loan portfolio by loan class for the periods indicated:

|                                                                  | September<br>30,<br>2011 | December<br>31,<br>2010 |
|------------------------------------------------------------------|--------------------------|-------------------------|
| <b>Loans:</b>                                                    |                          |                         |
| Commercial and industrial loans                                  | \$ 518,848               | \$ 530,322              |
| Agricultural production financing and other loans to farmers     | 106,761                  | 95,516                  |
| <b>Real estate loans:</b>                                        |                          |                         |
| Construction                                                     | 70,044                   | 106,615                 |
| Commercial and farm land                                         | 1,196,270                | 1,229,037               |
| Residential                                                      | 495,954                  | 522,051                 |
| Home Equity                                                      | 196,191                  | 201,969                 |
| Individual's loans for household and other personal expenditures | 90,810                   | 115,295                 |
| Lease financing receivables, net of unearned income              | 4,160                    | 5,157                   |
| Other loans                                                      | 33,900                   | 29,721                  |
|                                                                  | 2,712,938                | 2,835,683               |
| Allowance for loan losses                                        | (73,074)                 | (82,977)                |
| <b>Total Loans</b>                                               | <b>\$ 2,639,864</b>      | <b>\$ 2,752,706</b>     |

The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. The allowance is increased by the provision for loan losses and decreased by charge offs less recoveries. All charge offs are approved by the Bank's senior loan officers or loan committees, depending on the amount of the charge off, and are reported to the Bank's Board of Directors. The Bank charges off loans when a determination is made that all or a portion of a loan is uncollectible. The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings.

The amount provided for loan losses in a given period may be greater than or less than net loan losses, and is based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision amount in a given period is based on management's continuing review and evaluation of the loan portfolio, including an internally administered loan "watch" list and an independent loan review. The evaluation takes into consideration identified credit problems, the possibility of losses inherent in the loan portfolio that are not specifically identified and management's judgment as to the impact of current economic conditions on the portfolio.

Management believes that the allowance for loan losses is adequate to cover probable incurred losses inherent in the loan portfolio at September 30, 2011. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation's financial results. It requires management to make difficult, subjective and complex judgments, as estimates about the effect of uncertain matters are needed. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examination processes and will increase or decrease as deemed necessary to ensure the allowance for loan losses remains adequate. In addition, the allowance as a percentage of charge offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

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NOTE 3. Loans and Allowance continued

The historical loss allocation for loans not deemed impaired according to ASC 310 is the product of the volume of loans within the non-impaired criticized and non-criticized risk grade classifications, each segmented by call code, and the historical loss factor for each respective classification and call code segment. The historical loss factors are based upon actual loss experience within each risk and call code classification. The historical look back period for non-criticized loans looks to the most recent rolling-four-quarter average and aligns with the look up back period for non-impaired criticized loans. Each of the rolling four quarter periods used to obtain the average, include all charge offs for the previous twelve-month period, therefore the historical look back period includes seven quarters. The resulting allocation is reflective of current conditions. Criticized loans are grouped based on the risk grade assigned to the loan. Loans with a special mention grade are assigned a loss factor and loans with a classified grade but not impaired are assigned a separate loss factor. The loss factor computation for this allocation includes a segmented historical loss migration analysis of criticized risk grades to charge off.

In addition to the specific reserves and historical loss components of the allowance, consideration is given to various environmental factors to help ensure that losses inherent in the portfolio are reflected in the allowance for loan losses. The environmental component adjusts the historical loss allocations for commercial and consumer loans to reflect relevant current conditions that, in management's opinion, have an impact on loss recognition. Environmental factors that management reviews in the analysis include: national and local economic trends and conditions; trends in growth in the loan portfolio and growth in higher risk areas; levels of, and trends in, delinquencies and non-accruals; experience and depth of lending management and staff; adequacy of, and adherence to, lending policies and procedures including those for underwriting; industry concentrations of credit; and adequacy of risk identification systems and controls through the internal loan review and internal audit processes.

The risk characteristics of the Corporation's material portfolio segments are as follows:

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on

collateral and risk grade criteria. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

#### Residential and Consumer

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Corporation generally establishes a maximum loan-to-value ratio and requires PMI if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income and credit rating of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.



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## NOTE 3. Loans and Allowance continued

The following tables summarize changes in the allowance for loan losses by loan segment for the three and six months ended September 30, 2011:

|                              | Three Months Ended September 30, 2011 |                           |          |             |                   |           |
|------------------------------|---------------------------------------|---------------------------|----------|-------------|-------------------|-----------|
|                              | Commercial                            | Real Estate<br>Commercial | Consumer | Residential | Finance<br>Leases | Total     |
| Allowance for loan losses:   |                                       |                           |          |             |                   |           |
| Balances, July 1             | \$ 23,715                             | \$ 38,668                 | \$ 2,859 | \$ 11,877   | \$ 14             | \$ 77,133 |
| Provision for losses         | (903)                                 | 3,042                     | 281      | 3,142       | (6)               | 5,556     |
| Recoveries on loans          | 1,176                                 | 378                       | 163      | 237         | 1                 | 1,955     |
| Loans charged off            | (4,344)                               | (5,003)                   | (266)    | (1,957)     |                   | (11,570)  |
| Balances, September 30, 2011 | \$ 19,644                             | \$ 37,085                 | \$ 3,037 | \$ 13,299   | \$ 9              | \$ 73,074 |

|                              | Nine Months Ended September 30, 2011 |                           |          |             |                   |           |
|------------------------------|--------------------------------------|---------------------------|----------|-------------|-------------------|-----------|
|                              | Commercial                           | Real Estate<br>Commercial | Consumer | Residential | Finance<br>Leases | Total     |
| Allowance for loan losses:   |                                      |                           |          |             |                   |           |
| Balances, January 1          | \$ 32,508                            | \$ 36,341                 | \$ 3,622 | \$ 10,408   | \$ 98             | \$ 82,977 |
| Provision for losses         | (14,778)                             | 24,232                    | (187)    | 7,601       | (93)              | 16,775    |
| Recoveries on loans          | 8,174                                | 1,244                     | 781      | 934         | 4                 | 11,137    |
| Loans charged off            | (6,260)                              | (24,732)                  | (1,179)  | (5,644)     |                   | (37,815)  |
| Balances, September 30, 2011 | \$ 19,644                            | \$ 37,085                 | \$ 3,037 | \$ 13,299   | \$ 9              | \$ 73,074 |

The following tables summarize changes in the allowance for loan losses for the year ended December 31, 2010:

| 2010                       |           |
|----------------------------|-----------|
| Allowance for loan losses: |           |
| Balance, January 1         | \$ 92,131 |
| Provision for losses       | 46,483    |
| Recoveries on loans        | 11,935    |
| Loans charged off          | (67,572)  |
| Balance, December 31, 2010 | \$ 82,977 |



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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
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## NOTE 3. Loans and Allowance continued

The following table shows the Corporation's allowance for credit losses and loan portfolio by loan segment for the periods indicated:

|                                       | September 30, 2011 |                           |            |             |                   |  | Total        |
|---------------------------------------|--------------------|---------------------------|------------|-------------|-------------------|--|--------------|
|                                       | Commercial         | Commercial<br>Real Estate | Consumer   | Residential | Finance<br>Leases |  |              |
| <b>Allowance Balances:</b>            |                    |                           |            |             |                   |  |              |
| Individually evaluated for impairment | \$ 5,379           | \$ 2,305                  | \$         | \$ 493      | \$                |  | \$ 8,177     |
| Collectively evaluated for impairment | 14,265             | 34,780                    | 3,037      | 12,806      | 9                 |  | 64,897       |
| Total Allowance for Loan Losses       | \$ 19,644          | \$ 37,085                 | \$ 3,037   | \$ 13,299   | \$ 9              |  | \$ 73,074    |
| <b>Loan Balances:</b>                 |                    |                           |            |             |                   |  |              |
| Individually evaluated for impairment | \$ 21,899          | \$ 55,803                 | \$         | \$ 10,070   | \$                |  | \$ 87,772    |
| Collectively evaluated for impairment | 637,611            | 1,210,510                 | 90,810     | 682,075     | 4,160             |  | 2,625,166    |
| Total Loans                           | \$ 659,510         | \$ 1,266,313              | \$ 90,810  | \$ 692,145  | \$ 4,160          |  | \$ 2,712,938 |
|                                       | December 31, 2010  |                           |            |             |                   |  | Total        |
|                                       | Commercial         | Commercial<br>Real Estate | Consumer   | Residential | Finance<br>Leases |  |              |
| <b>Allowance Balances:</b>            |                    |                           |            |             |                   |  |              |
| Individually evaluated for impairment | \$ 5,726           | \$ 7,545                  | \$         | \$ 643      | \$                |  | \$ 13,914    |
| Collectively evaluated for impairment | 26,782             | 28,796                    | 3,622      | 9,765       | 98                |  | 69,063       |
| Total Allowance for Loan Losses       | \$ 32,508          | \$ 36,341                 | \$ 3,622   | \$ 10,408   | \$ 98             |  | \$ 82,977    |
| <b>Loan Balances:</b>                 |                    |                           |            |             |                   |  |              |
| Individually evaluated for impairment | \$ 28,965          | \$ 77,705                 | \$         | \$ 9,534    | \$                |  | \$ 116,204   |
| Collectively evaluated for impairment | 626,594            | 1,257,947                 | 115,295    | 714,486     | 5,157             |  | 2,719,479    |
| Total Loans                           | \$ 655,559         | \$ 1,335,652              | \$ 115,295 | \$ 724,020  | \$ 5,157          |  | \$ 2,835,683 |

Information on non-performing assets, including non-accruing, real estate owned and renegotiated loans, plus accruing loans contractually past due 90 days or more, is summarized below:

|                                          | September 30,<br>2011 | December 31,<br>2010 |
|------------------------------------------|-----------------------|----------------------|
| <b>Non-Performing Assets:</b>            |                       |                      |
| Non-accrual loans                        | \$ 78,933             | \$ 90,591            |
| Renegotiated loans                       | 6,701                 | 7,139                |
| Non-performing loans (NPL)               | 85,634                | 97,730               |
| Real estate owned and repossessed assets | 19,425                | 20,927               |
| Non-performing assets (NPA)              | 105,059               | 118,657              |
| 90+ days delinquent and still accruing   | 1,595                 | 1,330                |
| NPAs & 90+ days delinquent               | \$ 106,654            | \$ 119,987           |

Loans are reclassified to a non-accruing status when, in management's judgment, the collateral value and financial condition of the borrower do not justify accruing interest. Interest previously recorded, but not deemed collectible, is reversed and charged against current income. Payments subsequently received on nonaccrual loans are applied to principal. A loan is returned to accrual status when principal and interest are no longer past due and collectability is probable, typically after a minimum of six consecutive months of performance. Payments received on impaired accruing or delinquent loans are applied to interest income as accrued.

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## NOTE 3. Loans and Allowance continued

The following table summarizes the Corporation's non-accrual loans by loan class for the periods indicated:

## Non Accruals by Class

|                                                                 | September<br>30,<br>2011 | December<br>31,<br>2010 |
|-----------------------------------------------------------------|--------------------------|-------------------------|
| Commercial and Industrial                                       | \$ 13,725                | \$ 9,812                |
| Agriculture production financing and other loans                | 304                      | 544                     |
| Real Estate Loans:                                              |                          |                         |
| Construction                                                    | 8,353                    | 17,164                  |
| Commercial and farm land                                        | 39,209                   | 45,308                  |
| Residential                                                     | 14,640                   | 15,115                  |
| Home Equity                                                     | 2,066                    | 2,648                   |
| Individuals loans for household and other personal expenditures | 54                       |                         |
| Lease financing receivables, net of unearned income             |                          |                         |
| Other Loans                                                     | 582                      |                         |
| Total                                                           | \$ 78,933                | \$ 90,591               |

Impaired loans include all non-accrual loans and renegotiated loans as well as substandard, doubtful and loss grade loans that were still accruing but deemed impaired according to guidance set forth in ASC 310. Also included in impaired loans are accruing loans that are contractually past due 90 days or more. A loan is deemed impaired when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected.

Impaired loans are measured by the present value of expected future cash flows or the fair value of the collateral of the loans, if collateral dependent. The fair value for impaired loans is measured based on the value of the collateral securing those loans and is determined using several methods. The fair value of real estate is generally based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically valued by using the financial information such as financial statements and aging reports provided by the borrower and is discounted as considered appropriate.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
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## NOTE 3. Loans and Allowance continued

The following table shows the composition of the Corporation's impaired loans by loan class as of September 30, 2011, and December 31, 2010:

|                                                                        | September 30, 2011             |                        |                      | Three Months Ended<br>September 30, 2011 |                                  | Nine Months Ended<br>September 30, 2011 |                                  |
|------------------------------------------------------------------------|--------------------------------|------------------------|----------------------|------------------------------------------|----------------------------------|-----------------------------------------|----------------------------------|
|                                                                        | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment        | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment       | Interest<br>Income<br>Recognized |
| <b>Impaired loans with no related allowance:</b>                       |                                |                        |                      |                                          |                                  |                                         |                                  |
| Commercial and industrial                                              | \$ 27,338                      | \$ 13,328              | \$ 4,800             | \$ 16,080                                | \$ 80                            | \$ 17,536                               | \$ 255                           |
| Agriculture production financing and other loans to farmers            | 663                            | 304                    |                      | 304                                      |                                  | 362                                     |                                  |
| <b>Real Estate Loans:</b>                                              |                                |                        |                      |                                          |                                  |                                         |                                  |
| Construction                                                           | 14,045                         | 7,819                  | 90                   | 8,290                                    |                                  | 8,977                                   |                                  |
| Commercial and farm land                                               | 56,795                         | 37,079                 | 2,215                | 38,800                                   | 102                              | 41,646                                  | 438                              |
| Residential                                                            | 9,680                          | 6,545                  | 493                  | 6,982                                    | 6                                | 7,239                                   | 16                               |
| Home equity                                                            | 4,670                          | 1,317                  |                      | 1,422                                    | 4                                | 1,416                                   | 12                               |
| <b>Individuals loans for household and other personal expenditures</b> |                                |                        |                      |                                          |                                  |                                         |                                  |
| Lease financing receivables, net of unearned income                    |                                |                        |                      |                                          |                                  |                                         |                                  |
| Other loans                                                            | 90                             | 10                     | 579                  | 11                                       |                                  | 12                                      |                                  |
| <b>Total</b>                                                           | <b>\$ 113,281</b>              | <b>\$ 66,402</b>       | <b>\$ 8,177</b>      | <b>\$ 71,889</b>                         | <b>\$ 192</b>                    | <b>\$ 77,188</b>                        | <b>\$ 721</b>                    |
| <b>Impaired loans with related allowance:</b>                          |                                |                        |                      |                                          |                                  |                                         |                                  |
| Commercial and industrial                                              | \$ 7,932                       | \$ 7,686               | \$                   | \$ 8,745                                 | \$ 51                            | \$ 9,047                                | \$ 206                           |
| Agriculture production financing and other loans to farmers            |                                |                        |                      |                                          |                                  |                                         |                                  |

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|                                                                 |            |           |          |           |        |            |          |
|-----------------------------------------------------------------|------------|-----------|----------|-----------|--------|------------|----------|
| Real Estate Loans:                                              |            |           |          |           |        |            |          |
| Construction                                                    | 763        | 350       |          | 350       |        | 350        |          |
| Commercial and farm land                                        | 10,683     | 10,554    |          | 10,619    | 43     | 10,669     | 112      |
| Residential                                                     | 2,299      | 2,208     |          | 2,231     | 8      | 2,273      | 23       |
| Home equity                                                     |            |           |          |           |        |            |          |
| Individuals loans for household and other personal expenditures |            |           |          |           |        |            |          |
| Lease financing receivables, net of unearned income             |            |           |          |           |        |            |          |
| Other loans                                                     | 591        | 572       |          | 582       |        | 600        |          |
| Total                                                           | \$ 22,268  | \$ 21,370 | \$       | \$ 22,527 | \$ 102 | \$ 22,939  | \$ 341   |
| Total Impaired Loans                                            | \$ 135,549 | \$ 87,772 | \$ 8,177 | \$ 94,416 | \$ 294 | \$ 100,127 | \$ 1,062 |

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(Table dollars in thousands)  
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## NOTE 3. Loans and Allowance continued

|                                                                    | December 31, 2010              |                        |                      |
|--------------------------------------------------------------------|--------------------------------|------------------------|----------------------|
|                                                                    | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance |
| <b>Impaired loans with no related allowance:</b>                   |                                |                        |                      |
| Commercial and industrial                                          | \$ 30,006                      | \$ 16,572              |                      |
| Agriculture production financing and other<br>loans to farmers     | 966                            | 530                    |                      |
| <b>Real Estate Loans:</b>                                          |                                |                        |                      |
| Construction                                                       | 12,598                         | 9,150                  |                      |
| Commercial and farm land                                           | 64,064                         | 43,653                 |                      |
| Residential                                                        | 7,909                          | 5,153                  |                      |
| Home equity                                                        | 4,460                          | 1,245                  |                      |
| Individuals loans for household and other<br>personal expenditures |                                |                        |                      |
| Lease financing receivables, net of unearned<br>income             |                                |                        |                      |
| Other loans                                                        | 101                            | 14                     |                      |
| <b>Total</b>                                                       | <b>\$ 120,104</b>              | <b>\$ 76,317</b>       |                      |
| <b>Impaired loans with related allowance:</b>                      |                                |                        |                      |
| Commercial and industrial                                          | \$ 11,477                      | \$ 11,374              | \$ 5,250             |
| Agriculture production financing and other<br>loans to farmers     |                                |                        |                      |
| <b>Real Estate Loans:</b>                                          |                                |                        |                      |
| Construction                                                       | 9,353                          | 7,824                  | 2,049                |
| Commercial and farm land                                           | 17,984                         | 17,076                 | 5,496                |
| Residential                                                        | 2,740                          | 2,691                  | 465                  |
| Home equity                                                        | 458                            | 446                    | 178                  |
| Individuals loans for household and other<br>personal expenditures |                                |                        |                      |
| Lease financing receivables, net of unearned<br>income             |                                |                        |                      |
| Other loans                                                        | 476                            | 476                    | 476                  |
| <b>Total</b>                                                       | <b>\$ 42,488</b>               | <b>\$ 39,887</b>       | <b>\$ 13,914</b>     |
| <b>Total Impaired Loans</b>                                        | <b>\$ 162,592</b>              | <b>\$ 116,204</b>      | <b>\$ 13,914</b>     |



As part of the on-going monitoring of the credit quality of the Corporation's loan portfolio, management tracks certain credit quality indicators including trends related to: (i) the level of criticized commercial loans, (ii) net charge offs, (iii) non-performing loans and (iv) the general national and local economic conditions.

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NOTE 3. Loans and Allowance continued

The Corporation utilizes a risk grading of pass, special mention, substandard, doubtful and loss to assess the overall credit quality of large commercial loans. All large commercial credit grades are reviewed at a minimum of once a year for pass grade loans. Loans with grades below pass are reviewed more frequently depending on the grade. A description of the general characteristics of these grades is as follows:

- Pass – Loans that are considered to be of acceptable credit quality.
- Special Mention – Loans which possess some credit deficiency or potential weakness, which deserves close attention. A special mention asset has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Corporation’s credit position at some future date. Special mention assets are not adversely classified and do not expose the Corporation to sufficient risk to warrant adverse classification. Such loans pose an unwarranted financial risk that, if not corrected, could weaken the loan adversely impacting the future repayment ability of the borrower. The key distinctions of this category’s classification are that it is indicative of an unwarranted level of risk; and weaknesses are considered “potential”, not “defined”, impairments to the primary source of repayment. Examples include businesses that may be suffering from inadequate management, loss of key personnel or significant customer or litigation.
- Substandard – A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Other characteristics may include:
  - o the likelihood that a loan will be paid from the primary source of repayment is uncertain or financial deterioration is underway and very close attention is warranted to ensure that the loan is collected without loss,
  - o the primary source of repayment is gone, and the Corporation is forced to rely on a secondary source of repayment, such as collateral liquidation or guarantees,
    - o loans have a distinct possibility that the Corporation will sustain some loss if deficiencies are not corrected,
      - o unusual courses of action are needed to maintain a high probability of repayment,
  - o the borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments,
    - o the Corporation is forced into a subordinated or unsecured position due to flaws in documentation,
  - o loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms,
  - o the Corporation is seriously contemplating foreclosure or legal action due to the apparent deterioration of the loan, and
    - o there is significant deterioration in market conditions to which the borrower is highly vulnerable.
- Doubtful – Loans that have all of the weaknesses of those classified as Substandard. However, based on currently existing facts, conditions and values, these weaknesses make full collection of principal highly questionable and improbable. Other credit characteristics may include the primary source of repayment is gone or there is considerable doubt as to the quality of the secondary sources of repayment. The possibility of loss is high, but because of certain important pending factors that may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

- Loss – Loans that are considered uncollectible and of such little value that continuing to carry them as an asset is not warranted. Loans will be classified as Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
(Unaudited)

## NOTE 3. Loans and Allowance continued

The following table summarizes the credit quality of the Corporation's loan portfolio, by loan class for the periods indicated. Consumer Non-Performing loans include accruing consumer loans 90 plus days delinquent and consumer non-accrual loans. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified date.

September 30, 2011

|                                                                 | Commercial         |                    |                           |                        |                    | Consumer<br>Performing | Consumer<br>Non-Performing | Total Loans  |
|-----------------------------------------------------------------|--------------------|--------------------|---------------------------|------------------------|--------------------|------------------------|----------------------------|--------------|
|                                                                 | Commercial<br>Pass | Special<br>Mention | Commercial<br>Substandard | Commercial<br>Doubtful | Commercial<br>Loss |                        |                            |              |
| Commercial and industrial                                       | \$ 457,917         | \$ 24,741          | \$ 28,739                 | \$ 7,451               | \$                 | \$                     | \$                         | \$ 518,848   |
| Agriculture production financing and other loans                | 101,889            | 2,247              | 2,625                     |                        |                    |                        |                            | 106,761      |
| Real Estate Loans:                                              |                    |                    |                           |                        |                    |                        |                            |              |
| Construction                                                    | 43,285             | 8,875              | 16,745                    | 956                    |                    |                        | 183                        | 70,044       |
| Commercial and farm land                                        | 1,023,996          | 54,925             | 113,761                   | 3,550                  |                    |                        | 38                         | 1,196,270    |
| Residential                                                     | 142,211            | 8,952              | 18,144                    | 945                    |                    | 318,941                | 6,760                      | 495,953      |
| Home equity                                                     | 19,437             | 25                 | 4,128                     |                        |                    | 171,355                | 1,246                      | 196,191      |
| Individuals loans for household and other personal expenditures |                    |                    |                           |                        |                    | 90,752                 | 58                         | 90,810       |
| Lease financing receivables, net of unearned income             | 111                |                    | 9                         |                        |                    | 4,040                  |                            | 4,160        |
| Other loans                                                     | 33,214             | 15                 | 100                       | 572                    |                    |                        |                            | 33,901       |
| Total                                                           | \$ 1,822,060       | \$ 99,780          | \$ 184,251                | \$ 13,474              | \$                 | \$ 585,088             | \$ 8,285                   | \$ 2,712,938 |

December 31, 2010

|                           | Commercial         |                    |                           |                        |                    | Consumer<br>Performing | Consumer<br>Non-Performing | Total Loans |
|---------------------------|--------------------|--------------------|---------------------------|------------------------|--------------------|------------------------|----------------------------|-------------|
|                           | Commercial<br>Pass | Special<br>Mention | Commercial<br>Substandard | Commercial<br>Doubtful | Commercial<br>Loss |                        |                            |             |
| Commercial and industrial | \$ 454,305         | \$ 19,928          | \$ 53,199                 | \$ 2,870               | \$ 20              |                        |                            | \$ 530,322  |
| Agriculture production    | 92,293             | 574                | 2,649                     |                        |                    |                        |                            | 95,516      |

financing and other  
loans

|                                                                          |              |           |            |           |            |            |          |  |              |
|--------------------------------------------------------------------------|--------------|-----------|------------|-----------|------------|------------|----------|--|--------------|
| Real Estate Loans:                                                       |              |           |            |           |            |            |          |  |              |
| Construction                                                             | 66,918       | 10,100    | 28,167     | 1,430     |            |            |          |  | 106,615      |
| Commercial<br>and farm land                                              | 1,038,861    | 38,676    | 146,213    | 5,287     |            |            |          |  | 1,229,037    |
| Residential                                                              | 144,163      | 9,220     | 18,747     | 1,169     | \$ 340,932 | \$ 7,820   |          |  | 522,051      |
| Home equity                                                              | 17,913       | 283       | 2,872      | 524       | 178,470    | 1,907      |          |  | 201,969      |
| Individuals loans<br>for household and<br>other personal<br>expenditures |              |           |            |           |            | 115,239    | 56       |  | 115,295      |
| Lease financing<br>receivables, net of<br>unearned income                | 280          |           | 18         |           | 4,859      |            |          |  | 5,157        |
| Other loans                                                              | 27,642       | 1,295     | 784        |           |            |            |          |  | 29,721       |
| Total                                                                    | \$ 1,842,375 | \$ 80,076 | \$ 252,649 | \$ 11,280 | \$ 20      | \$ 639,500 | \$ 9,783 |  | \$ 2,835,683 |

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
(Unaudited)

## NOTE 3. Loans and Allowance continued

The following table shows a past due aging of the Corporation's loan portfolio, by loan class for September 30, 2011, and December 31, 2010:

|                                                                 | September 30, 2011 |                           |                           |                                       |             |                                    |              |
|-----------------------------------------------------------------|--------------------|---------------------------|---------------------------|---------------------------------------|-------------|------------------------------------|--------------|
|                                                                 | Current            | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | Loans ><br>90 Days<br>And<br>Accruing | Non-Accrual | Total Past<br>Due &<br>Non-Accrual | Total Loans  |
| Commercial and industrial                                       | \$ 500,951         | \$ 2,626                  | \$ 437                    | \$ 1,109                              | \$ 13,725   | \$ 17,897                          | \$ 518,848   |
| Agriculture production financing and other loans                | 106,457            |                           |                           |                                       | 304         | 304                                | 106,761      |
| Real Estate Loans:                                              |                    |                           |                           |                                       |             |                                    |              |
| Construction                                                    | 60,368             | 1,251                     | 72                        |                                       | 8,353       | 9,676                              | 70,044       |
| Commercial and farm land                                        | 1,140,235          | 1,455                     | 15,240                    | 131                                   | 39,209      | 56,035                             | 1,196,270    |
| Residential                                                     | 474,519            | 5,695                     | 1,032                     | 68                                    | 14,640      | 21,435                             | 495,954      |
| Home equity                                                     | 192,002            | 1,544                     | 296                       | 283                                   | 2,066       | 4,189                              | 196,191      |
| Individuals loans for household and other personal expenditures | 89,616             | 996                       | 140                       | 4                                     | 54          | 1,194                              | 90,810       |
| Lease financing receivables, net of unearned income             | 4,160              |                           |                           |                                       |             |                                    | 4,160        |
| Other loans                                                     | 33,318             |                           |                           |                                       | 582         | 582                                | 33,900       |
| Total                                                           | \$ 2,601,626       | \$ 13,567                 | \$ 17,217                 | \$ 1,595                              | \$ 78,933   | \$ 111,312                         | \$ 2,712,938 |

|                                                  | December 31, 2010 |                           |                           |                                       |             |                                    |             |
|--------------------------------------------------|-------------------|---------------------------|---------------------------|---------------------------------------|-------------|------------------------------------|-------------|
|                                                  | Current           | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | Loans ><br>90 Days<br>And<br>Accruing | Non-Accrual | Total Past<br>Due &<br>Non-Accrual | Total Loans |
| Commercial and industrial                        | \$ 518,683        | \$ 1,477                  | \$ 211                    | \$ 139                                | \$ 9,812    | \$ 11,639                          | \$ 530,322  |
| Agriculture production financing and other loans | 94,972            |                           |                           |                                       | 544         | 544                                | 95,516      |
| Real Estate Loans:                               |                   |                           |                           |                                       |             |                                    |             |

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|                                                                 |              |           |           |          |           |            |              |
|-----------------------------------------------------------------|--------------|-----------|-----------|----------|-----------|------------|--------------|
| Construction                                                    | 86,710       | 1,543     | 996       | 202      | 17,164    | 19,905     | 106,615      |
| Commercial and farm land                                        | 1,171,580    | 6,769     | 5,380     |          | 45,308    | 57,457     | 1,229,037    |
| Residential                                                     | 498,066      | 5,261     | 3,363     | 246      | 15,115    | 23,985     | 522,051      |
| Home equity                                                     | 196,276      | 1,825     | 534       | 686      | 2,648     | 5,693      | 201,969      |
| Individuals loans for household and other personal expenditures | 112,760      | 1,989     | 489       | 57       |           | 2,535      | 115,295      |
| Lease financing receivables, net of unearned income             | 5,157        |           |           |          |           |            | 5,157        |
| Other loans                                                     | 29,721       |           |           |          |           |            | 29,721       |
| Total                                                           | \$ 2,713,925 | \$ 18,864 | \$ 10,973 | \$ 1,330 | \$ 90,591 | \$ 121,758 | \$ 2,835,683 |

See the information regarding the analysis of loan loss experience in the Loan Quality/Provision for Loan Losses section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as ITEM 2 of this Form 10-Q.

Given recent economic conditions, borrowers of all types are experiencing declines in income and cash flow. As a result, borrowers are occasionally seeking to reduce contractual cash outlays including debt payments. Concurrently, in an effort to preserve and protect its earning assets, specifically troubled loans, the Corporation is working to maintain its relationship with certain customers who are experiencing financial difficulty by contractually modifying the borrower's debt agreement with the Corporation. In certain loan restructuring situations, the Corporation may grant a concession to a debtor experiencing financial difficulty, resulting in a trouble debt restructuring. A concession is deemed to be granted when, as a result of the restructuring, the Corporation does not expect to collect all amounts due, including interest accrued at the original contract rate. If the payment of principal at original maturity is primarily dependent on the value of collateral, the current value of the collateral is considered in determining whether the principal will be paid.

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(Table dollars in thousands)  
(Unaudited)

## NOTE 3. Loans and Allowance continued

The following table summarizes troubled debt restructurings that occurred during the periods indicated:

|                                                                                  | Three Months Ended<br>September 30, 2011 |                                         |                                          | Nine Months Ended<br>September 30, 2011 |                                         |                                          |
|----------------------------------------------------------------------------------|------------------------------------------|-----------------------------------------|------------------------------------------|-----------------------------------------|-----------------------------------------|------------------------------------------|
|                                                                                  | Number<br>of<br>Loans                    | Pre-Modification<br>Recorded<br>Balance | Post-Modification<br>Recorded<br>Balance | Number<br>of<br>Loans                   | Pre-Modification<br>Recorded<br>Balance | Post-Modification<br>Recorded<br>Balance |
| Commercial and Industrial<br>Agriculture production<br>financing and other loans | 5                                        | \$ 535                                  | \$ 552                                   | 10                                      | \$ 1,636                                | \$ 1,651                                 |
| Real Estate Loans:                                                               |                                          |                                         |                                          |                                         |                                         |                                          |
| Construction                                                                     | 1                                        | 40                                      | 41                                       | 3                                       | 175                                     | 184                                      |
| Commercial and farm land                                                         | 1                                        | 379                                     | 379                                      | 6                                       | 4,357                                   | 4,346                                    |
| Residential                                                                      | 10                                       | 1,034                                   | 1,407                                    | 30                                      | 2,690                                   | 3,115                                    |
| Home Equity                                                                      |                                          |                                         |                                          | 8                                       | 82                                      | 87                                       |
| Individuals loans for household<br>and other personal expenditures               |                                          |                                         |                                          |                                         |                                         |                                          |
| Lease financing receivables,<br>net of unearned income                           |                                          |                                         |                                          |                                         |                                         |                                          |
| Other Loans                                                                      |                                          |                                         |                                          |                                         |                                         |                                          |
| Total                                                                            | 17                                       | \$ 1,988                                | \$ 2,379                                 | 57                                      | \$ 8,940                                | \$ 9,383                                 |

Residential real estate loans, including home equity, account for 67 percent of the troubled debt restructured loans made in the nine months ending September 30, 2011. Five troubled debt restructured loans made during 2011, totaling \$2,721,000, remain in non-accrual status.

The following table summarizes troubled debt restructures that occurred between October 1, 2010, and September 30, 2011, that subsequently defaulted during the periods indicated:

|                                                                               | Three Months Ended<br>September 30, 2011 |                     | Nine Months Ended<br>September 30, 2011 |                     |
|-------------------------------------------------------------------------------|------------------------------------------|---------------------|-----------------------------------------|---------------------|
|                                                                               | Number<br>of Loans                       | Recorded<br>Balance | Number<br>of Loans                      | Recorded<br>Balance |
| Commercial and Industrial<br>Agriculture production financing and other loans | 1                                        | \$ 66               | 2                                       | \$ 553              |
| Real Estate Loans:                                                            |                                          |                     |                                         |                     |
| Construction                                                                  |                                          |                     |                                         |                     |



|                                                                 |   |        |   |          |
|-----------------------------------------------------------------|---|--------|---|----------|
| Commercial and farm land                                        |   |        | 1 |          |
| Residential                                                     | 3 | 271    | 3 | 657      |
| Home Equity                                                     | 1 | 11     | 1 | 11       |
| Individuals loans for household and other personal expenditures |   |        |   |          |
| Lease financing receivables, net of unearned income             |   |        |   |          |
| Other Loans                                                     | 5 | \$ 348 | 7 | \$ 1,221 |
| Total                                                           |   |        |   |          |

During the third quarter of 2011, two delinquent trouble debt restructurings totaling \$873,000 were paid down to a zero principal balance.

For potential consumer loan restructures, impairment evaluation occurs prior to modification. Any subsequent impairment is typically addressed through the charge off process. Consumer troubled debt restructurings are consequently included in the general historical allowance for loan loss at the post modification balance. Consumer non-accrual and delinquent trouble debt restructurings are also considered in the calculation of the non-accrual and delinquency trend environmental allowance allocation. Commercial trouble debt restructured loans risk graded special mention, substandard, doubtful and loss are individually evaluated for impairment under ASC 310. Any resulting specific reserves are included in the allowance for loan losses. Commercial 30 – 89 day delinquent trouble debt restructurings are included in the calculation of the delinquency trend environmental allowance allocation. All commercial non-impaired loans, including non-accrual and 90+ day delinquents, are included in the ASC 450 loss migration analysis.

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(Unaudited)

Note 4. Goodwill

During 2009, the impact of deteriorating economic conditions had significantly impacted the banking industry and the financial results of the Corporation. As a result, while only required to test goodwill annually, the Corporation decided to test its goodwill for impairment on three separate occasions during 2009. In 2010, the Corporation returned to its annual testing of goodwill for impairment, most recently as of November 30, 2010.

The Corporation used an independent, outside firm to help determine the fair value of the Corporation for purposes of the first step of the impairment test. The Discounted Earnings method (an Income Approach) as well as the Guideline Publicly Traded Company Method and the Transaction Method (both Market Approaches that apply market multiples to various financial metrics to derive value) were used and weighted to form the conclusion of fair value. The Discounted Earnings method was given primary weight in the fair value analysis.

The Discounted Earnings method was based primarily on: 1) management projections derived from expected balance sheet and income statement assumptions, based on current economic conditions, which continue to show signs of stabilization from 2009, improvements in 2010 and continued improvements going forward; 2) present value factors based on an implied market cost of equity, and 3) historic (long-term) price-to-earnings multiples for comparable companies. Determining the Corporation's fair value using the Discounted Earnings method involves a significant amount of judgment. The methodology is largely based on unobservable level three inputs. The test results are dependent upon attaining actual financial results consistent with the forecasts and assumptions used in the valuation model. The Discounted Earnings method relied on a terminal Price/Earnings ("P/E") multiple. The P/E multiple used to determine terminal value was notably lower than the historic P/E multiple observed for the Corporation, the peer group, and the NASDAQ community banking index (ABAQ). Based on the results of the step one analysis, the fair value exceeded the Corporation's carrying value; therefore, it was concluded goodwill is not impaired.

Additionally, a sensitivity analysis was performed on the Discounted Earnings methodology by testing a range of the following metrics: 1) implied market cost of equity; and 2) historic (long-term) price-to-earnings multiples for comparable companies. Based on the sensitivity testing, at the low-end of the sensitivity test range (for both metrics), the fair value of the Corporation exceeded its carrying value. For reasons that include but are not limited to the aforementioned, management believes the Corporation's recently traded stock price is not indicative of fair value.

NOTE 5. Derivative Financial Instruments

Cash Flow Hedges of Interest Rate Risk

The Corporation's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Corporation primarily uses interest rate swaps and interest rate caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the payment of fixed amounts to a counterparty in exchange for the Corporation receiving variable payments over the life of the agreements without exchange of the underlying notional amount. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. As of September 30, 2011, the Corporation had

one interest rate swap with a notional amount of \$13 million and one interest rate cap with a notional amount of \$13 million that were designated as cash flow hedges.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2011, such derivatives were used to hedge the forecasted LIBOR-based outflows associated with existing trust preferred securities when the outflows convert from a fixed rate to variable rate in September 2012. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the nine months ended September 30, 2011, the Corporation did not recognize any ineffectiveness.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Corporation's variable-rate liabilities. During the next twelve months, the Corporation does not expect to reclassify any amounts from accumulated other comprehensive income to interest expense.

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## NOTE 5. Derivative Financial Instruments continued

## Non-designated Hedges

The Corporation does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain customers. The Corporation executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Corporation executes with a third party, such that the Corporation minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of September 30, 2011, the notional amount of customer-facing swaps was approximately \$107,478,000. This amount is offset with third party counterparties, as described above.

## Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Corporation's derivative financial instruments as well as their classification on the Balance Sheet as of September 30, 2011, and December 31, 2010.

|                                                    | Asset Derivatives      |            |                        |            | Liability Derivatives  |            |                        |            |
|----------------------------------------------------|------------------------|------------|------------------------|------------|------------------------|------------|------------------------|------------|
|                                                    | September 30, 2011     |            | December 31, 2010      |            | September 30, 2011     |            | December 31, 2010      |            |
|                                                    | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments:     |                        |            |                        |            |                        |            |                        |            |
| Interest rate contracts                            | Other Assets           | \$ 456     | Other Assets           | \$ 1,393   | Other Liabilities      | \$ 1,772   | Other Liabilities      | \$         |
| Derivatives not designated as hedging instruments: |                        |            |                        |            |                        |            |                        |            |
| Interest rate contracts                            | Other Assets           | \$ 5,308   | Other Assets           | \$ 3,718   | Other Liabilities      | \$ 5,559   | Other Liabilities      | \$ 3,876   |

## Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Corporation's derivative financial instruments on the Income Statement for the three and nine months ended September 30, 2011, and September 30, 2010.

| Derivatives<br>Not<br>Designated as           |                                                                     |                                                                                                               |                                                                                                              |
|-----------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| Hedging<br>Instruments<br>under ASC<br>815-10 | Location of<br>Gain (Loss)<br>Recognized<br>Income on<br>Derivative | Amount of Gain<br>(Loss) Recognized<br>Income on<br>Derivative<br>Three Months<br>Ended September<br>30, 2011 | Amount of Gain<br>(Loss) Recognized<br>Income on<br>Derivative<br>Nine Months<br>Ended September<br>30, 2011 |
| Interest rate<br>contracts                    | Other income                                                        | \$ (95)                                                                                                       | \$ (93)                                                                                                      |

| Derivatives<br>Not<br>Designated as           |                                                                     |                                                                                                               |                                                                                                              |
|-----------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| Hedging<br>Instruments<br>under ASC<br>815-10 | Location of<br>Gain (Loss)<br>Recognized<br>Income on<br>Derivative | Amount of Gain<br>(Loss) Recognized<br>Income on<br>Derivative<br>Three Months<br>Ended September<br>30, 2010 | Amount of Gain<br>(Loss) Recognized<br>Income on<br>Derivative<br>Nine Months<br>Ended September<br>30, 2010 |
| Interest rate<br>contracts                    | Other income                                                        | \$ (24)                                                                                                       | \$ (237)                                                                                                     |

The Corporation's exposure to credit risk occurs because of nonperformance by its counterparties. The counterparties approved by the Corporation are usually financial institutions, which are well capitalized and have credit ratings through Moody's and/or Standard & Poor's, at or above investment grade. The Corporation's control of such risk is through quarterly financial reviews, comparing mark-to-mark values with policy limitations, credit ratings and collateral pledging.

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NOTE 5. Derivative Financial Instruments continued

Credit-risk-related Contingent Features

The Corporation has agreements with certain of its derivative counterparties that contain a provision where if the Corporation fails to maintain its status as a well or adequate capitalized institution, then the Corporation could be required to terminate or fully collateralize all outstanding derivative contracts.

The Corporation has agreements with certain of its derivative counterparties that contain a provision where if the Corporation defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, the Corporation could also be declared in default on its derivative obligations.

As of September 30, 2011, the termination value of derivatives in a net liability position related to these agreements was \$7,546,000. As of September 30, 2011, the Corporation has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of \$6,535,000. If the Corporation had breached any of these provisions at September 30, 2011, it could have been required to settle its obligations under the agreements at their termination value.

Note 6. Disclosures About Fair Value of Assets and Liabilities

The Corporation has adopted fair value accounting guidance that defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This guidance also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying Consolidated Condensed Balance Sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.



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NOTE 6. Disclosures About Fair Value of Assets and Liabilities continued

Investment securities

Where quoted, market prices are available in an active market and securities are classified within Level 1 of the valuation hierarchy. There are no securities classified within Level 1 of the hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include agencies, mortgage backs, state and municipal and equity securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. Level 3 fair value, including corporate obligations, state and municipal and equity securities, was determined using a discounted cash flow model that incorporated market estimates of interest rates and volatility in markets that have not been active.

Third party vendors compile prices from various sources and may apply such techniques as matrix pricing to determine the value of identical or similar investment securities classified within Level 2. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Any investment security not valued based upon the methods above are considered Level 3.

Pooled Trust Preferred Securities

Pooled trust preferred securities in the portfolio amount to \$5.6 million in amortized cost, with a fair value of \$165,000; all of which are classified as Level 3 inputs in the fair value hierarchy. These securities were rated A or better at inception, but at September 30, 2011, Moody's ratings on these securities now range from Ca to C. The issuers in these securities are primarily banks, but some of the pools do include a limited number of insurance companies. On a quarterly basis, the Corporation uses an other-than-temporary impairment ("OTTI") evaluation process to compare the present value of expected cash flows to determine whether an adverse change in cash flows has occurred. The OTTI process considers the structure and term of the collateralized debt obligation ("CDO"), interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. Assumptions used in the process include expected future default rates and prepayments as well as recovery assumptions on defaults and deferrals. In addition, the process is used to "stress" each CDO, or make assumptions more severe than expected activity, to determine the degree to which assumptions could deteriorate before the CDO could no longer fully support repayment of the Corporation's note class. Upon completion of the September 30, 2011, quarterly analysis, the conclusion was no additional OTTI impairment for the three months ending September 30, 2011. The Corporation recognized OTTI impairment of \$400,000 and \$1,544,000 for the nine months ended September 30, 2011, and September 30, 2010.

Interest rate swap agreements



See information regarding the Corporation's interest rate derivative products in Note 5. Derivative Financial Instruments, included within the Notes to Consolidated Condensed Financial Statements of this Form 10Q.

The fair value is estimated by a third party using inputs that are primarily unobservable and cannot be corroborated by observable market data and, therefore, are classified within Level 3 of the valuation hierarchy.

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NOTE 6. Disclosures About Fair Value of Assets and Liabilities continued

The following presents the fair value measurements of assets and liabilities recognized in the Consolidated Condensed Balance Sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2011, and December 31, 2010.

|                                             | Fair Value | Fair Value Measurements Using                                                    |                                                           |                                                    |
|---------------------------------------------|------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                             |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs (Level<br>3) |
| September 30, 2011                          |            |                                                                                  |                                                           |                                                    |
| Available for sale securities:              |            |                                                                                  |                                                           |                                                    |
| U.S. Government-sponsored agency securities | \$ 117     |                                                                                  | \$ 117                                                    |                                                    |
| State and municipal                         | 140,000    |                                                                                  | 121,289                                                   | \$ 18,711                                          |
| Mortgage-backed securities                  | 354,465    |                                                                                  | 354,465                                                   |                                                    |
| Corporate obligations                       | 196        |                                                                                  |                                                           | 196                                                |
| Equity securities                           | 1,830      |                                                                                  | 1,826                                                     | 4                                                  |
| Interest rate swap asset                    | 5,308      |                                                                                  |                                                           | 5,308                                              |
| Interest rate cap                           | 456        |                                                                                  |                                                           | 456                                                |
| Interest rate swap liability                | (7,331 )   |                                                                                  |                                                           | (7,331 )                                           |

|                                             | Fair Value | Fair Value Measurements Using                                                    |                                                           |                                                    |
|---------------------------------------------|------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                             |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs (Level<br>3) |
| December 31, 2010                           |            |                                                                                  |                                                           |                                                    |
| Available for sale securities:              |            |                                                                                  |                                                           |                                                    |
| U.S. Government-sponsored agency securities | \$ 616     |                                                                                  | \$ 616                                                    |                                                    |
| State and municipal                         | 239,990    |                                                                                  | 239,990                                                   |                                                    |
| Mortgage-backed securities                  | 295,317    |                                                                                  | 295,317                                                   |                                                    |
| Corporate obligations                       | 182        |                                                                                  |                                                           | \$ 182                                             |
| Equity securities                           | 3,265      |                                                                                  | 3,261                                                     | 4                                                  |
| Interest rate swap asset                    | 4,002      |                                                                                  |                                                           | 4,002                                              |
| Interest rate cap                           | 1,109      |                                                                                  |                                                           | 1,109                                              |

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|                              |         |         |
|------------------------------|---------|---------|
| Interest rate swap liability | (3,876) | (3,876) |
|------------------------------|---------|---------|

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the Consolidated Condensed Balance Sheets using significant unobservable Level 3 inputs for the three and six months ended September 30, 2011, and 2010.

|                                                 | Three Months Ended September 30, 2011 |                          |                   |                              | Nine Months Ended September 30, 2011 |                          |                   |                              |
|-------------------------------------------------|---------------------------------------|--------------------------|-------------------|------------------------------|--------------------------------------|--------------------------|-------------------|------------------------------|
|                                                 | Available for Sale Securities         | Interest Rate Swap Asset | Interest Rate Cap | Interest Rate Swap Liability | Available for Sale Securities        | Interest Rate Swap Asset | Interest Rate Cap | Interest Rate Swap Liability |
| Balance at beginning of the period              | \$ 180                                | \$ 3,783                 | \$ 954            | \$ (3,986)                   | \$ 186                               | \$ 4,002                 | \$ 1,109          | \$ (3,876)                   |
| Total realized and unrealized gains and losses: |                                       |                          |                   |                              |                                      |                          |                   |                              |
| Included in net income (loss)                   |                                       | 3,251                    |                   | (3,345)                      | (400)                                | 3,363                    |                   | (3,455)                      |
| Included in other comprehensive income          | (45)                                  | (1,726)                  | (498)             |                              | 195                                  | (2,057)                  | (653)             |                              |
| Purchases, issuances and settlements            |                                       |                          |                   |                              |                                      |                          |                   |                              |
| Transfers in/(out) of Level 3                   | 18,711                                |                          |                   |                              | 18,711                               |                          |                   |                              |
| Principal payments                              | 65                                    |                          |                   |                              | 219                                  |                          |                   |                              |
| Ending balance at September 30, 2011            | \$ 18,911                             | \$ 5,308                 | \$ 456            | \$ (7,331)                   | \$ 18,911                            | \$ 5,308                 | \$ 456            | \$ (7,331)                   |

|                                                 | Three Months Ended September 30, 2010 |                          |                              | Nine Months Ended September 30, 2010 |                          |                              |
|-------------------------------------------------|---------------------------------------|--------------------------|------------------------------|--------------------------------------|--------------------------|------------------------------|
|                                                 | Available for Sale Securities         | Interest Rate Swap Asset | Interest Rate Swap Liability | Available for Sale Securities        | Interest Rate Swap Asset | Interest Rate Swap Liability |
| Balance at beginning of the period              | \$ 1,431                              | \$ 3,924                 | \$ (4,161)                   | \$ 2,483                             | \$ 2,624                 | \$ (2,648)                   |
| Total realized and unrealized gains and losses: |                                       |                          |                              |                                      |                          |                              |
| Included in net income (loss)                   | (656)                                 | 767                      | (791)                        | (1,544)                              | 2,067                    | (2,304)                      |
| Included in other comprehensive income          | 213                                   |                          |                              | (111)                                |                          |                              |
| Purchases, issuances and settlements            |                                       |                          |                              |                                      |                          |                              |
| Transfers in/(out) of Level 3                   |                                       |                          |                              |                                      |                          |                              |
| Principal payments                              | 78                                    |                          |                              | 238                                  |                          |                              |
| Ending balance at September 30, 2010            | \$ 1,066                              | \$ 4,691                 | \$ (4,952)                   | \$ 1,066                             | \$ 4,691                 | \$ (4,952)                   |



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## NOTE 6. Disclosures About Fair Value of Assets and Liabilities continued

Following is a description of valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the Consolidated Condensed Balance Sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

|                                                | Fair Value | Fair Value Measurements Using                                                    |                                                           |                                                 |
|------------------------------------------------|------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|-------------------------------------------------|
|                                                |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |
| September 30, 2011                             |            |                                                                                  |                                                           |                                                 |
| Impaired loans                                 | \$ 29,298  |                                                                                  |                                                           | \$ 29,298                                       |
| Other real estate owned (collateral dependent) | \$ 8,320   |                                                                                  |                                                           | \$ 8,320                                        |

|                                                | Fair Value | Fair Value Measurements Using                                                    |                                                           |                                                 |
|------------------------------------------------|------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|-------------------------------------------------|
|                                                |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |
| December 31, 2010                              |            |                                                                                  |                                                           |                                                 |
| Impaired loans                                 | \$ 45,432  |                                                                                  |                                                           | \$ 45,432                                       |
| Other real estate owned (collateral dependent) | \$ 6,314   |                                                                                  |                                                           | \$ 6,314                                        |

## Impaired Loans (collateral dependent) and Other Real Estate Owned

Loan impairment is reported when substantial doubt about the collectability of scheduled payments exists. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of the loan is confirmed. During the first nine months of 2011, certain impaired loans were partially charged-off or re-evaluated. The valuation would be considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

The fair value for impaired loans and other real estate owned is measured based on the value of the collateral securing those loans or real estate and is determined using several methods. The fair value of real estate is generally determined based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically calculated by using financial information such as financial statements and aging reports provided by the borrower and is discounted as considered appropriate.

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NOTE 6. Disclosures About Fair Value of Assets and Liabilities continued

The estimated fair values of the Corporation's financial instruments are as follows:

|                                                                   | September 30, 2011 |              | December 31, 2010  |              |
|-------------------------------------------------------------------|--------------------|--------------|--------------------|--------------|
|                                                                   | Carrying<br>Amount | Fair Value   | Carrying<br>Amount | Fair Value   |
| <b>Assets:</b>                                                    |                    |              |                    |              |
| Cash and due from banks                                           | \$ 60,166          | \$ 60,166    | \$ 50,844          | \$ 50,844    |
| Federal funds sold                                                |                    |              | 7,463              | 7,463        |
| Interest-bearing time deposits                                    | 16,115             | 16,115       | 65,216             | 65,216       |
| Investment securities available for sale                          | 496,608            | 496,608      | 539,370            | 539,370      |
| Investment securities held to maturity                            | 441,220            | 452,948      | 287,427            | 286,270      |
| Mortgage loans held for sale                                      | 12,257             | 12,257       | 21,469             | 21,469       |
| Loans                                                             | 2,639,864          | 2,659,242    | 2,752,706          | 2,715,924    |
| Federal Reserve Bank and Federal<br>Home Loan Bank stock          | 31,381             | 31,381       | 33,884             | 33,884       |
| Interest Rate Swap Asset                                          | 5,764              | 5,764        | 5,111              | 5,111        |
| Interest receivable                                               | 17,770             | 17,770       | 18,674             | 18,674       |
| <b>Liabilities:</b>                                               |                    |              |                    |              |
| Deposits                                                          | \$ 3,064,250       | \$ 3,070,271 | \$ 3,268,880       | \$ 3,280,489 |
| <b>Borrowings:</b>                                                |                    |              |                    |              |
| Federal funds purchased                                           | 27,946             | 27,946       |                    |              |
| Securities sold under repurchase<br>agreements                    | 117,097            | 117,597      | 109,871            | 110,494      |
| Federal Home Loan Bank advances                                   | 168,764            | 172,688      | 82,684             | 87,463       |
| Subordinated debentures, revolving<br>credit lines and term loans | 194,961            | 141,883      | 226,440            | 176,259      |
| Interest Rate Swap Liability                                      | 7,331              | 7,331        | 3,876              | 3,876        |
| Interest Payable                                                  | 2,186              | 2,186        | 4,262              | 4,262        |

Cash and due from banks: The fair value of cash and cash equivalents approximates carrying value.

Federal Funds Sold: The fair value of Federal funds sold approximates carrying value.

Interest-bearing time deposits: The fair value of interest-bearing time deposits approximates carrying value.

Investment securities: Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Mortgage loans held for sale: The fair value of mortgage loans held for sale approximates carrying value.

Loans: The fair value for loans is estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. See Impaired Loans above.

Federal Reserve and Federal Home Loan Bank stock: The fair value of Federal Reserve Bank and Federal Home Loan Bank stock is based on the price which it may be resold to the Federal Reserve and Federal Home Loan Bank.

Interest receivable and Interest payable: The fair value of interest receivable/payable approximates carrying value.

Derivative instruments: The fair value of the derivatives, consisting of interest rate swaps, reflects the estimated amounts that would have been received to terminate these contracts at the reporting date based upon pricing or valuation models applied to current market information.

Deposits: The fair values of noninterest-bearing and interest-bearing demand accounts and savings deposits are equal to the amount payable on demand at the balance sheet date. The carrying amounts for variable rate, fixed-term certificates of deposit approximate their fair values at the balance sheet date. Fair values for fixed-rate certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly maturities on such time deposits.

Federal funds purchased: The fair value of federal funds purchased approximates carrying value.

Borrowings: The fair value of borrowings is estimated using a discounted cash flow calculation, based on current rates for similar debt.



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NOTE 7. Share-Based Compensation

Stock options and restricted stock awards ("RSAs") have been issued to directors, officers and other management employees under the Corporation's 1999 Long-term Equity Incentive Plan and the 2009 Long-term Equity Incentive Plan. The stock options, which have a ten-year life, become 100 percent vested ranging from three months to two years and are fully exercisable when vested. Option exercise prices equal the Corporation's common stock closing price on NASDAQ on the date of grant. RSAs provide for the issuance of shares of the Corporation's common stock at no cost to the holder and generally vest after three years. The RSAs vest only if the employee is actively employed by the Corporation on the vesting date and, therefore, any unvested shares are forfeited. RSAs for employees retired from the Corporation are either immediately vested at retirement or continue to vest after retirement, depending on which plan the shares were granted under. Deferred stock units ("DSUs") have been credited to non-employee directors who have elected to defer payment of compensation under the Corporation's 2008 Equity Compensation Plan for Non-employee Directors. DSUs credited are equal to the restricted shares that the non-employee director would have received under the plan. As of September 30, 2011, all outstanding DSUs have been converted to RSA's due to director retirements.

The Corporation's 2009 Employee Stock Purchase Plan ("ESPP") provides eligible employees of the Corporation and its subsidiaries an opportunity to purchase shares of common stock of the Corporation through quarterly offerings financed by payroll deductions. The price of the stock to be paid by the employees shall be equal to 85 percent of the average of the closing price of the Corporation's common stock on each trading day during the offering period. However, in no event shall such purchase price be less than the lesser of an amount equal to 85 percent of the market price of the Corporation's stock on the offering date or an amount equal to 85 percent of the market value on the date of purchase. Common stock purchases are made quarterly and are paid through advance payroll deductions up to a calendar year maximum of \$25,000.

Compensation expense related to unvested share-based awards is recorded by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards, with no change in historical reported fair values and earnings. Awards are valued at fair value in accordance with provisions of share-based compensation guidance and are recognized on a straight-line basis over the service periods of each award. To complete the exercise of vested stock options, RSA's and ESPP options, the Corporation generally issues new shares from its authorized but unissued share pool. Share-based compensation for the three months and nine months ended September 30, 2011, was \$290,000 and \$1,009,000, respectively compared to \$437,000 and \$1,369,000, respectively, for the three months and nine months ended September 30, 2010. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying Consolidated Condensed Statements of Income.

The estimated fair value of the stock options granted during 2011 and in prior years was calculated using a Black Scholes option pricing model. The following summarizes the assumptions used in the 2011 Black Scholes model:

|                           |        |
|---------------------------|--------|
| Risk-free interest rate   | 2.74%  |
| Expected price volatility | 45.53% |

|                                                      |               |
|------------------------------------------------------|---------------|
| Dividend yield                                       | 3.65%         |
| Forfeiture rate                                      | 5.00%         |
| Weighted-average<br>expected life, until<br>exercise | 6.91<br>years |

The Black Scholes model incorporates assumptions to value share-based awards. The risk-free rate of interest, for periods equal to the expected life of the option, is based on a U.S. government instrument over a similar contractual term of the equity instrument. Expected price volatility is based on historical volatility of the Corporation's common stock. In addition, the Corporation generally uses historical information to determine the dividend yield and weighted-average expected life of the options until exercise. Separate groups of employees that have similar historical exercise behavior with regard to option exercise timing and forfeiture rates are considered separately for valuation and attribution purposes.

Share-based compensation expense recognized in the Consolidated Condensed Statements of Income is based on awards ultimately expected to vest and is reduced for estimated forfeitures. Share-based compensation guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods, if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated to be approximately five percent for the nine months ended September 30, 2011, based on historical experience.

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## NOTE 7. Share-Based Compensation continued

The following table summarizes the components of the Corporation's share-based compensation awards recorded as expense:

|                                                             | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|-------------------------------------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                                                             | 2011                                | 2010   | 2011                               | 2010     |
| <b>Stock and ESPP Options</b>                               |                                     |        |                                    |          |
| Pre-tax compensation expense                                | \$ 56                               | \$ 143 | \$ 165                             | \$ 487   |
| Income tax benefit                                          | (7)                                 | (20)   | (8)                                | (51)     |
| Stock and ESPP option expense, net of income taxes          | \$ 49                               | \$ 123 | \$ 157                             | \$ 436   |
| <b>Restricted Stock Awards</b>                              |                                     |        |                                    |          |
| Pre-tax compensation expense                                | \$ 234                              | \$ 294 | \$ 844                             | \$ 882   |
| Income tax benefit                                          | (76)                                | (103)  | (289)                              | (309)    |
| Restricted stock awards expense, net of income taxes        | \$ 158                              | \$ 191 | \$ 555                             | \$ 573   |
| <b>Total Share-Based Compensation:</b>                      |                                     |        |                                    |          |
| Pre-tax compensation expense                                | \$ 290                              | \$ 437 | \$ 1,009                           | \$ 1,369 |
| Income tax benefit                                          | (83)                                | (123)  | (297)                              | (360)    |
| Total share-based compensation expense, net of income taxes | \$ 207                              | \$ 314 | \$ 712                             | \$ 1,009 |

As of September 30, 2011, unrecognized compensation expense related to stock options and RSAs totaling \$98,263 and \$1,395,754, respectively, is expected to be recognized over weighted-average periods of 0.75 and 1.56 years, respectively.

Stock option activity under the Corporation's stock option plans, as of September 30, 2011, and changes during the nine months ended September 30, 2011, were as follows:

|                                                      | Number of<br>Shares | Weighted-Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Term<br>(in Years) | Aggregate<br>Intrinsic Value |
|------------------------------------------------------|---------------------|------------------------------------|-----------------------------------------------------------------|------------------------------|
| Outstanding at January 1, 2011                       | 1,061,429           | \$ 23.01                           |                                                                 |                              |
| Granted/ Converted                                   | 52,298              | \$ 9.14                            |                                                                 |                              |
| Cancelled                                            | (75,291)            | \$ 20.46                           |                                                                 |                              |
| Outstanding September 30, 2011                       | 1,038,436           | \$ 22.51                           | 4.63                                                            | 39,730                       |
| Vested and Expected to Vest at<br>September 30, 2011 | 1,038,436           | \$ 22.55                           | 4.63                                                            | 39,730                       |
| Exercisable at September 30, 2011                    | 956,686             | \$ 23.81                           | 4.25                                                            | 0                            |

The weighted-average grant date fair value was \$3.09 for stock options granted during the nine months ended September 30, 2011.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the first nine months of 2011 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their stock options on September 30, 2011. The amount of aggregate intrinsic value will change based on the fair market value of the Corporation's common stock. There were no stock options exercised during the first nine months of 2011.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
(Unaudited)

## NOTE 7. Share-Based Compensation continued

The following table summarizes information on unvested RSAs outstanding as of September 30, 2011:

|                                        | Number of<br>Shares | Weighted-Average<br>Grant Date Fair<br>Value |
|----------------------------------------|---------------------|----------------------------------------------|
| Unvested RSAs at<br>January 1, 2011    | 272,737             | \$ 12.46                                     |
| Granted                                | 136,933             | \$ 8.93                                      |
| Forfeited                              | (5,135)             | \$ 8.83                                      |
| Vested                                 | (70,543)            | \$ 23.37                                     |
| Unvested RSAs at<br>September 30, 2011 | 333,992             | \$ 8.74                                      |

The grant date fair value of ESPP options was estimated at the beginning of the July 1, 2011, quarterly offering period of approximately \$36,000. The ESPP options vested during the three months ending September 30, 2011, leaving no unrecognized compensation expense related to unvested ESPP options at September 30, 2011.

## NOTE 8. Income tax

|                                                            | 2011     | 2010        |
|------------------------------------------------------------|----------|-------------|
| Income Tax Expense for the Nine Months Ended September 30: |          |             |
| Currently Payable:                                         |          |             |
| Federal                                                    | \$ (855) | \$ (19,905) |
| State                                                      |          | (378)       |
| Deferred:                                                  |          |             |
| Federal                                                    | 7,211    | 16,531      |
| State                                                      |          | 378         |
| Total Income Tax Expense                                   | \$ 6,356 | \$ (3,374)  |
| Reconciliation of Federal Statutory to Actual Tax Expense: |          |             |
| Federal Statutory income Tax at 35%                        | \$ 8,416 | \$ (173)    |
| Tax-exempt Interest Income                                 | (2,793)  | (2,935)     |
| Non-deductible Interest Expense                            | 649      | 212         |
| Stock Compensation                                         | 56       | 119         |
| Earnings on Life Insurance                                 | (610)    | (551)       |
| Tax Credits                                                | (55)     | (85)        |
| Other                                                      | 693      | 39          |

|                    |    |       |    |         |
|--------------------|----|-------|----|---------|
| Actual Tax Expense | \$ | 6,356 | \$ | (3,374) |
|--------------------|----|-------|----|---------|

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

NOTE 9. Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average shares outstanding during the reporting period. Diluted net income per share is computed by dividing net income by the combination of all dilutive common share equivalents, comprised of shares issuable under the Corporation's share-based compensation plans, and the weighted-average shares outstanding during the reporting period.

Dilutive common share equivalents include the dilutive effect of in-the-money share-based awards, which are calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of share-based awards, the amount of compensation expense, if any, for future service that the Corporation has not yet recognized, and the amount of estimated tax benefits that would be recorded in additional paid-in capital when share-based awards are exercised, are assumed to be used to repurchase common stock in the current period.

|                                                      | Three Months Ended September 30, |                            |                        |               |                            |                        |
|------------------------------------------------------|----------------------------------|----------------------------|------------------------|---------------|----------------------------|------------------------|
|                                                      | 2011                             |                            |                        | 2010          |                            |                        |
|                                                      | Net<br>Income<br>(Loss)          | Weighted-Average<br>Shares | Per<br>Share<br>Amount | Net<br>Income | Weighted-Average<br>Shares | Per<br>Share<br>Amount |
| Basic net income per share:                          | \$ 6,742                         |                            |                        | \$ 1,635      |                            |                        |
| Loss on extinguishment of trust preferred securities | (10,857)                         |                            |                        |               |                            |                        |
| Loss on CPP unamortized discount                     | (1,401)                          |                            |                        |               |                            |                        |
| Preferred Stock dividends and discount accretion     | (868)                            |                            |                        | (870)         |                            |                        |
| Net income (loss) available to common stockholders   | (6,384)                          | 26,367,067                 | \$ (0.25)              | 765           | 25,550,222                 | \$ 0.02                |
| Effect of dilutive stock options and warrants        |                                  |                            |                        |               | 135,316                    |                        |
| Diluted net income (loss) per share:                 |                                  |                            |                        |               |                            |                        |
| Net income (loss) available to common stockholders   | \$ (6,384)                       | 26,367,067                 | \$ (0.25)              | \$ 765        | 25,685,538                 | \$ 0.02                |

Stock options to purchase 1,008,957 and 1,029,668 shares for the three months ended September 30, 2011, and 2010, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

Nine Months Ended September 30,  
2011 2010

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|                                                              | Net<br>Income | Weighted-Average<br>Shares | Per<br>Share<br>Amount | Net<br>Income | Weighted-Average<br>Shares | Per<br>Share<br>Amount |
|--------------------------------------------------------------|---------------|----------------------------|------------------------|---------------|----------------------------|------------------------|
| Basic net income per share:                                  | \$ 17,691     |                            |                        | \$ 2,878      |                            |                        |
| Gain on exchange of preferred stock for trust preferred debt |               |                            |                        | 10,052        |                            |                        |
| Loss on extinguishment of trust preferred securities         | (10,857)      |                            |                        |               |                            |                        |
| Loss on CPP unamortized discount                             | (1,401)       |                            |                        |               |                            |                        |
| Less: Preferred Stock dividends and discount accretion       | (2,846)       |                            |                        | (3,763)       |                            |                        |
| Net income available to common stockholders                  | 2,587         | 25,879,277                 | \$ 0.10                | 9,167         | 24,164,224                 | \$ 0.38                |
| Effect of dilutive stock options and warrants                |               | 139,659                    |                        |               | 108,666                    |                        |
| Diluted net income per share:                                |               |                            |                        |               |                            |                        |
| Net income available to common stockholders                  | \$ 2,587      | 26,018,936                 | \$ 0.10                | \$ 9,167      | 24,272,890                 | \$ 0.38                |

Stock options to purchase 1,024,775 and 1,061,571 shares for the nine months ended September 30, 2011, and 2010, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.



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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

Note 10. Preferred Stock

On February 20, 2009, the Corporation entered into a Letter Agreement (Purchase Agreement) with the U.S. Treasury (the "Treasury"), pursuant to which the Corporation agreed to issue and sell (a) 116,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("the Series A Preferred Stock") and (b) a warrant to purchase 991,453 shares of the Corporation's common stock for an aggregate purchase price of \$116 million in cash.

The Preferred Stock qualified as Tier I capital and was to pay cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. The Series A Preferred Stock was non-voting except with respect to certain matters affecting the rights of the holders thereof, and was redeemable by the Corporation after three years. The Warrant has a ten year term and is immediately exercisable with an exercise price of \$17.55 per share of common stock. Pursuant to the Purchase Agreement, the Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrant.

On June 30, 2010, the Corporation entered into an Exchange Agreement with the United States Department of the Treasury whereby the Treasury exchanged 46,400 shares of the Series A Preferred Stock for 46,400 shares of trust preferred securities, having a liquidation amount of \$1,000 per share (the "Capital Securities") issued by the Corporation's wholly-owned subsidiary trust, First Merchants Capital Trust III, a Delaware Statutory Trust (the "Trust"). The Trust simultaneously issued 1,435 shares of the Trust's common securities (the "Common Securities") to the Corporation for the purchase price of \$1.4 million which constituted all of the issued and outstanding common securities of the Trust. The Trust used the tendered Series A Preferred Stock and the proceeds from the sale of the Common Securities to purchase \$47.8 million in aggregate principal amount of Fixed Rate Perpetual Junior Subordinated Debentures, Series A issued by the Corporation (the "Debentures"). The Capital Securities and the Debentures bore interest, payable quarterly, at a rate of five percent (5%) until February 20, 2014 when the rate increases to nine percent (9%). The Capital Securities and Debentures were redeemable by the Corporation upon proper notice and regulatory approval (a) at any time, so long as the Capital Securities were held by the Treasury and (b) at any time after June 30, 2015, if the Capital Securities were held by a person or entity other than the Treasury.

The Series A Preferred Stock, which had been issued to the Treasury in connection with the Troubled Assets Relief Program's Capital Purchase Program ("TARP"), has been cancelled. Following the exchange, the Treasury continued to hold 69,600 shares of Series A Preferred Stock along with the Warrant to initially purchase up to 991,453 shares of the Corporation's common stock, which was also issued pursuant to TARP.

This particular exchange resulted in a gain on retirement of Preferred Stock favorably impacting retained earnings by \$10.1 million (net of deferred taxes), which was also considered as part of earnings available to common stockholders in the earnings per common share ("EPS") computations.

On September 22, 2011, the Corporation entered into a Securities Purchase Agreement (the "Purchase Agreement") with the 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 Purchase Agreement was entered into, and the Series B Preferred Stock was issued, pursuant to the SBLF program, a \$30 billion fund established under the Small Business

Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion.

FIRST MERCHANTS CORPORATION  
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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

Note 10. Preferred Stock continued

The Series B Preferred Stock is 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, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of “Qualified Small Business Lending” or “QSBL” (as defined in the Purchase Agreement) by the Bank. Based upon the Bank’s level of QSBL over the baseline level calculated under the terms of the Purchase Agreement (the “Baseline”), the dividend rate for the initial dividend period has been set at five percent (5%). For the second through tenth dividend periods, the dividend rate may be adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank’s level of QSBL. In addition to the dividend, in the event the Bank’s level of QSBL has not increased relative to the Baseline, at the beginning of the tenth calendar quarter, the Corporation will be subject to an additional lending incentive fee equal to two percent (2%) per annum. For the eleventh dividend period through the eighteenth dividend period, inclusive, and that portion of the nineteenth dividend period before, but not including, the four and one half (4½) year anniversary of the date of issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) per annum based upon the increase in QSBL as compared to the baseline. After four and one half (4½) years from issuance, the dividend rate will increase to nine percent (9%).

The Series B Preferred Stock is non-voting, except in limited circumstances. In the event that the Corporation misses five dividend payments, whether or not consecutive, the holder of the Series B Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Corporation’s Board of Directors. In the event that the Corporation misses six dividend payments, whether or not consecutive, and if the then outstanding aggregate liquidation amount of the Series B Preferred Stock is at least \$25,000,000, then the holder of the Series B Preferred Stock will have the right to designate two directors to the Board of Directors of the Corporation.

The Series B Preferred Stock may be redeemed at any time at the Corporation’s option, at a redemption price of one hundred percent (100%) of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

The Series B Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Corporation has agreed to register the Series B Preferred Stock under certain circumstances set forth in Annex E to the Purchase Agreement. The Series B Preferred Stock is not subject to any contractual restrictions on transfer.

The foregoing summary of the terms of the Purchase Agreement is subject to, and qualified in its entirety by, the full text of the Purchase Agreement.

Also on September 22, 2011, the Corporation entered into and consummated two letter agreements (each, a “Repurchase Letter”) with the Treasury, pursuant to which the Corporation redeemed, out of the proceeds of the issuance of the Series B Preferred Stock in the amount of \$90,782,940 and cash of \$25,813,171 (of which \$21,165,000 was raised through a private placement of the Corporation’s common stock on September 9, 2011) for an aggregate redemption price of \$116,596,111, including accrued but unpaid dividends to the date of redemption: (i) all 69,600 shares of the Corporation’s Series A Preferred Stock, and (ii) all 46,400 Capital Securities held by the Treasury

The Treasury continues to hold a Warrant to purchase 991,453 shares of the Corporation's common stock at an exercise price of \$17.55 per share. Under the terms of the Repurchase Letter the Treasury has provided the Corporation notice of its intention to sell the Warrant.

The foregoing summary of the terms of the Repurchase Letters is subject to, and qualified in its entirety by, the full text of the Repurchase Letters.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

Note 11. Impact of Accounting Changes

**Goodwill:** In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-08 “Intangibles — Goodwill and Other (Topic 350) - Testing Goodwill for Impairment.” ASU 2011-08 allows an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of the reporting unit. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Corporation is assessing the impact of ASU 2011-08 on goodwill impairment testing but does not expect an impact on its financial condition or results of operations.

**Comprehensive Income:** In June 2011, the FASB issued ASU No. 2011-05 “Comprehensive Income (Topic 220) - Presentation of Comprehensive Income.” ASU 2011-05 requires that all nonowner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 is effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Corporation is assessing the impact of ASU 2011-05 on its comprehensive income presentation.

**Fair Value Measurements:** In May 2011, the FASB issued ASU No. 2011-04 “Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs (International Financial Reporting Standards). ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. Early application by public entities is not permitted. The Corporation is assessing the impact of ASU 2011-04 on its fair value disclosures.

**Transfers and Servicing:** In April 2011, the FASB issued ASU No. 2011-03 “Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreement.” ASU 2011-03 removes from the assessment of effective control the criterion relating to the transferor’s ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Corporation is assessing the impact of ASU 2011-03 on its financial condition, results of operations, and disclosures.

**Receivables:** In April 2011, the FASB issued ASU No. 2011-02 “Receivables (Topic 310) - A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring.” ASU 2011-02 clarifies whether loan modifications constitute troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 was effective for the first interim and annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of

adoption. The impact of ASU 2011-02 on The Corporation's disclosures is reflected in Note 3 — Loan and Allowance, included within the Notes to Consolidated Condensed Financial Statements of this Form 10Q.

FIRST MERCHANTS CORPORATION  
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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

From time to time, we include forward-looking statements in our oral and written communication. We may include forward-looking statements in filings with the Securities and Exchange Commission, such as this Form 10-Q, in other written materials and in oral statements made by senior management to analysts, investors, representatives of the media and others. We intend 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 we are 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 our goals, intentions and expectations;
- statements regarding our business plan and growth strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors which could affect the actual outcome of future events:

• fluctuations in market rates of interest and loan and deposit pricing, which could negatively affect our net interest margin, asset valuations and expense expectations;

• adverse changes in the economy, which might affect our business prospects and could cause credit-related losses and expenses;

- adverse developments in our loan and investment portfolios;
- competitive factors in the banking industry, such as the trend towards consolidation in our market;

• changes in the banking legislation or the regulatory requirements of federal and state agencies applicable to bank holding companies and banks like our affiliate banks;

- acquisitions of other businesses by us and integration of such acquired businesses;

• changes in market, economic, operational, liquidity, credit and interest rate risks associated with our business; and

• the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

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



FIRST MERCHANTS CORPORATION  
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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CRITICAL ACCOUNTING POLICIES

Generally accepted accounting principles are complex and require us to apply significant judgments to various accounting, reporting and disclosure matters. We must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. For a complete discussion of our significant accounting policies, see "Notes to the Consolidated Financial Statements" in our Annual Report on Form 10-K for the year ended December 31, 2010. Certain policies are considered critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. We have reviewed the application of these policies with the Audit Committee of our Board of Directors.

We believe there have been no significant changes during the nine months ended September 30, 2011, to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2010.

BUSINESS SUMMARY

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 of 1893. The Bank also operates Lafayette Bank and Trust, Commerce National Bank and First Merchants Trust Company as divisions of First Merchants Bank, N.A. The Bank includes seventy-eight banking locations in twenty-three Indiana and two Ohio counties. In addition to its branch network, the Corporation's delivery channels include ATMs, check cards, interactive voice response systems, remote deposit and internet technology.

The Bank services the following Indiana counties: Adams, Brown, Carroll, Clinton, Delaware, Fayette, Hamilton, Hendricks, Henry, Howard, Jasper, Jay, Johnson, Madison, Miami, Montgomery, Morgan, Randolph, Tippecanoe, Union, Wabash, Wayne and White counties. Ohio counties include Butler and Franklin.

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.



FIRST MERCHANTS CORPORATION  
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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

REGULATORY DEVELOPMENTS

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.

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 1.50 percent. These new rules became effective on April 1, 2011.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Executive Summary

First Merchants Corporation reported a net loss available to common stockholders of \$6.4 million, or \$.25 per fully diluted common share for the quarter ended September 30, 2011, compared to net income of \$765,000, or \$.10 per common share for the quarter ended September 30, 2010. The Corporation's year-to-date net income available to common stockholders was \$2.6 million, or \$.10 per fully diluted common share, down from the prior year net income of \$9.2 million, or \$.38 per common share.

In the third quarter of 2011, an after-tax loss of \$12.3 million, or \$.47 per share, was recorded due to the accounting treatment for the extinguishment of trust preferred securities. The extinguishment of the trust preferred securities was done in conjunction with the redemption of 69,600 shares of the Corporation's fixed rate cumulative perpetual preferred stock, under the Capital Purchase Program, for \$69.6 million, the issuance of 90,783 shares of the Corporation's senior non-cumulative perpetual preferred stock, through the Small Business Lending Fund, for \$90.8 million and the issuance of 2.8 million of the Corporation's common stock for \$20.8 million.

In the second quarter of 2010, an after-tax gain of \$10.1 million applicable to income available to common stockholders was recorded. The gain was a result of favorable accounting treatment attributed to the exchange of 46,400 shares of the Corporation's fixed rate cumulative perpetual preferred stock for \$46.4 million of trust preferred securities. Also, as a result of this transaction, a \$5.4 million deferred tax liability was recorded resulting in a net decrease of the tax asset.

Net charge offs were \$9.6 million for the quarter, exceeding provision expense of \$5.6 million by \$4.0 million as certain charge offs were preceded by specific reserves. The specific reserves at September 30, 2011, were \$8.2 million compared to \$13.9 million at December 31, 2010, as specific reserves were charged off. Non-performing assets plus 90 days delinquent loans were \$106.7 million or 2.6 percent of total assets at September 30, 2011, compared to \$120.0 million, or 2.9 percent of total assets at December 31, 2010. The Corporation's allowance for loan losses decreased to 2.68 percent of total loans from 2.90 percent of loans at December 31, 2010.

Assets decreased by \$52.3 million during the first nine months of 2011. Loans, including loans held for sale, decreased \$132.0 million during the first nine months of 2011, or 4.6 percent, due to normal loan run-off coupled with a reduction in both consumer and commercial demand for borrowing. The combined cash and cash equivalents and interest bearing deposits declined by \$47.2 million. These declines have generated excess liquidity of \$179.2 million, of which \$111.0 million has been invested in the investment securities portfolio.

Deposits decreased \$204.6 million during the first nine months of 2011, or 6.3 percent. CDs below \$100,000 and CDs over \$100,000 accounted for \$91.2 million and \$56.6 million of the decline, respectively. Another \$51.4 million of the decline was a result of declining savings deposits. Management continues to focus on maximizing deposit pricing in an effort to balance maintaining strong customer relationships, remaining competitive in the local markets while still allowing higher cost deposits to mature.

Net deferred and refundable taxes have declined by \$9.8 million in the first nine months of 2011. The decline is primarily a result of receiving \$3.0 million in net tax refunds during 2011, utilization of \$2.2 million of deferred tax asset associated with net operating loss carryforwards and \$4.4 million reduction in deferred tax asset related to the allowance for loan losses. The change in deferred tax liability, which is in the net deferred tax asset, remained relatively neutral based on the decrease in liability of \$5.3 million related to the repayment of the preferred stock under the Capital Purchase Program, which was offset by the increase of \$6.8 million related to increased unrealized gains on securities.

The Corporation continues to maintain all regulatory capital ratios in excess of the regulatory definition of “well capitalized” as discussed in the section entitled “CAPITAL” below.

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NET INTEREST INCOME

Net interest income is the primary source of the Corporation's earnings. It is a function of net interest margin and the level of average earning assets. Net interest income and net interest margin are presented in the following table on a fully taxable equivalent basis, which adjusts tax-exempt or nontaxable interest income to an amount that would be comparable to interest subject to income taxes using the federal statutory tax rate of 35% in effect for all periods. Net interest margin increased 9 basis points from 3.93 percent in the third quarter of 2010 to 4.02 percent in the third quarter of 2011, while earning assets decreased by \$77 million. The table below presents the Corporation's asset yields, interest expense, and net interest income as a percent of average earning assets for the three and nine months ended September 30, 2011, and 2010.

During the nine months ended September 30, 2011, asset yields decreased 33 basis points on a fully taxable equivalent basis (FTE) and interest costs decreased 43 basis points, resulting in a 10 basis point (FTE) increase in net interest income as compared to the same period in 2010.

| (Dollars in thousands)                                             | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|--------------------------------------------------------------------|-------------------------------------|--------------|------------------------------------|--------------|
|                                                                    | 2011                                | 2010         | 2011                               | 2010         |
| Annualized net interest income                                     | \$ 143,402                          | \$ 142,731   | \$ 142,900                         | \$ 144,102   |
| Annualized FTE adjustment                                          | \$ 5,633                            | \$ 6,130     | \$ 5,781                           | \$ 6,152     |
| Annualized net interest income on a fully taxable equivalent basis | \$ 149,035                          | \$ 148,861   | \$ 148,681                         | \$ 150,254   |
| Average earning assets                                             | \$ 3,714,401                        | \$ 3,790,904 | \$ 3,736,503                       | \$ 3,871,484 |
| Interest income (FTE) as a percent of average earning assets       | 5.01%                               | 5.38%        | 5.05%                              | 5.38%        |
| Interest expense as a percent of average earning assets            | 0.99%                               | 1.45%        | 1.07%                              | 1.50%        |
| Net interest income (FTE) as a percent of average earning assets   | 4.02%                               | 3.93%        | 3.98%                              | 3.88%        |

Average earning assets include the average balance of securities classified as available for sale, computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment. Annualized amounts are computed utilizing a 30/360 day basis.

NON-INTEREST INCOME

Non-interest income increased by \$2,185,000 or 19.8% during the third quarter of 2011, compared to the third quarter of 2010. During the third quarter of 2011, gains recognized on the sale of investment securities totaled \$861,000 with no other-than-temporary impairment losses on pooled trust preferred investments. In comparison, during third quarter of 2010, gains recognized on the sale of investment securities totaled \$2,000 while other-than-temporary impairment losses on pooled trust preferred investments of \$656,000 were recognized.

Additionally, \$424,000 of fee income from origination of loan level hedges was recognized in the third quarter of 2011 with none being recognized during the same period of 2010. Interchange income from electronic card

transactions was \$251,000 higher in the third quarter of 2011 when compared to the third quarter of 2010. Gains on the sale of mortgage loans declined \$320,000 in the third quarter when compared to the same period in 2010. Additionally, service charges declined by \$235,000 when compared to the third quarter of 2010.

During the first nine months of 2011, non-interest income was \$36.1 million or 3.4% higher than the same period in 2010. The sale of investment securities resulted in net gains of approximately \$1,749,000 when netted against other-than-temporary impairment charges of \$400,000 recognized on pooled trust preferred investments, an increase of \$1,192,000 from the same period in 2010. Service charges declined \$1,227,000 from the same period in 2010 due to a decrease in the volume of customer overdrafts and returned items. Fee income from origination of loan level hedges increased \$430,000 from the same period in 2010. Insurance commissions were \$518,000 lower in the first nine months of 2011 than 2010, which was offset by an increase in investment commissions, gains on the sale of mortgage loans and interchange from electronic card transactions by \$357,000, \$248,000 and \$229,000 respectively.

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NON-INTEREST EXPENSE

Non-interest expenses for the third quarter of 2011, compared with the same period in 2010, decreased by \$913,000 or 2.6 percent. Salaries and benefits represented the largest increase of \$1,870,000, primarily related to health insurance expenses \$1,200,000 over the same period in 2010. These increases were offset by decreases in FDIC expenses of \$911,000, credit related expenses of \$984,000 and amortization of core deposit intangibles of \$406,000 over the same period in 2010.

Non-interest expenses in the first nine months of 2011 remained relatively constant to 2010, with a 1.6 percent decrease, or \$1,616,000, compared to the same period in 2010. Salaries and benefits represented the only material increase of \$2,102,000, with \$1,134,000 of the increase related to health insurance expenses with the remainder of the increase in salaries, commissions and incentives. Significant decreases in non-interest expenses, over the same period in 2010, included FDIC expenses of \$1,321,000 and amortization of core deposit intangibles of \$603,000.

INCOME TAX

The income tax expense for the nine months ended September 30, 2011, was \$6,356,000 on pre-tax net income of \$24,047,000, an effective tax rate of 26.4%. For the same period in 2010, the income tax benefit was \$3,374,000 on a pre-tax net loss of \$496,000.

CAPITAL

Capital adequacy is an important indicator of financial stability and performance. The Corporation maintained a strong capital position as tangible common equity to tangible assets was 6.88% at September 30, 2011, and 5.86% at December 31, 2010.

The Corporation and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. The assigned capital category is largely determined by three ratios that are calculated according to the regulations: total risk-based capital, Tier 1 capital, and Tier 1 leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios. At September 30, 2011, the management of the Corporation believes that it meets all capital adequacy requirements to which it is subject. The most recent notifications from the regulatory agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations.

To be considered well capitalized, a bank must have a total risk-based capital ratio of at least 10%, a Tier I capital ratio of at least 6%, a Tier 1 leverage ratio of at least 5%, and must not be subject to any order or directive requiring the bank to improve its capital level. An adequately capitalized bank has a total risk-based capital ratio of at least 8%, a Tier I capital ratio of at least 4% and a Tier 1 leverage ratio of at least 4%. Banks with lower capital levels are



deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized, depending on their actual levels. The appropriate federal regulatory agency may also downgrade a bank to the next lower capital category upon a determination that the bank is in an unsafe or unsound practice. Banks are required to monitor closely their capital levels and to notify their appropriate regulatory agency of any basis for a change in capital category.

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CAPITAL continued

As of September 30, 2011, the Corporation, on a consolidated basis, as well as the Bank, exceeded the minimum capital levels of the well capitalized category.

| (Dollars in thousands)                             | September 30, 2011 |        | December 31, 2010 |        |
|----------------------------------------------------|--------------------|--------|-------------------|--------|
|                                                    | Amount             | Ratio  | Amount            | Ratio  |
| <b>Consolidated</b>                                |                    |        |                   |        |
| Total risk-based capital (to risk-weighted assets) | \$ 479,785         | 16.21% | \$ 476,490        | 15.74% |
| Tier 1 capital (to risk-weighted assets)           | 402,350            | 13.60% | 388,090           | 12.82% |
| Tier 1 capital (to average assets)                 | 402,350            | 10.20% | 388,090           | 9.50%  |
| <b>First Merchants Bank</b>                        |                    |        |                   |        |
| Total risk-based capital (to risk-weighted assets) | \$ 470,344         | 15.96% | \$ 450,629        | 14.89% |
| Tier 1 capital (to risk-weighted assets)           | 433,275            | 14.79% | 412,654           | 13.64% |
| Tier 1 capital (to average assets)                 | 433,275            | 11.01% | 412,654           | 10.14% |

Tier I regulatory capital consists primarily of total stockholders' equity and subordinated debentures issued to business trusts categorized as qualifying borrowings, less non-qualifying intangible assets and unrealized net securities gains or losses.

On September 9, 2011, the Corporation entered into securities purchase agreements with two institutional investors, pursuant to which the Corporation sold an aggregate of 2,822,000 shares of its common stock in exchange for gross proceeds of \$21,165,000. The purchase price for each share of common stock was \$7.50. The common stock was issued in a direct private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder (the "Private Placement").

On September 22, 2011, the Corporation entered into a Securities Purchase Agreement (the "Purchase Agreement") with the 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 Purchase Agreement was entered into, and the Series B Preferred Stock was issued, pursuant to the SBLF program, a \$30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion. The Corporation also entered into two (2) letter agreements (each, a "Repurchase Letter") with the Treasury, pursuant to which the Corporation redeemed, out of the proceeds of the issuance of the Series B Preferred Stock in the amount of \$90,782,940 and cash of \$25,813,171 (of which \$21,165,000 was raised through the Private Placement of the Corporation's common stock on September 9, 2011) for an aggregate redemption price of \$116,596,111, including accrued but unpaid dividends to the date of redemption: (i) 69,600 shares of the Corporation's Fixed Rate Cumulative Perpetual Preferred Stock, Series A held by the Treasury, and (ii) 46,400 shares of trust preferred securities issued through the Corporation's wholly owned subsidiary trust, First Merchants Capital Trust, III, a Delaware Statutory Trust, held by the Treasury. The Treasury also holds a warrant to purchase 991,453 shares of the Corporation's common stock at an exercise price of \$17.55 per share. See information regarding the Corporation's preferred stock transactions in Note 10. Preferred Stock of the Notes To Consolidated Financial Statements of this

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAPITAL continued

Management believes that all of the above capital ratios are meaningful measurements for evaluating the safety and soundness of the Corporation. Additionally, management believes the following table is also meaningful when considering performance measures of the Corporation. The table details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures.

| (Dollars in thousands, except per share amounts)                             | September<br>30,<br>2011 | December<br>31,<br>2010 |
|------------------------------------------------------------------------------|--------------------------|-------------------------|
| Average goodwill                                                             | \$ 141,357               | \$ 141,357              |
| Average core deposit intangible (CDI)                                        | 11,074                   | 15,026                  |
| Average deferred tax on CDI                                                  | (2,534)                  | (3,385)                 |
| Intangible adjustment                                                        | \$ 149,897               | \$ 152,998              |
| Average stockholders' equity (GAAP capital)                                  | \$ 466,671               | \$ 470,379              |
| Average cumulative preferred stock issued under the Capital Purchase Program | (68,829)                 | (89,847)                |
| Intangible adjustment                                                        | (149,897)                | (152,998)               |
| Average tangible capital                                                     | \$ 247,945               | \$ 227,534              |
| Average assets                                                               | \$ 4,124,696             | \$ 4,271,715            |
| Intangible adjustment                                                        | (149,897)                | (152,998)               |
| Average tangible assets                                                      | \$ 3,974,799             | \$ 4,118,717            |
| Net income available to common stockholders                                  | \$ 2,587                 | \$ 11,722               |
| CDI amortization, net of tax                                                 | 1,771                    | 2,852                   |
| Tangible net income available to common stockholders                         | \$ 4,358                 | \$ 14,574               |
|                                                                              |                          |                         |
| Diluted earnings per share                                                   | \$ 0.10                  | \$ 0.48                 |
| Diluted tangible earnings per share                                          | \$ 0.17                  | \$ 0.60                 |
| Return on average GAAP capital                                               | 0.74%                    | 2.49%                   |
| Return on average tangible capital                                           | 2.34%                    | 6.40%                   |
| Return on average assets                                                     | 0.08%                    | 0.27%                   |
| Return on average tangible assets                                            | 0.15%                    | 0.35%                   |

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LOAN QUALITY/PROVISION FOR LOAN LOSSES

The Corporation's primary business focus is small business and middle market commercial and residential real estate, auto and small consumer lending, which results in portfolio diversification. Commercial loans are individually underwritten and judgmentally risk rated. They are periodically monitored and prompt corrective actions are taken on deteriorating loans. Retail loans are typically underwritten with statistical decision-making tools and are managed throughout their life cycle on a portfolio basis.

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The amount provided for loan losses and the determination of the adequacy of the allowance are based on a continuous review of the loan portfolio, including an internally administered loan "watch" list and an ongoing loan review. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that are not specifically identified.

Non-performing loans will change as a result of routine problem loan recognition and resolution through collections, sales or charge offs. The performance of any loan can be affected by external factors such as economic conditions, or factors particular to a borrower, such as actions of a borrower's management.

Non-accruals declined by \$11,658,000 during the nine month period; from \$90,591,000 at December 31, 2010, to the September 30, 2011, balance of \$78,933,000. In addition, other real estate owned declined \$1,502,000 during the first nine months of 2011. For other real estate owned, current appraisals are obtained to determine value as management continues to aggressively market these real estate assets. Accruing loan delinquent 90 or more days were \$1,595,000 at September 30, up slightly from \$1,330,000 at December 31, 2010.

|                                          | September<br>30,<br>2011 | December<br>31,<br>2010 |
|------------------------------------------|--------------------------|-------------------------|
| (Dollars in thousands)                   |                          |                         |
| <b>Non-Performing Assets:</b>            |                          |                         |
| Non-accrual loans                        | \$ 78,933                | \$ 90,591               |
| Renegotiated loans                       | 6,701                    | 7,139                   |
| Non-performing loans (NPL)               | 85,634                   | 97,730                  |
| Real estate owned and repossessed assets | 19,425                   | 20,927                  |
| Non-performing assets (NPA)              | 105,059                  | 118,657                 |
| 90+ days delinquent and still accruing   | 1,595                    | 1,330                   |
| NPAs & 90+ days delinquent               | \$ 106,654               | \$ 119,987              |
| Impaired Loans                           | \$ 87,772                | \$ 116,204              |

The composition of non-performing assets plus 90-days delinquent is reflected in the following table.

| September<br>30, | December<br>31, |
|------------------|-----------------|
|------------------|-----------------|

| (Dollars in thousands)                                              | 2011       | 2010       |
|---------------------------------------------------------------------|------------|------------|
| Non Performing Assets and 90+ Days<br>Delinquent:                   |            |            |
| Commercial and industrial loans                                     | \$ 16,253  | \$ 10,499  |
| Agricultural production financing and<br>other loans to farmers     | 304        | 544        |
| Real estate loans:                                                  |            |            |
| Construction                                                        | 17,487     | 28,907     |
| Commercial and farm land                                            | 50,202     | 54,297     |
| Residential                                                         | 21,664     | 25,339     |
| Individual's loans for household and<br>other personal expenditures | 162        | 401        |
| Other loans                                                         | 582        |            |
| Non performing assets plus 90+ days<br>delinquent                   | \$ 106,654 | \$ 119,987 |

A loan is deemed impaired when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected substantially within the contractual terms of the note. At September 30, 2011, impaired loans totaled \$87,772,000, which is a decrease of \$28,432,000 from the December 31, 2010, balance of \$116,204,000. At September 30, 2011, an allowance for losses was not deemed necessary for impaired loans totaling \$66,402,000, as there was no identified loss on these credits. An allowance of \$8,177,000 was recorded for the remaining balance of impaired loans totaling \$21,370,000 and is included in the corporation's allowance for loan losses.

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LOAN QUALITY/PROVISION FOR LOAN LOSSES continued

At September 30, 2011, the allowance for loan losses was \$73,074,000, a decrease of \$9,903,000 from year end 2010. As a percent of loans, the allowance was 2.68 percent at September 30, 2011, and 2.90 percent at December 31, 2010. The provision for loan losses for the first nine months of 2011 was \$16,775,000, a decrease of \$22,630,000 from \$39,405,000 for the same period in 2010. Specific reserves on impaired loans decreased \$5,737,000 from \$13,914,000 at December 31, 2010, to \$8,177,000 at September 30, 2011.

Net charge offs for the third quarter of 2011 were \$9,615,000, a decrease of \$4,216,000 from the same period in 2010. Of this amount, \$4,560,000, or 47.4%, was made up of four customer charge offs of more than \$500,000. Specific reserves totaling \$3,085,000 were held against these four loans at the time of charge off. In addition to the previously identified specific reserves, the provision was lower than net charge offs due to the decrease in criticized loans, which play a large part in the allowance for loan loss methodology as discussed in Note 3. Loans and Allowance, of the Notes To Consolidated Financial Statements of this Form 10Q. One of the primary drivers was a decrease in commercial loans graded Substandard, which declined \$66,225,000 or 25 percent since December 31, 2010. The distribution of the net charge offs for both the three months ended and nine months ended September 30, 2011, and September 30, 2010, is reflected in the following table.

| (Dollars in thousands)                                           | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|------------------------------------------------------------------|-------------------------------------|------------------|------------------------------------|------------------|
|                                                                  | 2011                                | 2010             | 2011                               | 2010             |
| <b>Net Charge Offs:</b>                                          |                                     |                  |                                    |                  |
| Commercial and industrial loans                                  | \$ 3,238                            | \$ (134)         | \$ (1,682)                         | \$ 13,983        |
| Agricultural production financing and other loans to farmers     | (68)                                | 366              | (224)                              | 1,008            |
| Real estate loans                                                |                                     |                  |                                    |                  |
| Construction                                                     | 640                                 | 14               | 5,830                              | 2,845            |
| Commercial and farm land                                         | 3,985                               | 9,891            | 17,658                             | 22,478           |
| Residential                                                      | 1,720                               | 3,241            | 4,710                              | 6,405            |
| Individual's loans for household and other personal expenditures | 103                                 | 453              | 398                                | 1,103            |
| Lease financing receivables, net of unearned income              | (1)                                 |                  | (4)                                | 54               |
| Other Loans                                                      | (2)                                 |                  | (8)                                |                  |
| <b>Total Net Charge Offs</b>                                     | <b>\$ 9,615</b>                     | <b>\$ 13,831</b> | <b>\$ 26,678</b>                   | <b>\$ 47,876</b> |

The declines in the value of commercial and residential real estate in our market over the last couple of years has had a negative impact on the underlying collateral value in our commercial, residential, land development and construction loans. Management continually evaluates commercial borrowers by including consideration of specific borrower cash flow analysis and estimated collateral values, types and amounts on non-performing loans, past and anticipated loan loss experience, changes in the composition of the loan portfolio, and the current condition and amount of loans outstanding. The determination of the provision in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio.

## LIQUIDITY

Liquidity management is the process by which we ensure that adequate liquid funds are available for the holding company and its subsidiaries. These funds are necessary in order to meet financial commitments on a timely basis. These commitments include withdrawals by depositors, funding credit obligations to borrowers, paying dividends to stockholders, paying operating expenses, funding capital expenditures, and maintaining deposit reserve requirements. Liquidity is monitored and closely managed by the asset/liability committee.

The Corporation's liquidity is dependent upon our receipt of dividends from the Bank, which is subject to certain regulatory limitations and access to other funding sources. Liquidity of the Bank is derived primarily from core deposit growth, principal payments received on loans, the sale and maturity of investment securities, net cash provided by operating activities, and access to other funding sources.



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LIQUIDITY continued

The most stable source of liability-funded liquidity for both the long-term and short-term is deposit growth and retention in the core deposit base. In addition, Federal Home Loan Bank ("FHLB") advances are utilized as funding sources. At September 30, 2011, total borrowings from the FHLB were \$168,764,000. The Bank has pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at September 30, 2011, was \$76,562,000.

The Bank currently has \$79,000,000 of Senior Notes (the "Notes") that are guaranteed by the FDIC under its Temporary Liquidity Guarantee Program ("TLGP") and are backed by the full faith and credit of the United States. The Notes mature on March 30, 2012. The Notes are issued by the Bank and are not obligations of, or guaranteed by, the Corporation. In connection with the FDIC's TLGP, the Bank entered into a Master Agreement with the FDIC that contains, among other things, certain terms and conditions that must be included in the governing documents for any senior debt securities issued by the Bank that are guaranteed pursuant to the FDIC's TLGP.

The principal source of asset-funded liquidity is investment securities classified as available for sale, the market values of which totaled \$496,608,000 at September 30, 2011, a decrease of \$42,762,000, or 7.93 percent, from December 31, 2010. Securities classified as held to maturity that are maturing within a short period of time can also be a source of liquidity. Securities classified as held to maturity that are maturing in one year or less, totaled \$2,010,000 at September 30, 2011. In addition, other types of assets such as cash and due from banks, federal funds sold, and securities purchased under agreements to resell, loans and interest-bearing deposits with other banks maturing within one year are sources of liquidity.

The Corporation currently has a \$55 million credit facility with Bank of America, N.A., comprised of (a) a term loan in the principal amount of \$5.0 million (the "Term Loan") and (b) a subordinated debenture in the principal amount of \$50.0 million (the "Subordinated Debt"). Pursuant to the terms of the underlying Loan Agreement (the "Loan Agreement"), the Term Loan and the Subordinated Debt each mature on February 15, 2015. The Term Loan is secured by a pledge of all of the issued and outstanding shares of the Bank.

The Loan Agreement contains certain customary representations and warranties and financial and negative covenants. A breach of any of these covenants could result in a default under the Loan Agreement. As of September 30, 2011, the Corporation failed to meet the minimum return on average total assets covenant of at least 0.75%.

The Loan Agreement provides that upon an event of default as the result of the Corporation's failure to comply with a financial covenant, Bank of America may (a) declare the \$5 million outstanding principal amount of the Term Loan immediately due and payable, (b) exercise all of its rights and remedies at law, in equity and/or pursuant to any or all collateral documents, including foreclosing on the collateral if payment of the Term Loan is not made in full, and (c) add a default rate of 3% per annum to the Term Loan. Because the Subordinated Debt is treated as Tier 2 capital for regulatory capital purposes, the Loan Agreement does not provide Bank of America with any right of acceleration or other remedies with regard to the Subordinated Debt upon an event of default caused by the Corporation's breach of a financial covenant. To date, Bank of America has chosen to apply the default rate, but not to accelerate the Term Loan based on the Corporation's failure to meet these financial covenants.

In the normal course of business, the Bank is a party to a number of other off-balance sheet activities that contain credit, market and operational risk that are not reflected in whole or in part in our consolidated financial statements. Such activities include traditional off-balance sheet credit-related financial instruments, commitments under operating leases and long-term debt.

The Bank provides customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments at September 30, 2011, are as follows:

|                                   | September<br>30,<br>(Dollars in thousands) 2011 |
|-----------------------------------|-------------------------------------------------|
| Amounts of commitments:           |                                                 |
| Loan commitments to extend credit | \$ 655,477                                      |
| Standby letters of credit         | 21,624                                          |
|                                   | \$ 677,101                                      |

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LIQUIDITY continued

Since many of the commitments are expected to expire unused or be only partially used, the total amount of unused commitments in the preceding table does not necessarily represent future cash requirements.

In addition to owned banking facilities, the Corporation has entered into a number of long-term leasing arrangements to support ongoing activities. The required payments under such commitments and borrowings at September 30, 2011, are as follows:

| (Dollars in thousands)                                         | 2011<br>Remaining | 2012       | 2013     | 2014      | 2015      | 2016      | 2017 and<br>after | Total      |
|----------------------------------------------------------------|-------------------|------------|----------|-----------|-----------|-----------|-------------------|------------|
| Operating leases                                               | \$ 542            | \$ 2,108   | \$ 1,848 | \$ 1,708  | \$ 1,534  | \$ 1,166  | \$ 741            | \$ 9,647   |
| Federal funds purchased                                        | 27,946            |            |          |           |           |           |                   | 27,946     |
| Securities sold under repurchase agreements                    | 92,847            | 14,250     |          | 10,000    |           |           |                   | 117,097    |
| Federal Home Loan Bank advances                                | 55,500            | 49,862     | 219      | 1,207     | 27,000    | 29,095    | 5,881             | 168,764    |
| Subordinated debentures, revolving credit lines and term loans | 143               | 78,992     |          |           | 55,000    |           | 60,826            | 194,961    |
| Total                                                          | \$ 176,978        | \$ 145,212 | \$ 2,067 | \$ 12,915 | \$ 83,534 | \$ 30,261 | \$ 67,448         | \$ 518,415 |

INTEREST SENSITIVITY AND DISCLOSURE ABOUT MARKET RISK

Asset/Liability Management has been an important factor in the Corporation's ability to record consistent earnings growth through periods of interest rate volatility and product deregulation. Management and the Board of Directors monitor the Corporation's liquidity and interest sensitivity positions at regular meetings to review how changes in interest rates may affect earnings. Decisions regarding investment and the pricing of loan and deposit products are made after analysis of reports designed to measure liquidity, rate sensitivity, the Corporation's exposure to changes in net interest income given various rate scenarios and the economic and competitive environments.

It is the objective of the Corporation to monitor and manage risk exposure to net interest income caused by changes in interest rates. It is the goal of the Corporation's Asset/Liability function to provide optimum and stable net interest income. To accomplish this, management uses two asset liability tools. GAP/Interest Rate Sensitivity Reports and Net Interest Income Simulation Modeling are constructed, presented and monitored quarterly.

Net interest income simulation modeling, or earnings-at-risk, measures the sensitivity of net interest income to various interest rate movements. The Corporation's asset liability process monitors simulated net interest income under three separate interest rate scenarios; base, rising and falling. Estimated net interest income for each scenario is calculated over a 12-month horizon. The immediate and parallel changes to the base case scenario used in the model are

presented below. The interest rate scenarios are used for analytical purposes and do not necessarily represent management's view of future market movements. Rather, these are intended to provide a measure of the degree of volatility interest rate movements may introduce into the earnings of the Corporation.

The base scenario is highly dependent on numerous assumptions embedded in the model, including assumptions related to future interest rates. While the base sensitivity analysis incorporates management's best estimate of interest rate and balance sheet dynamics under various market rate movements, the actual behavior and resulting earnings impact will likely differ from that projected. For certain assets, the base simulation model captures the expected prepayment behavior under changing interest rate environments. Assumptions and methodologies regarding the interest rate or balance behavior of indeterminate maturity products, such as savings, money market, NOW and demand deposits, reflect management's best estimate of expected future behavior.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTEREST SENSITIVITY AND DISCLOSURE ABOUT MARKET RISK continued

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of September 30, 2011, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In the current rate environment, many driver rates are at or near historical lows, thus total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management have the following results:

| Driver Rates   | At September 30, 2011              |                               |
|----------------|------------------------------------|-------------------------------|
|                | RISING<br>(200<br>Basis<br>Points) | FALLING<br>(100 Basis Points) |
| Prime          | 200                                | 0                             |
| Federal Funds  | 200                                | 0                             |
| One-Year CMT   | 200                                | (2)                           |
| Three-Year CMT | 200                                | (6)                           |
| Five-Year CMT  | 200                                | 0                             |
| CD's           | 200                                | (49)                          |
| FHLB Advances  | 200                                | 0                             |

Results for the base, rising 200 basis points, and falling 100 basis points interest rate scenarios are listed below based upon the Corporation's rate sensitive assets and liabilities at September 30, 2011. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

| Driver Rates                | Base       | At September 30, 2011           |                                  |
|-----------------------------|------------|---------------------------------|----------------------------------|
|                             |            | RISING<br>(200 Basis<br>Points) | FALLING<br>(100 Basis<br>Points) |
| Net Interest Income         | \$ 142,697 | \$ 143,908                      | \$ 137,073                       |
| Variance from Base          |            | \$ 1,211                        | \$ (5,624)                       |
| Percent of change from base |            | 0.85%                           | -3.94%                           |
| Policy Limit                |            | -5.00%                          | -2.00%                           |

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of December 31, 2010, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate

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and parallel changes to the base case scenario. In addition, total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management in the base simulation are as follows:

| Driver Rates   | At December 31, 2010               |                               |
|----------------|------------------------------------|-------------------------------|
|                | RISING<br>(200<br>Basis<br>Points) | FALLING<br>(100 Basis Points) |
| Prime          | 200                                | 0                             |
| Federal Funds  | 200                                | 0                             |
| One-Year CMT   | 200                                | (3)                           |
| Three-Year CMT | 200                                | (37)                          |
| Five-Year CMT  | 200                                | (77)                          |
| CD's           | 200                                | (59)                          |
| FHLB Advances  | 200                                | (47)                          |

Results for the base, rising 200 basis points, and falling 100 basis points interest rate scenarios are listed below. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

| Driver Rates                | Base       | At December 31, 2010            |                                  |
|-----------------------------|------------|---------------------------------|----------------------------------|
|                             |            | RISING<br>(200 Basis<br>Points) | FALLING<br>(100 Basis<br>Points) |
| Net Interest Income         | \$ 144,603 | \$ 147,478                      | \$ 140,811                       |
| Variance from Base          |            | \$ 2,875                        | \$ (3,792)                       |
| Percent of change from base |            | 1.99%                           | -2.62%                           |
| Policy Limit                |            | -5.00%                          | -2.00%                           |

FIRST MERCHANTS CORPORATION  
FORM 10Q

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

EARNING ASSETS

The following table presents the earning asset mix as of September 30, 2011, and December 31, 2010. Earning assets decreased by \$79,993,000 in the nine months ended September 30, 2011. Federal funds sold decreased \$7,463,000, and interest-bearing time deposits decreased \$49,101,000. Investments increased by approximately \$111,031,000, while loans and loans held for sale decreased by \$131,957,000. Excess liquidity mainly created by the decline in the loan portfolio was used to increase the investment securities portfolio. The four largest loan segments that decreased were construction, commercial and farmland, residential real estate and individual loans.

| (Dollars in thousands)                           | September 30,<br>2011 | December 31,<br>2010 |
|--------------------------------------------------|-----------------------|----------------------|
| Federal funds sold                               | \$                    | \$ 7,463             |
| Interest-bearing time deposits                   | 16,115                | 65,216               |
| Investment securities available for sale         | 496,608               | 539,370              |
| Investment securities held to maturity           | 441,220               | 287,427              |
| Mortgage loans held for sale                     | 12,257                | 21,469               |
| Loans                                            | 2,712,938             | 2,835,683            |
| Federal Reserve and Federal Home Loan Bank stock | 31,381                | 33,884               |
| Total                                            | \$ 3,710,519          | \$ 3,790,512         |

OTHER

The Securities and Exchange Commission maintains a Web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission, including us, and that address is (<http://www.sec.gov>).

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required under this item is included as part of Management's Discussion and Analysis of Financial Condition and Results of Operations, under the headings "LIQUIDITY" and "INTEREST SENSITIVITY AND DISCLOSURE ABOUT MARKET RISK".

ITEM 4. CONTROLS AND PROCEDURES

At the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information

required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in the Corporation's internal control over financial reporting identified in connection with the evaluation discussed above that occurred during the Corporation's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.



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## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

None

## ITEM 1.A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in the Corporation's December 31, 2010, Annual Report on Form 10-K.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

a. None

b. None

c. Issuer Purchases of Equity Securities

The following table presents information relating to our purchases of equity securities during the quarter ended September 30, 2011, as follows:

| Period          | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as part of Publicly announced Plans or Programs | Maximum Number of Shares that may yet be Purchased Under the Plans or Programs |
|-----------------|----------------------------------|------------------------------|----------------------------------------------------------------------------------|--------------------------------------------------------------------------------|
| July, 2011      | 51                               | \$ 9.04                      | 0                                                                                | 0                                                                              |
| August, 2011    |                                  |                              | 0                                                                                | 0                                                                              |
| September, 2011 | 204                              | \$ 9.22                      | 0                                                                                | 0                                                                              |

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

## ITEM 4. [RESERVED]

## ITEM 5. OTHER INFORMATION

a. None

b. None

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ITEM 6. EXHIBITS.

Exhibit No: Description of Exhibits:

|         |                                                                                                                                                                                                                                                        |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1     | First Merchants Corporation Articles of Incorporation, as amended (1)                                                                                                                                                                                  |
| 3.2     | Bylaws of First Merchants Corporation dated October 28, 2009 (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2009)                                                                                                           |
| 4.1     | First Merchants Corporation Amended and Restated Declaration of Trust of First Merchants Capital Trust II dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)                                          |
| 4.2     | Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)                                                                                                                                          |
| 4.3     | Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)                                                                                                                                |
| 4.4     | Form of Capital Securities Certification of First Merchants Capital Trust II (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)                                                                                                |
| 4.5     | Warrant to Purchase Common Stock of First Merchants Corporation dated February 20, 2009 (Incorporated by reference to registrant's Form 8-K filed on February 23, 2009)                                                                                |
| 4.6     | First Merchants Corporation Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to registrant's Post-Effective Amendment No. 1 to Form S-3 filed on August 21, 2009)                                                              |
| 10.1    | First Merchants Corporation Share Purchase Agreement with Castle Creek Capital Partners IV, L.P. and Endicott Opportunity Partners III, L.P. dated September 9, 2011 (Incorporated by reference to registrant's Form 8-K filed on September 13, 2011)  |
| 10.2    | First Merchants Corporation Securities Purchase Agreement with the U.S. Department of Treasury, with respect to the Series B Preferred Stock dated September 22, 2011 (Incorporated by reference to registrant's Form 8-K filed on September 23, 2011) |
| 10.3    | First Merchants Corporation Repurchase Letter with the U.S. Department of Treasury, with respect to the Designated Preferred Stock dated September 23, 2011 (Incorporated by reference to registrant's Form 8-K filed on September 23, 2011)           |
| 10.4    | First Merchants Corporation Repurchase Letter with the U.S. Department of Treasury, with respect to the Capital Securities dated September 22, 2011 (Incorporated by reference to registrant's Form 8-K filed on September 23, 2011)                   |
| 31.1    | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)                                                                                                                                               |
| 31.2    | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)                                                                                                                                               |
| 32      | Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (1)                                                                                                                            |
| 101.INS | XBRL Instance Document (2)                                                                                                                                                                                                                             |
| 101.SCH | XBRL Taxonomy Extension Schema Document (2)                                                                                                                                                                                                            |

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101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (2)

101.DEF XBRL Taxonomy Extension Definition Linkbase Document (2)

101.LAB XBRL Taxonomy Extension Label Linkbase Document (2)

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document (2)

(1) Filed herewith.

(2) Furnished herewith.

FIRST MERCHANTS CORPORATION  
FORM 10Q

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

First Merchants Corporation

(Registrant)

Date: November 9, 2011

Michael C. Rechin

President and Chief Executive Officer

(Principal Executive Officer)

by /s/ Michael C. Rechin

Date: November 9, 2011

Mark K. Hardwick

Executive Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)

by /s/ Mark K. Hardwick

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INDEX TO EXHIBITS

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(2) Furnished herewith.

FIRST MERCHANTS CORPORATION  
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Exhibit 3.1

ARTICLES OF INCORPORATION  
OF  
FIRST MERCHANTS CORPORATION

Following are the Articles of Incorporation, as amended, of First Merchants Corporation (hereinafter referred to as the "Corporation"), a corporation existing pursuant to the provisions of the Indiana Business Corporation Law, as amended (hereinafter referred to as the "Act"):

ARTICLE I

Name

The name of the Corporation is First Merchants Corporation.

ARTICLE II

Purposes

The purposes for which the Corporation is formed are:

Section 1. To acquire control of The Merchants National Bank of Muncie and to operate as a bank holding company.

Section 2. General Powers. To possess, exercise, and enjoy all rights, powers and privileges conferred upon bank holding companies by the Bank Holding Company Act of 1956 as amended and as hereafter amended or supplemented, and all other rights and powers authorized by the laws of the State of Indiana, and the laws of the United States of America applicable to bank holding companies and the regulations of the Board of Governors of the Federal Reserve System.

Section 3. To Deal in Real Property. Subject to the limitations of Section 2 above, to acquire by purchase, exchange, lease or otherwise, and to hold, own, use, construct, improve, equip, manage, occupy, mortgage, sell, lease, convey, exchange or otherwise dispose of, alone or in conjunction with others, real estate and leaseholds of every kind, character and description whatsoever and wheresoever situated, and any other interests therein, including, but without limiting the generality thereof, buildings, factories, warehouses, offices and structures of all kinds.

Section 4. Capacity to Act. Subject to the limitations of Section 2 above, to have the capacity to act possessed by natural persons and to perform such acts as are necessary and advisable to accomplish the purposes, activities and business of the Corporation.

Section 5. To Act as Agent. Subject to the limitations of Section 2 above, to act as agent or representative for any firm, association, corporation, partnership, government or person, public or private, with respect to any activity or business of the Corporation.



Section 6. To Make Contracts and Guarantees. Subject to the limitations of Section 2 above, to make, execute and perform, or cancel and rescind, contracts of every kind and description, including guarantees and contracts of suretyship, with any firm, association, corporation, partnership, government or person, public or private.

Section 7. To Borrow Funds. Subject to the limitations of Section 2 above, to borrow moneys for any activity or business of the Corporation and, from time to time, without limit as to amount, to draw, make, accept, endorse, execute and issue promissory notes, drafts, bills of exchange, warrants, bonds, debentures, notes, trust receipts, and other negotiable or non-negotiable instruments and evidences of indebtedness, and to secure the payment thereof, and the interest thereon, by mortgage, pledge, conveyance, or assignment in trust of all or any part of the assets of the Corporation, real, personal or mixed, including contract rights, whether at the time owned or thereafter acquired, and to sell, exchange or otherwise dispose of such securities or other obligations of the Corporation.

FIRST MERCHANTS CORPORATION  
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Section 8. To Deal in its Own Securities. Subject to the limitations of Section 2 above, to purchase, take, receive or otherwise acquire, and to hold, own, pledge, transfer or otherwise dispose of shares of its own capital stock and other securities. Purchases of the Corporation's own shares, whether direct or indirect, may be made without shareholder approval only to the extent of unreserved and unrestricted earned surplus available therefor.

ARTICLE III

Period of Existence

The period during which the Corporation shall continue is perpetual.

Article IV

Resident Agent and Principal Office

Section 1. Resident Agent. The name and address of the Corporation's Resident Agent for service of process is:

Mark K. Hardwick  
200 East Jackson Street  
Muncie, IN 47305

Section 2. Principal Office. The post office address of the principal office of the Corporation is:

200 East Jackson Street  
Muncie, IN 47305

ARTICLE V

Authorized Shares

Section 1. Number of Shares. The total number of shares of common stock which the Corporation is to have authority to issue is 50,000,000, all with no par value. The total number of shares of preferred stock the Corporation is to have authority to issue is 500,000, all with no par value.

Section 2. Terms of Shares. The authorized shares of "Common Stock" shall be equal to every other share of Common Stock and shall participate equally with other shares of Common Stock in all earnings and profits of the Corporation and on distribution of assets, either on dissolution, liquidation or otherwise. The authorized shares of "Preferred Stock" shall be equal to every other share of Preferred Stock and shall participate equally with other shares of Preferred Stock. The terms of the Preferred Stock and its relative rights, preferences, limitations or restrictions shall be established by the Board of Directors prior to issuance of any Preferred Stock.

Section 3. Voting Rights. Each holder of Common Stock shall have the right to vote on all matters presented to shareholders and shall be entitled on all matters including elections of Directors to one vote for each

share of Common Stock registered in his/her name on the books of the Corporation. The voting rights of the Preferred Stock, if any, shall be determined by the Board of Directors prior to issuance of the Preferred Stock.

## ARTICLE VI

### Requirements Prior to Doing Business

The Corporation will not commence business until consideration of the value of at least One Thousand Dollars (\$1,000.00) has been received for the issuance of shares.

FIRST MERCHANTS CORPORATION  
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ARTICLE VII

Directors

Section 1. Number. The number of Directors of the Corporation shall not be less than nine (9) nor more than twenty-one (21), as may be specified from time to time by the Bylaws. If and whenever the Bylaws do not contain a provision specifying the number of Directors, the number shall be sixteen (16). The Directors shall be classified, with respect to the time for which they severally hold office, into three (3) classes as nearly equal in number as possible, as shall be specified in the Bylaws, one class to be elected for a term expiring at each annual meeting of shareholders, with each Director to hold office until his successor is elected and qualified. At each annual meeting of shareholders, the successor of each Director whose term expires at that meeting shall be elected to hold office for a term expiring at the annual meeting of shareholders held in the third year following the year of his election, or until his successor is elected and qualified.

Section 2. Names and Post Office Addresses of the Directors. The names and post office addresses of the initial Board of Directors of the Corporation are:

| Name               | Number and Street or<br>Building | City       | State | Zip Code |
|--------------------|----------------------------------|------------|-------|----------|
| Stefan S. Anderson | 2705 W. Twickingham Drive        | Muncie     | IN    | 47304    |
| Thomas F. Bluemle  | 1900 N. Brentwood Lane           | Muncie     | IN    | 47304    |
| Frank A. Bracken   | 1011 E. Parkway Drive            | Muncie     | IN    | 47304    |
| Clell W. Douglass  | 305 Normandy Drive               | Muncie     | IN    | 47304    |
| David A. Galliher  | 2500 W. Berwyn Road              | Muncie     | IN    | 47304    |
| William P. Givens  | 1209 W. Beechwood Avenue         | Muncie     | IN    | 47303    |
| John W. Hartmeyer  | 818 W. Riverside Avenue          | Muncie     | IN    | 47303    |
| David W. Howell    | Rural Route #2, Box 174          | Middletown | IN    | 47358    |
| Betty J. Kendall   | Rural Route #14, Box 425         | Muncie     | IN    | 47302    |
| Don E. Marsh       | 1250 Warwick Road                | Muncie     | IN    | 47304    |
| Robert H. Mohlman  | 3405 N. Vienna Woods<br>Drive    | Muncie     | IN    | 47304    |
| Robert R. Park     | Rural Route #2, Box 126          | Gaston     | IN    | 47342    |
| Peter L. Roesner   | 2207 W. Wiltshire Road           | Muncie     | IN    | 47304    |
| Hamer D. Shafer    | 3500 W. Gatewood Lane            | Muncie     | IN    | 47304    |
| Robert M. Smitson  | 2601 W. Chelsea Drive            | Muncie     | IN    | 47304    |
| Reed D. Voran      | 2308 W. Wiltshire Road           | Muncie     | IN    | 47304    |

Section 3. Qualifications of Directors. Directors need not be shareholders of the Corporation.

ARTICLE VIII

Incorporator(s)

The name and post office address of the incorporator of the Corporation is:

Stefan S. Anderson  
200 East Jackson Street  
Muncie, IN 47305

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ARTICLE IX

Provisions for Regulation of Business  
and Conduct of Affairs of Corporation

Section 1. Meetings of Shareholders. Meetings of shareholders of the Corporation shall be held at such place, within or without the State of Indiana, as may be specified in the notices or waivers of notice of such meetings.

Section 2. Meetings of Directors. Meetings of Directors of the Corporation shall be held at such place, within or without the State of Indiana, as may be specified in the notices or waivers of notice of such meetings. A member of the Board of Directors or of a committee designated by the Board may participate in a meeting of the Board or committee by means of a conference telephone or similar communications equipment by which all persons participating in the meeting can communicate with each other, and participation by these means constitutes presence in person at the meeting.

Section 3. Consideration for Shares. Shares of stock of the Corporation shall be issued or sold in such manner and for such amount of consideration as may be fixed from time to time by the Board of Directors.

Section 4. Bylaws of the Corporation. The Board of Directors, unless otherwise provided in the Bylaws or in these Articles of Incorporation, may by a majority vote of the actual number of Directors elected and qualified from time to time make, alter, amend or repeal the Bylaws.

The Board of Directors may, by resolution adopted by a majority of the actual number of Directors elected and qualified, from time to time, designate from among its members an executive committee and one or more other committees, each of which, to the extent provided in the resolution, the Articles of Incorporation, or the Bylaws, may exercise all of the authority of the Board of Directors of the Corporation, including, but not limited to, the authority to issue and sell or approve any contract to issue and sell, securities or shares of the Corporation or designate the terms of a series of a class of securities or shares of the Corporation. The terms which may be affixed by each such committee include, but are not limited to, the price, dividend rate, and provisions of redemption, a sinking fund, conversion, voting or preferential rights or other features of securities or class or series of a class of shares. Each such committee may have full power to adopt a final resolution which sets forth those terms and to authorize a statement of such terms to be filed with the Secretary of State. However, no such committee has the authority to declare dividends or distributions, amend the Articles of Incorporation or the Bylaws, approve a plan of merger or consolidation even if such plan does not require shareholder approval, reduce earned or capital surplus, authorize or approve the reacquisition of shares unless pursuant to a general formula or method specified by the Board of Directors, or recommend to the shareholders a voluntary dissolution of the Corporation or a revocation thereof. No member of any such committee shall continue to be a member thereof after he ceases to be a Director of the Corporation. The calling and holding of meetings of any such committee and its method of procedure shall be determined by the Board of Directors. A member of the Board of Directors shall not be liable for any action taken by any such committee if he is not a member of that committee and has acted in good faith and in a manner he reasonably believes is in the best interest of the Corporation.

Section 5. Consent Action by Shareholders. Any action required by statute to be taken at a meeting of the shareholders, or any action which may be taken at a meeting of the shareholders, may be taken without a meeting if, prior to such action, a consent in writing, setting forth the action so taken, shall be signed by all of the shareholders entitled to vote with respect to the subject matter thereof, and such written consent is filed with the minutes of the

proceedings of the shareholders.

Section 6. Consent Action by Directors. Any action required or permitted to be taken at any meeting of the Board of Directors or any committee thereof may be taken without a meeting, if prior to such action a written consent to such action is signed by all members of the Board of Directors or such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the Board of Directors or committee.

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Section 7. Interest of Directors in Contracts. Any contract or other transaction between the Corporation or any corporation in which this Corporation owns a majority of the capital stock shall be valid and binding, notwithstanding that the Directors or officers of this Corporation are identical or that some or all of the Directors or officers, or both, are also directors or officers of such other corporation.

Any contract or other transaction between the Corporation and one or more of its Directors or members or employees, or between the Corporation and any firm of which one or more of its Directors are members or employees or in which they are interested, or between the Corporation and any corporation or association of which one or more of its Directors are stockholders, members, directors, officers, or employees, or in which they are interested, shall be valid for all purposes notwithstanding the presence of such Director or Directors at the meeting of the Board of Directors of the Corporation which acts upon, or in reference to, such contract or transaction and notwithstanding his or their participation in such action, if the fact of such interest shall be disclosed or known to the Board of Directors and the Board of Directors shall authorize, approve and ratify such contract or transaction by a vote of a majority of the Directors present, such interested Director or Directors to be counted in determining whether a quorum is present, but not to be counted in calculating the majority of such quorum necessary to carry such vote. This Section shall not be construed to invalidate any contract or other transaction which would otherwise be valid under the common and statutory law applicable thereto.

Section 8. Indemnification of Directors, Officers, Employees and Agents. Every person who is or was a Director, officer, employee or agent of this Corporation or of any other corporation for which he is or was serving in any capacity at the request of this Corporation shall be indemnified by this Corporation against any and all liability and expense that may be incurred by him in connection with or resulting from or arising out of any claim, action, suit or proceeding, provided that such person is wholly successful with respect thereto or acted in good faith in what he reasonably believed to be in or not opposed to the best interest of this Corporation or such other corporation, as the case may be, and, in addition, in any criminal action or proceeding in which he had no reasonable cause to believe that his conduct was unlawful. As used herein, "claim, action, suit or proceeding" shall include any claim, action, suit or proceeding (whether brought by or in the right of this Corporation or such other corporation or otherwise), civil, criminal, administrative or investigative, whether actual or threatened or in connection with an appeal relating thereto, in which a Director, officer, employee or agent of this Corporation may become involved, as a party or otherwise,

(i) by reason of his being or having been a Director, officer, employee, or agent of this Corporation or such other corporation or arising out of his status as such or

(ii) by reason of any past or future action taken or not taken by him in any such capacity, whether or not he continues to be such at the time such liability or expense is incurred.

The terms "liability" and "expense" shall include, but shall not be limited to, attorneys' fees and disbursements, amounts of judgments, fines or penalties, and amounts paid in settlement by or on behalf of a Director, officer, employee, or agent, but shall not in any event include any liability or expenses on account of profits realized by him in the purchase or sale of securities of the Corporation in violation of the law. The termination of any claim, action, suit or proceeding, by judgment, settlement (whether with or without court approval) or conviction or upon a plea of guilty or of nolo contendere, or its equivalent, shall not create a presumption that a Director, officer, employee, or agent did not meet the standards of conduct set forth in this paragraph.

Any such Director, officer, employee, or agent who has been wholly successful with respect to any such claim, action, suit or proceeding shall be entitled to indemnification as a matter of right. Except as provided in the preceding



sentence, any indemnification hereunder shall be made only if (i) the Board of Directors acting by a quorum consisting of Directors who are not parties to or who have been wholly successful with respect to such claim, action, suit or proceeding shall find that the Director, officer, employee, or agent has met the standards of conduct set forth in the preceding paragraph; or (ii) independent legal counsel shall deliver to the Corporation their written opinion that such Director, officer, employee, or agent has met such standards of conduct.

If several claims, issues or matters of action are involved, any such person may be entitled to indemnification as to some matters even though he is not entitled as to other matters.

The Corporation may advance expenses to or, where appropriate, may at its expense undertake the defense of any such Director, officer, employee, or agent upon receipt of an undertaking by or on behalf of such person to repay such expenses if it should ultimately be determined that he is not entitled to indemnification hereunder.

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The provisions of this Section shall be applicable to claims, actions, suits or proceedings made or commenced after the adoption hereof, whether arising from acts or omissions to act during, before or after the adoption hereof.

The rights of indemnification provided hereunder shall be in addition to any rights to which any person concerned may otherwise be entitled by contract or as a matter of law and shall inure to the benefit of the heirs, executors and administrators of any such person.

The Corporation may purchase and maintain insurance on behalf of any person who is or was a Director, officer, employee or agent of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation against any liability asserted against him and incurred by him in any capacity or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under the provisions of this Section or otherwise.

Section 9. Distributions Out of Capital Surplus. The Board of Directors of the Corporation may from time to time distribute to its shareholders out of the capital surplus of the Corporation a portion of its assets, in cash or property, without the assent or vote of the shareholders, provided that with respect to such a distribution the requirements of the Act other than shareholder approval are satisfied.

Section 10. Powers of Directors. In addition to the powers and the authority granted by these Articles or by statute expressly conferred, the Board of Directors of the Corporation is hereby authorized to exercise all powers and to do all acts and things as may be exercised or done under the laws of the State of Indiana by a corporation organized and existing under the provisions of the Act and not specifically prohibited or limited by these Articles.

Section 11. Removal of Directors. Any and all members of the Board of Directors may be removed, with or without cause, at a meeting of the shareholders called expressly for that purpose by the affirmative vote of the holders of not less than two-thirds (2/3) of the outstanding shares of capital stock then entitled to vote on the election of Directors, except that if the Board of Directors, by an affirmative vote of at least two-thirds (2/3) of the entire Board of Directors, recommends removal of a Director to the shareholders, such removal may be effected by the affirmative vote of the holders of not less than a majority of the outstanding shares of capital stock then entitled to vote on the election of Directors at a meeting of shareholders called expressly for that purpose.

Section 12. Fair Price, Form of Consideration and Procedural Safeguards for Certain Business Combinations.

(A) The affirmative vote of the holders of not less than three-fourths (3/4) of the Voting Shares (as hereinafter defined) of the Corporation shall be required for the authorization or adoption, except as provided in subsection (D) of this Section, of the following transactions:

1. Any merger or consolidation of the Corporation or its subsidiary or subsidiaries (as hereinafter defined) with or into either of the following:

(a) 10% Shareholders (as hereinafter defined); or

(b) Any other corporation (whether or not itself a 10% Shareholder) which, after such merger or consolidation, would be an Affiliate (as hereinafter defined) of a 10% Shareholder.

2. Any sale, lease, exchange, transfer or other disposition (including, without limitation, the granting of a mortgage or other security interest) to or with any 10% Shareholder of any material part of the assets of the Corporation or any of its subsidiaries; and
3. A liquidation or dissolution of the Corporation or any material subsidiary thereof or adoption of any plan with respect thereto.
4. Any reclassification of securities (including any reverse stock split), or recapitalization of the Corporation, or any merger or consolidation of the Corporation with any of its subsidiaries or any other transaction (whether or not with or into or otherwise involving a 10% Shareholder) which has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any class of equity or convertible securities of the Corporation or any subsidiary which is directly or indirectly owned by any 10% Shareholder; and

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5. Any agreement, contract or other arrangement providing for any one or more of the actions specified in the foregoing clauses (A)1. through (A)4.

(B) Prior to the approval of any of the transactions referred to in subsection (A) of this section ("Business Combination"), the Board of Directors of the Corporation shall make an evaluation of all relevant factors and issues arising out of or in connection with any such Business Combination and shall report to the shareholders the conclusion which the Board of Directors reaches from such evaluation. Relevant factors and issues shall include consideration of the impact which any such Business Combination will have on the community in which the Corporation or its subsidiaries conducts business, the employees of the Corporation or any of its subsidiaries, and the suppliers and customers of the Corporation and its subsidiaries, and shall also include any and all other factors which the Board of Directors in its discretion deems relevant.

(C) The following definitions shall apply when used in this Section:

1. "10% Shareholder" shall mean, in respect of any Business Combination, any person (other than the Corporation) who or which, as of the record date for the determination of shareholders entitled to notice of and to vote on such Business Combination or immediately prior to the consummation of any such Business Combination:

(a) Is the beneficial owner (as determined in accordance with Rule 13d-3 promulgated by the Securities and Exchange Commission) ("Beneficial Owner"), directly or indirectly, of not less than ten percent (10%) of the Voting Shares;  
or

(b) Is an Affiliate (as hereinafter defined) of the Corporation and at any time within two years prior thereto was the Beneficial Owner, directly or indirectly, of not less than ten percent (10%) of the then outstanding Voting Shares;  
or

(c) Any individual, corporation, partnership or other person or entity which, together with any of its Affiliates (as hereinafter defined), beneficially owns in the aggregate more than ten percent (10%) of the Voting Shares of the Corporation.

2. "Voting Shares" includes:

(a) Any securities of the Corporation which are entitled to vote on any matter referred to in this Section;

(b) Any securities, including but not limited to, preferred stock, bonds, debentures, or options, which can be converted into voting securities at the time of the vote referred to in this Section; and

(c) Security agreements of any nature for which voting securities are pledged as collateral.

3. "Affiliate" shall include all persons who would be defined as affiliates under Rule 12b-2 under the Securities Exchange Act of 1934.

4. "Subsidiary" means any corporation of which a majority of any class of equity securities (as defined in Rule 3a 11-1 of the general rules and regulations under the Securities Exchange Act of 1934) are owned, directly or indirectly, by the Corporation; provided, however, that for the purposes of the definition of a 10% Shareholder set

forth above, the term "Subsidiary" shall mean only a corporation of which a majority of each class of equity security is owned, directly or indirectly, by the Corporation.

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5. "Fair Market Value" means:

(1) In the case of stock, in the absence of any determination price as established on a national, regional, or local exchange or over-the-counter market, or in the absence of any market-maker dealing in the stock on a regular basis, the fair market value of such stock on the date in question as determined by the Board in good faith; and

(2) In the case of property other than cash or stock, the fair market value of such property on the date in question as determined by the Board in good faith.

(D) The additional voting requirement set forth in subsection (A) above shall not be applicable, and any such Business Combination shall require the affirmative vote of two-thirds (2/3) of the Voting Shares, if one of the following occurs:

1. The Business Combination shall have been approved by two-thirds (2/3) of the Directors of the Corporation; or

2. All of the following conditions shall have been met:

(a) The aggregate amount of the cash and the Fair Market Value as of the date of the consummation of the Business Combination of consideration other than cash to be received per share by holders of Common Stock in such Business Combination shall be at least equal to the greater of (i) and (ii), where (i) is the highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the 10% Shareholder or any other party for any shares of Common Stock acquired within the two-year period immediately prior to the first public announcement of the proposal of the Business Combination (the "Announcement Date") or, if higher, the per share price paid in the transaction in which the 10% Shareholder became a 10% Shareholder, and (ii) is the per share book value of the Corporation reported at the end of the fiscal quarter immediately preceding the later of any public announcement of any proposed Business Combination or the meeting date on which the shareholders are to consider the proposed Business Combination;

(b) The consideration to be received by holders of a particular class of outstanding Voting Stock (including Common Stock) shall be in cash or in the same form as the 10% Shareholder has previously paid for shares of such class of Voting Stock. If the 10% Shareholder has paid for shares of any class of Voting Stock with varying forms of consideration, the form of consideration for such class of Voting Stock shall be either cash or the form used to acquire the largest number of shares of such class of Voting Stock previously acquired by it;

(c) A proxy or information statement describing the proposed merger or consolidation and complying with the requirements of the Securities Exchange Act of 1934 and the rules and regulations thereunder (or any subsequent provisions replacing such Act, rules or regulations) shall be mailed to shareholders of the Corporation at least thirty (30) days prior to the meeting of shareholders called to consider the proposed Business Combination or, if no meeting, thirty (30) days prior to the consummation of such Business Combination (whether or not such proxy or information statement is required to be mailed pursuant to such Act or subsequent provisions).

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ARTICLE X

Amendments

These Articles of Incorporation may be amended at any time, subject to the provisions of this Article, by the affirmative vote of a majority of the outstanding shares of stock of the Corporation entitled to vote on such amendment. No amendment shall be adopted which shall repeal, modify, amend, alter or diminish in any way the provisions of Article V, Section 1 of Article VII, Section 4 of Article IX, Section 11 of Article IX, Section 12 of Article IX, or this Article X without the affirmative vote of three-fourths (3/4) of the outstanding shares of stock of the Corporation entitled to vote on such amendment.

The Bylaws of the Corporation may be amended as provided herein and therein except that no amendment shall in any way repeal, modify, amend, alter or diminish the provisions of this Article or the other provisions of the Articles of Incorporation referenced in this Article.

Articles of Amendment  
of the  
Articles of Incorporation  
of  
First Merchants Corporation

First Merchants Corporation (hereinafter referred to as the "Corporation"), a corporation existing pursuant to the provisions of the Indiana Business Corporation Law (hereinafter referred to as the "Act"), desiring to give notice of corporate action effectuating the amendment of its Restated Articles of Incorporation, hereby sets forth the following facts:

ARTICLE I

Name of Corporation; Date of Incorporation

The name of the Corporation is First Merchants Corporation. The date of incorporation of the Corporation is September 20, 1982.

ARTICLE II

Text of Amendment

Article V of the Articles of Incorporation of the Corporation is hereby amended to create a series of preferred stock and the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, by adding a new Section 4 as follows:

"Section 4. FIXED RATE CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES A.

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Corporation a series of preferred stock designated as the “Fixed Rate Cumulative Perpetual Preferred Stock, Series A” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be 116,000.

Part 2. Standard Provisions. The Standard Provisions contained in Annex A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this Certificate of Designations to the same extent as if such provisions had been set forth in full herein.



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Part. 3. Definitions. The following terms are used in this Certificate of Designations (including the Standard Provisions in Annex A hereto) as defined below:

- (a) “Common Stock” means the common stock, without par value, of the Corporation.
- (b) “Dividend Payment Date” means February 15, May 15, August 15 and November 15 of each year.
- (c) “Junior Stock” means the Common Stock and any other class or series of stock of the Corporation the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Corporation.
- (d) “Liquidation Amount” means \$1,000 per share of Designated Preferred Stock.
- (e) “Minimum Amount” means \$29,000,000.
- (f) “Parity Stock” means any class or series of stock of the Corporation (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Corporation (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).
- (g) “Signing Date” means the Original Issue Date.

Part. 4. Certain Voting Matters. Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.

[Annex A follows immediately hereafter]

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ANNEX A

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Corporation.

Section 2. Standard Definitions. As used herein with respect to Designated Preferred Stock:

- (a) “Applicable Dividend Rate” means (i) during the period from the Original Issue Date to, but excluding, the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 5% per annum and (ii) from and after the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 9% per annum.
- (b) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Corporation as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.
- (c) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Corporation’s stockholders.
- (d) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.
- (e) “Bylaws” means the bylaws of the Corporation, as they may be amended from time to time.
- (f) “Certificate of Designations” means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.
- (g) “Charter” means the Corporation’s certificate or articles of incorporation, articles of association, or similar organizational document.
- (h) “Dividend Period” has the meaning set forth in Section 3(a).
- (i) “Dividend Record Date” has the meaning set forth in Section 3(a).
- (j) “Liquidation Preference” has the meaning set forth in Section 4(a).
- (k) “Original Issue Date” means the date on which shares of Designated Preferred Stock are first issued.
- (l) “Preferred Director” has the meaning set forth in Section 7(b).



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- (m) “Preferred Stock” means any and all series of preferred stock of the Corporation, including the Designated Preferred Stock.
- (n) “Qualified Equity Offering” means the sale and issuance for cash by the Corporation to persons other than the Corporation or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Corporation at the time of issuance under the applicable risk-based capital guidelines of the Corporation’s Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to October 13, 2008).
- (o) “Share Dilution Amount” has the meaning set forth in Section 3(b).
- (p) “Standard Provisions” mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.
- (q) “Successor Preferred Stock” has the meaning set forth in Section 5(a).
- (r) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

- (a) **Rate.** Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a rate per annum equal to the Applicable Dividend Rate on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Original Issue Date, shall compound on each subsequent Dividend Payment Date (i.e., no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a “Dividend Period”, provided that the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Corporation on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a “Dividend Record Date”). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

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(b) **Priority of Dividends.** So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Corporation or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business (including purchases to offset the Share Dilution Amount (as defined below) pursuant to a publicly announced repurchase plan) and consistent with past practice, provided that any purchases to offset the Share Dilution Amount shall in no event exceed the Share Dilution Amount; (ii) purchases or other acquisitions by a broker-dealer subsidiary of the Corporation solely for the purpose of market-making, stabilization or customer facilitation transactions in Junior Stock or Parity Stock in the ordinary course of its business; (iii) purchases by a broker-dealer subsidiary of the Corporation of capital stock of the Corporation for resale pursuant to an offering by the Corporation of such capital stock underwritten by such broker-dealer subsidiary; (iv) any dividends or distributions of rights or Junior Stock in connection with a stockholders' rights plan or any redemption or repurchase of rights pursuant to any stockholders' rights plan; (v) the acquisition by the Corporation or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Corporation or any of its subsidiaries), including as trustees or custodians; and (vi) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock. "Share Dilution Amount" means the increase in the number of diluted shares outstanding (determined in accordance with generally accepted accounting principles in the United States, and as measured from the date of the Corporation's consolidated financial statements most recently filed with the Securities and Exchange Commission prior to the Original Issue Date) resulting from the grant, vesting or exercise of equity-based compensation to employees and equitably adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared pro rata so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the

Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Corporation will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

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Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Corporation, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Corporation or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Corporation, subject to the rights of any creditors of the Corporation, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Corporation ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the "Liquidation Preference").

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Corporation or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Corporation ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Corporation ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Corporation shall be entitled to receive all remaining assets of the Corporation (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Corporation with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Corporation, shall not constitute a liquidation, dissolution or winding up of the Corporation.

Section 5. Redemption.

(a) Optional Redemption. Except as provided below, the Designated Preferred Stock may not be redeemed prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Corporation, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Corporation, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i)



the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; provided that (x) the Corporation (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the “Minimum Amount” as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the “Successor Preferred Stock”) in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Corporation (or any successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

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The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Corporation or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Corporation. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either pro rata or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Corporation, in trust for the pro rata benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Corporation, after which time the holders of the shares so called for redemption shall look only to the Corporation for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Corporation shall revert to authorized but unissued shares of Preferred Stock (provided that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

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Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Corporation shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Corporation's next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to reversion in the event of each and every subsequent default of the character above mentioned; provided that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Corporation to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Corporation may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock and Voting Parity Stock as a class to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class together with the holders of shares of Voting Parity Stock, to the extent the voting rights of such holders described above are then exercisable. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the remaining Preferred Director may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

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(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Corporation ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Corporation;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Corporation with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Corporation is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof, taken as a whole, as are not materially less favorable to the holders thereof than the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole;

provided, however, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Corporation to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Corporation will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection

therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Corporation and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Corporation nor such transfer agent shall be affected by any notice to the contrary.

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Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Corporation, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Corporation shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Corporation. The Corporation shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Corporation of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Corporation.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law. ”

[End of Annex A]

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ARTICLE III

Manner and Date of Adoption

This amendment was adopted by the Board of Directors of the Corporation on February 16, 2009 and shareholder action was not required.

ARTICLE IV

Compliance with Legal Requirements

The manner of adoption of the foregoing amendment to the Articles of Incorporation constitutes full legal compliance with the provisions of the Act, the Articles of Incorporation and the By-Laws of the Corporation.

\* \* \*

In Witness Whereof, the undersigned officer of the Corporation has executed these Articles of Amendment as of this 17th day of February, 2009.

First Merchants Corporation

by /s/ Michael C. Rechin  
Michael C. Rechin  
President and  
Chief Executive Officer  
(Principal Executive Officer)



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ARTICLES OF AMENDMENT  
OF THE  
ARTICLES OF INCORPORATION  
OF  
FIRST MERCHANTS CORPORATION

First Merchants Corporation (hereinafter referred to as the “Corporation”), a corporation existing pursuant to the provisions of the Indiana Business Corporation Law (hereinafter referred to as the “Act”), desiring to give notice of corporate action effectuating the amendment of its Restated Articles of Incorporation, hereby sets forth the following facts:

ARTICLE I

Name of Corporation; Date of Incorporation

The name of the Corporation is First Merchants Corporation. The date of incorporation of the Corporation is September 20, 1982.

ARTICLE II

Text of Amendment

Article V of the Articles of Incorporation of the Corporation is hereby amended to create a series of preferred stock and the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, by adding a new Section 5 as follows:

Section 5. SENIOR NON-CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES B.

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Corporation a series of preferred stock designated as the “Senior Non-Cumulative Perpetual Preferred Stock, Series B” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be 90,823.23.

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of these Articles of Incorporation to the same extent as if such provisions had been set forth in full herein.

Part 3. Definitions. The following terms are used in these Articles of Incorporation (including the Standard Provisions in Schedule A hereto) as defined below:

(a) “Common Stock” means the common stock, without par value, of the Corporation.

(b) “Definitive Agreement” means that certain Securities Purchase Agreement by and between the Corporation and Treasury, dated as of the Signing Date.

(c) “Junior Stock” means the Common Stock and any other class or series of stock of the Corporation the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend and redemption rights and/or as to rights on liquidation, dissolution or winding up of the Corporation.

(d) “Liquidation Amount” means \$1,000 per share of Designated Preferred Stock.

(e) “Minimum Amount” means (i) the amount equal to twenty-five percent (25%) of the aggregate Liquidation Amount of Designated Preferred Stock issued on the Original Issue Date or (ii) all of the outstanding Designated Preferred Stock, if the aggregate liquidation preference of the outstanding Designated Preferred Stock is less than the amount set forth in the preceding clause (i).

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(f) "Parity Stock" means any class or series of stock of the Corporation (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Corporation (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

(g) "Signing Date" means September 22, 2011.

(h) "Treasury" means the United States Department of the Treasury and any successor in interest thereto.

Part 4. Certain Voting Matters. Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.

[Schedule A follows immediately hereafter.]

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Schedule A

STANDARD PROVISIONS

(a) General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Articles of Incorporation. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Corporation, as set forth below.

(b) Standard Definitions. As used herein with respect to Designated Preferred Stock:

(i) “Acquiror,” in any Holding Company Transaction, means the surviving or resulting entity or its ultimate parent in the case of a merger or consolidation or the transferee in the case of a sale, lease or other transfer in one transaction or a series of related transactions of all or substantially all of the consolidated assets of the Corporation and its subsidiaries, taken as a whole.

(ii) “Affiliate” means, with respect to any person, any person directly or indirectly controlling, controlled by or under common control with, such other person. For purposes of this definition, “control” (including, with correlative meanings, the terms “controlled by” and “under common control with”) when used with respect to any person, means the possession, directly or indirectly through one or more intermediaries, of the power to cause the direction of management and/or policies of such person, whether through the ownership of voting securities by contract or otherwise.

(iii) “Applicable Dividend Rate” has the meaning set forth in Section 3(a).

(iv) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Corporation as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(v) “Bank Holding Company” means a company registered as such with the Board of Governors of the Federal Reserve System pursuant to 12 U.S.C. §1842 and the regulations of the Board of Governors of the Federal Reserve System thereunder.

(vi) “Baseline” means the “Initial Small Business Lending Baseline” set forth on the Initial Supplemental Report (as defined in the Definitive Agreement), subject to adjustment pursuant to Section 3(a).

(vii) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Corporation’s stockholders.

(viii) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York or the District of Columbia generally are authorized or required by law or other governmental actions to close.

(ix) “Bylaws” means the bylaws of the Corporation, as they may be amended from time to time.

(x) “Call Report” has the meaning set forth in the Definitive Agreement.

(xi) “Articles of Incorporation” means the Articles of Incorporation or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

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(xii) “Charge-Offs” means the net amount of loans charged off by the Corporation or, if the Corporation is a Bank Holding Company or a Savings and Loan Holding Company, by the IDI Subsidiary(ies) during quarters that begin on or after the Signing Date, determined as follows:

(i) if the Corporation or the applicable IDI Subsidiary is a bank, by subtracting (A) the aggregate dollar amount of recoveries reflected on line RIAD4605 of its Call Reports for such quarters from (B) the aggregate dollar amount of charge-offs reflected on line RIAD4635 of its Call Reports for such quarters (without duplication as a result of such dollar amounts being reported on a year-to-date basis); or

(ii) if the Corporation or the applicable IDI Subsidiary is a thrift, by subtracting (A) the sum of the aggregate dollar amount of recoveries reflected on line VA140 of its Call Reports for such quarters and the aggregate dollar amount of adjustments reflected on line VA150 of its Call Reports for such quarters from (B) the aggregate dollar amount of charge-offs reflected on line VA160 of its Call Reports for such quarters.

(xiii) “Charter” means the Corporation’s certificate or articles of incorporation, articles of association, or similar organizational document.

(xiv) “CPP Lending Incentive Fee” has the meaning set forth in Section 3(e).

(xv) “Current Period” has the meaning set forth in Section 3(a)(i)(2).

(xvi) “Dividend Payment Date” means January 1, April 1, July 1, and October 1 of each year.

(xvii) “Dividend Period” means the period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date; provided, however, the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date (the “Initial Dividend Period”).

(xviii) “Dividend Record Date” has the meaning set forth in Section 3(b).

(xix) “Dividend Reference Period” has the meaning set forth in Section 3(a)(i)(2).

(xx) “GAAP” means generally accepted accounting principles in the United States.

(xxi) “Holding Company Preferred Stock” has the meaning set forth in Section 7(c)(v).

(xxii) “Holding Company Transaction” means the occurrence of (a) any transaction (including, without limitation, any acquisition, merger or consolidation) the result of which is that a “person” or “group” within the meaning of Section 13(d) of the Securities Exchange Act of 1934, as amended, (i) becomes the direct or indirect ultimate “beneficial owner,” as defined in Rule 13d-3 under that Act, of common equity of the Corporation representing more than 50% of the voting power of the outstanding Common Stock or (ii) is otherwise required to consolidate the Corporation for purposes of generally accepted accounting principles in the United States, or (b) any consolidation or merger of the Corporation or similar transaction or any sale, lease or other transfer in one transaction or a series of related transactions of all or substantially all of the consolidated assets of the Corporation and its subsidiaries, taken as a whole, to any Person other than one of the Corporation’s subsidiaries; provided that, in the case of either clause (a) or (b), the Corporation or the Acquiror is or becomes a Bank Holding Company or Savings and Loan Holding Company.

(xxiii) “IDI Subsidiary” means any Corporation Subsidiary that is an insured depository institution.

(xxiv) “Increase in QSBL” means:

(i) with respect to the first (1st) Dividend Period, the difference obtained by subtracting (A) the Baseline from (B) QSBL set forth in the Initial Supplemental Report (as defined in the Definitive Agreement); and

(ii) with respect to each subsequent Dividend Period, the difference obtained by subtracting (A) the Baseline from (B) QSBL for the Dividend Reference Period for the Current Period.

(xxv) “Initial Dividend Period” has the meaning set forth in the definition of “Dividend Period”.

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(xxvi) “Corporation Subsidiary” means any subsidiary of the Corporation.

(xxvii) “Liquidation Preference” has the meaning set forth in Section 4(a).

(xxviii) “Non-Qualifying Portion Percentage” means, with respect to any particular Dividend Period, the percentage obtained by subtracting the Qualifying Portion Percentage from one (1).

(xxix) “Original Issue Date” means the date on which shares of Designated Preferred Stock are first issued.

(xxx) “Percentage Change in QSBL” has the meaning set forth in Section 3(a)(ii).

(xxxi) “Person” means a legal person, including any individual, corporation, estate, partnership, joint venture, association, joint-stock company, limited liability company or trust.

(xxxii) “Preferred Director” has the meaning set forth in Section 7(c).

(xxxiii) “Preferred Stock” means any and all series of preferred stock of the Corporation, including the Designated Preferred Stock.

(xxxiv) “Previously Acquired Preferred Shares” has the meaning set forth in the Definitive Agreement.

(xxxv) “Private Capital” means, if the Corporation is Matching Private Investment Supported (as defined in the Definitive Agreement), the equity capital received by the Corporation or the applicable Affiliate of the Corporation from one or more non-governmental investors in accordance with Section 1.3(m) of the Definitive Agreement.

(xxxvi) “Publicly-traded” means a company that (i) has a class of securities that is traded on a national securities exchange and (ii) is required to file periodic reports with either the Securities and Exchange Commission or its primary federal bank regulator.

(xxxvii) “Qualified Small Business Lending” or “QSBL” means, with respect to any particular Dividend Period, the “Quarter-End Adjusted Qualified Small Business Lending” for such Dividend Period set forth in the applicable Supplemental Report.

(xxxviii) “Qualifying Portion Percentage” means, with respect to any particular Dividend Period, the percentage obtained by dividing (i) the Increase in QSBL for such Dividend Period by (ii) the aggregate Liquidation Amount of then-outstanding Designated Preferred Stock.

(xxxix) “Savings and Loan Holding Company” means a company registered as such with the Office of Thrift Supervision pursuant to 12 U.S.C. §1467a(b) and the regulations of the Office of Thrift Supervision promulgated thereunder.

(xl) “Share Dilution Amount” means the increase in the number of diluted shares outstanding (determined in accordance with GAAP applied on a consistent basis, and as measured from the date of the Corporation’s most recent consolidated financial statements prior to the Signing Date) resulting from the grant, vesting or exercise of equity-based compensation to employees and equitably adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction.



(xli) "Signing Date Tier 1 Capital Amount" means \$346,108,000.

(xlii) "Standard Provisions" mean these Standard Provisions that form a part of the Articles of Incorporation relating to the Designated Preferred Stock.

(xliii) "Supplemental Report" means a Supplemental Report delivered by the Corporation to Treasury pursuant to the Definitive Agreement.

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(xiv) “Tier 1 Dividend Threshold” means, as of any particular date, the result of the following formula:

$$((A + B - C) * 0.9) - D$$

where:

A = Signing Date Tier 1 Capital Amount;

B = the aggregate Liquidation Amount of the Designated Preferred Stock issued to Treasury;

C = the aggregate amount of Charge-Offs since the Signing Date; and

D = (i) beginning on the first day of the eleventh (11th) Dividend Period, the amount equal to ten percent (10%) of the aggregate Liquidation Amount of the Designated Preferred Stock issued to Treasury as of the Effective Date (without regard to any redemptions of Designated Preferred Stock that may have occurred thereafter) for every one percent (1%) of positive Percentage Change in Qualified Small Business Lending between the ninth (9th) Dividend Period and the Baseline; and  
(ii) zero (0) at all other times.

(xlv) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Section 7(d) of these Standard Provisions that form a part of the Articles of Incorporation, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

(c) Dividends.

(i) Rate.

i. The “Applicable Dividend Rate” shall be determined as follows:

1. With respect to the Initial Dividend Period, the Applicable Dividend Rate shall be five percent (5.000000%).
2. With respect to each of the second (2nd) through the tenth (10th) Dividend Periods, inclusive (in each case, the “Current Period”), the Applicable Dividend Rate shall be:
  - a. (x) the applicable rate set forth in column “A” of the table in Section 3(a)(iii), based on the Percentage Change in QSBL between the Dividend Period that was two Dividend Periods prior to the Current Period (the “Dividend Reference Period”) and the Baseline, multiplied by (y) the Qualifying Portion Percentage; plus
  - b. (x) five percent (5%) multiplied by (y) the Non-Qualifying Portion Percentage.

In each such case, the Applicable Dividend Rate shall be determined at the time the Corporation delivers a complete and accurate Supplemental Report to Treasury with respect to the Dividend Reference Period.

3.

With respect to the eleventh (11th) through the eighteenth (18th) Dividend Periods, inclusive, and that portion of the nineteenth (19th) Dividend Period prior to, but not including, the four and one half (4½) year anniversary of the Original Issue Date, the Applicable Dividend Rate shall be:

- a. (x) the applicable rate set forth in column “B” of the table in Section 3(a)(iii), based on the Percentage Change in QSBL between the ninth (9th) Dividend Period and the Baseline, multiplied by (y) the Qualifying Portion Percentage, calculated as of the last day of the ninth (9th) Dividend Period; plus

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- b. (x) five percent (5%) multiplied by (y) the Non-Qualifying Portion Percentage, calculated as of the last day of the ninth (9th) Dividend Period.

In such case, the Applicable Dividend Rate shall be determined at the time the Corporation delivers a complete and accurate Supplemental Report to Treasury with respect to the ninth (9th) Dividend Period.

4. With respect to (A) that portion of the nineteenth (19th) Dividend Period beginning on the four and one half (4½) year anniversary of the Original Issue Date and (B) all Dividend Periods thereafter, the Applicable Dividend Rate shall be nine percent (9%).
5. Notwithstanding anything herein to the contrary, if the Corporation fails to submit a Supplemental Report that is due during any of the second (2nd) through tenth (10th) Dividend Periods on or before the sixtieth (60th) day of such Dividend Period, the Corporation's QSBL for the Dividend Period that would have been covered by such Supplemental Report shall be zero (0) for purposes hereof.
6. Notwithstanding anything herein to the contrary, but subject to Section 3(a)(i)(5) above, if the Corporation fails to submit the Supplemental Report that is due during the tenth (10th) Dividend Period, the Corporation's QSBL shall be zero (0) for purposes of calculating the Applicable Dividend Rate pursuant to Section 3(a)(i)(3) and (4). The Applicable Dividend Rate shall be re-determined effective as of the first day of the calendar quarter following the date such failure is remedied, provided it is remedied prior to the four and one half (4½) anniversary of the Original Issue Date.
7. Notwithstanding anything herein to the contrary, if the Corporation fails to submit any of the certificates required by Sections 3.1(d)(ii) or 3.1(d)(iii) of the Definitive Agreement when and as required thereby, the Corporation's QSBL shall be zero (0) for purposes of calculating the Applicable Dividend Rate pursuant to Section 3(a)(i)(2) or (3) above until such failure is remedied.

ii. The "Percentage Change in Qualified Lending" between any given Dividend Period and the Baseline shall be the result of the following formula, expressed as a percentage:

$$\left( \frac{\text{QSBL for the Dividend Period} - \text{Baseline}}{\text{Baseline}} \right) \times 100$$

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iii. The following table shall be used for determining the Applicable Dividend Rate:

| If the Percentage Change in Qualified Lending is: | The Applicable Dividend Rate shall be: |                                                                 |
|---------------------------------------------------|----------------------------------------|-----------------------------------------------------------------|
|                                                   | Column "A"                             | Column "B"                                                      |
|                                                   | (each of the 2nd - 10th Periods)       | (11th - 18th, and the first part of the 19th, Dividend Periods) |
| 0% or less                                        | 5%                                     | 7%                                                              |
| More than 0%, but less than 2.5%                  | 5%                                     | 5%                                                              |
| 2.5% or more, but less than 5%                    | 4%                                     | 4%                                                              |
| 5% or more, but less than 7.5%                    | 3%                                     | 3%                                                              |
| 7.5% or more, but less than 10%                   | 2%                                     | 2%                                                              |
| 10% or more                                       | 1%                                     | 1%                                                              |

iv. If the Corporation consummates a Business Combination, a purchase of loans or a purchase of participations in loans and the Designated Preferred Stock remains outstanding thereafter, then the Baseline shall thereafter be the "Quarter-End Adjusted Small Business Lending Baseline" set forth on the Quarterly Supplemental Report (as defined in the Definitive Agreement).

(ii) Payment. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, non-cumulative cash dividends with respect to:

i. each Dividend Period (other than the Initial Dividend Period) at a rate equal to one-fourth (1/4) of the Applicable Dividend Rate with respect to each Dividend Period on the Liquidation Amount per share of Designated Preferred Stock, and no more, payable quarterly in arrears on each Dividend Payment Date; and

ii. the Initial Dividend Period, on the first such Dividend Payment Date to occur at least twenty (20) calendar days after the Original Issue Date, an amount equal to (A) the Applicable Dividend Rate with respect to the Initial Dividend Period multiplied by (B) the number of days from the Original Issue Date to the last day of the Initial Dividend Period (inclusive) divided by 360.

In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. For avoidance of doubt, “payable quarterly in arrears” means that, with respect to any particular Dividend Period, dividends begin accruing on the first day of such Dividend Period and are payable on the first day of the next Dividend Period.

The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of four 90-day quarters, and actual days elapsed over a 90-day quarter.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Corporation on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a “Dividend Record Date”). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Articles of Incorporation).

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(iii) Non-Cumulative. Dividends on shares of Designated Preferred Stock shall be non-cumulative. If the Board of Directors or any duly authorized committee of the Board of Directors does not declare a dividend on the Designated Preferred Stock in respect of any Dividend Period:

i. the holders of Designated Preferred Stock shall have no right to receive any dividend for such Dividend Period, and the Corporation shall have no obligation to pay a dividend for such Dividend Period, whether or not dividends are declared for any subsequent Dividend Period with respect to the Designated Preferred Stock; and

ii. the Corporation shall, within five (5) calendar days, deliver to the holders of the Designated Preferred Stock a written notice executed by the Chief Executive Officer and the Chief Financial Officer of the Corporation stating the Board of Directors' rationale for not declaring dividends.

(iv) Priority of Dividends; Restrictions on Dividends.

i. Subject to Sections 3(d)(ii), (iii) and (v) and any restrictions imposed by the Appropriate Federal Banking Agency or, if applicable, the Corporation's state bank supervisor (as defined in Section 3(r) of the Federal Deposit Insurance Act (12 U.S.C. § 1813(q)), so long as any share of Designated Preferred Stock remains outstanding, the Corporation may declare and pay dividends on the Common Stock, any other shares of Junior Stock, or Parity Stock, in each case only if (A) after giving effect to such dividend the Corporation's Tier 1 capital would be at least equal to the Tier 1 Dividend Threshold, and (B) full dividends on all outstanding shares of Designated Preferred Stock for the most recently completed Dividend Period have been or are contemporaneously declared and paid.

ii. If a dividend is not declared and paid in full on the Designated Preferred Stock in respect of any Dividend Period, then from the last day of such Dividend Period until the last day of the third (3rd) Dividend Period immediately following it, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock; provided, however, that in any such Dividend Period in which a dividend is declared and paid on the Designated Preferred Stock, dividends may be paid on Parity Stock to the extent necessary to avoid any material breach of a covenant by which the Corporation is bound

iii. When dividends have not been declared and paid in full for an aggregate of four (4) Dividend Periods or more, and during such time the Corporation was not subject to a regulatory determination that prohibits the declaration and payment of dividends, the Corporation shall, within five (5) calendar days of each missed payment, deliver to the holders of the Designated Preferred Stock a certificate executed by at least a majority of the Board of Directors stating that the Board of Directors used its best efforts to declare and pay such dividends in a manner consistent with (A) safe and sound banking practices and (B) the directors' fiduciary obligations.

iv. Subject to the foregoing and Section 3(e) below and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

v. If the Corporation is not Publicly-Traded, then after the tenth (10th) anniversary of the Signing Date, so long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock.

(d) Special Lending Incentive Fee Related to CPP. If Treasury held Previously Acquired Preferred Shares immediately prior to the Original Issue Date and the Corporation did not apply to Treasury to redeem such Previously Acquired Preferred Shares prior to December 16, 2010, and if the Corporation's Supplemental Report with respect to the ninth (9th) Dividend Period reflects an amount of Qualified Small Business Lending that is less than or equal to the Baseline (or if the Corporation fails to timely file a Supplemental Report with respect to the ninth (9th) Dividend Period), then beginning on April 1, 2014, and on all Dividend Payment Dates thereafter ending on April 1, 2016, the Corporation shall pay to the Holders of Designated Preferred Stock, on each share of Designated Preferred Stock, but only out of assets legally available therefor, a fee equal to 0.5% of the Liquidation Amount per share of Designated Preferred Stock ("CPP Lending Incentive Fee"). All references in Section 3(d) to "dividends" on the Designated Preferred Stock shall be deemed to include the CPP Lending Incentive Fee.



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(i) Liquidation Rights.

i. Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Corporation, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Corporation or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Corporation, subject to the rights of any creditors of the Corporation, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Corporation ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends on each such share (such amounts collectively, the "Liquidation Preference").

ii. Partial Payment. If in any distribution described in Section 4(a) above the assets of the Corporation or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Corporation ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

iii. Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Corporation ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Corporation shall be entitled to receive all remaining assets of the Corporation (or proceeds thereof) according to their respective rights and preferences.

iv. Merger, Consolidation and Sale of Assets Is Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Corporation with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Corporation, shall not constitute a liquidation, dissolution or winding up of the Corporation.

(e) Redemption.

(i) Optional Redemption.

i. Subject to the other provisions of this Section 5:

1. The Corporation, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding; and

2. If, after the Signing Date, there is a change in law that modifies the terms of Treasury's investment in the Designated Preferred Stock or the terms of Treasury's Small Business Lending Fund program in a materially adverse respect for the Corporation, the Corporation may, after consultation with the Appropriate Federal Banking Agency, redeem all of the shares of Designated Preferred Stock at the time outstanding.

ii. The per-share redemption price for shares of Designated Preferred Stock shall be equal to the sum of:

1. the Liquidation Amount per share,
2. the per-share amount of any unpaid dividends for the then current Dividend Period at the Applicable Dividend Rate to, but excluding, the date fixed for redemption (regardless of whether any dividends are actually declared for that Dividend Period; and
3. the pro rata amount of CPP Lending Incentive Fees for the current Dividend Period.

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The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Corporation or its agent. Any declared but unpaid dividends for the then current Dividend Period payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above. No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(ii) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Corporation. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(iii) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either pro rata or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable, but in any event the shares to be redeemed shall not be less than the Minimum Amount. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time, subject to the approval of the Appropriate Federal Banking Agency. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(iv) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Corporation, in trust for the pro rata benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Corporation, after which time the holders of the shares so called for redemption shall look only to the Corporation for payment of the redemption price of such shares.

(v) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Corporation shall revert to authorized but unissued shares of Preferred Stock (provided that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

(f) Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

(g) Voting Rights.

(i) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

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(ii) Board Observation Rights. Whenever, at any time or times, dividends on the shares of Designated Preferred Stock have not been declared and paid in full within five (5) Business Days after each Dividend Payment Date for an aggregate of five (5) Dividend Periods or more, whether or not consecutive, the Corporation shall invite a representative selected by the holders of a majority of the outstanding shares of Designated Preferred Stock, voting as a single class, to attend all meetings of its Board of Directors in a nonvoting observer capacity and, in this respect, shall give such representative copies of all notices, minutes, consents, and other materials that it provides to its directors in connection with such meetings; provided, that the holders of the Designated Preferred Stock shall not be obligated to select such a representative, nor shall such representative, if selected, be obligated to attend any meeting to which he/she is invited. The rights of the holders of the Designated Preferred Stock set forth in this Section 7(b) shall terminate when full dividends have been timely paid on the Designated Preferred Stock for at least four consecutive Dividend Periods, subject to revesting in the event of each and every subsequent default of the character above mentioned.

(iii) Preferred Stock Directors. Whenever, at any time or times, (i) dividends on the shares of Designated Preferred Stock have not been declared and paid in full within five (5) Business Days after each Dividend Payment Date for an aggregate of six (6) Dividend Periods or more, whether or not consecutive, and (ii) the aggregate liquidation preference of the then-outstanding shares of Designated Preferred Stock is greater than or equal to \$25,000,000, the authorized number of directors of the Corporation shall automatically be increased by two and the holders of the Designated Preferred Stock, voting as a single class, shall have the right, but not the obligation, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Corporation's next annual meeting of stockholders (or, if the next annual meeting is not yet scheduled or is scheduled to occur more than thirty days later, the President of the Company shall promptly call a special meeting for that purpose) and at each subsequent annual meeting of stockholders until full dividends have been timely paid on the Designated Preferred Stock for at least four consecutive Dividend Periods, at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to revesting in the event of each and every subsequent default of the character above mentioned; provided that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Corporation to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Corporation may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the holders of a majority of the outstanding shares of Designated Preferred Stock, voting as a single class, may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(iv) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the written consent of (x) Treasury if Treasury holds any shares of Designated Preferred Stock, or (y) the holders of a majority of the outstanding shares of Designated Preferred Stock, voting as a single class, if Treasury does not hold any shares of Designated Preferred Stock, shall be necessary for effecting or validating:

i. Authorization of Senior Stock. Any amendment or alteration of the Articles of Incorporation for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any

shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Corporation ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Corporation;

ii. Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Articles of Incorporation for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(d)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock;

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iii. Share Exchanges, Reclassifications, Mergers and Consolidations. Subject to Section 7(d)(v) below, any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Corporation with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Corporation is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof that are the same as the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole; provided, that in all cases, the obligations of the Corporation are assumed (by operation of law or by express written assumption) by the resulting entity or its ultimate parent;

iv. Certain Asset Sales. Any sale of all, substantially all, or any material portion of, the assets of the Company, if the Designated Preferred Stock will not be redeemed in full contemporaneously with the consummation of such sale; and

v. Holding Company Transactions. Any consummation of a Holding Company Transaction, unless as a result of the Holding Company Transaction each share of Designated Preferred Stock shall be converted into or exchanged for one share with an equal liquidation preference of preference securities of the Corporation or the Acquiror (the "Holding Company Preferred Stock"). Any such Holding Company Preferred Stock shall entitle holders thereof to dividends from the date of issuance of such Holding Company Preferred Stock on terms that are equivalent to the terms set forth herein, and shall have such other rights, preferences, privileges and voting powers, and limitations and restrictions thereof that are the same as the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such conversion or exchange, taken as a whole;

provided, however, that for all purposes of this Section 7(d), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Corporation to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Corporation will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(v) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(d) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(vi) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any

national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

(h) Restriction on Redemptions and Repurchases.

(i) Subject to Sections 8(b) and (c), so long as any share of Designated Preferred Stock remains outstanding, the Corporation may repurchase or redeem any shares of Capital Stock (as defined below), in each case only if (i) after giving effect to such dividend, repurchase or redemption, the Corporation's Tier 1 capital would be at least equal to the Tier 1 Dividend Threshold and (ii) dividends on all outstanding shares of Designated Preferred Stock for the most recently completed Dividend Period have been or are contemporaneously declared and paid (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date).



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If a dividend is not declared and paid on the Designated Preferred Stock in respect of any Dividend Period, then from the last day of such Dividend Period until the last day of the third (3rd) Dividend Period immediately following it, neither the Corporation nor any Corporation Subsidiary shall, redeem, purchase or acquire any shares of Common Stock, Junior Stock, Parity Stock or other capital stock or other equity securities of any kind of the Corporation or any Corporation Subsidiary, or any trust preferred securities issued by the Corporation or any Affiliate of the Corporation (“Capital Stock”), (other than (i) redemptions, purchases, repurchases or other acquisitions of the Designated Preferred Stock and (ii) repurchases of Junior Stock or Common Stock in connection with the administration of any employee benefit plan in the ordinary course of business (including purchases to offset any Share Dilution Amount pursuant to a publicly announced repurchase plan) and consistent with past practice; provided that any purchases to offset the Share Dilution Amount shall in no event exceed the Share Dilution Amount, (iii) the acquisition by the Corporation or any of the Corporation Subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Corporation or any other Corporation Subsidiary), including as trustees or custodians, (iv) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock or trust preferred securities for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case set forth in this clause (iv), solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock, (v) redemptions of securities held by the Corporation or any wholly-owned Corporation Subsidiary or (vi) redemptions, purchases or other acquisitions of capital stock or other equity securities of any kind of any Corporation Subsidiary required pursuant to binding contractual agreements entered into prior to (x) if Treasury held Previously Acquired Preferred Shares immediately prior to the Original Issue Date, the original issue date of such Previously Acquired Preferred Shares, or (y) otherwise, the Signing Date).

(ii) If the Corporation is not Publicly-Traded, then after the tenth (10th) anniversary of the Signing Date, so long as any share of Designated Preferred Stock remains outstanding, no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Corporation or any of its subsidiaries.

(i) No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Corporation, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

(j) References to Line Items of Supplemental Reports. If Treasury modifies the form of Supplemental Report, pursuant to its rights under the Definitive Agreement, and any such modification includes a change to the caption or number of any line item on the Supplemental Report, then any reference herein to such line item shall thereafter be a reference to such re-captioned or re-numbered line item.

(k) Record Holders. To the fullest extent permitted by applicable law, the Corporation and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Corporation nor such transfer agent shall be affected by any notice to the contrary.

(l) Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in these Articles of Incorporation, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

(m) Replacement Certificates. The Corporation shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Corporation. The Corporation shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Corporation of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Corporation.

(n) Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

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ARTICLE III

Manner and Date of Adoption

This amendment was adopted by the Board of Directors of the Corporation on August 1, 2011 and shareholder action was not required.

ARTICLE IV

Compliance with Legal Requirements

The manner of adoption of the foregoing amendment to the Articles of Incorporation constitutes full legal compliance with the provisions of the Act, the Articles of Incorporation and the By-Laws of the Corporation.

IN WITNESS WHEREOF, the undersigned officer of the Corporation has executed these Articles of Amendment as of this 20th day of September, 2011.

FIRST MERCHANTS CORPORATION

by /s/ Michael C. Rechin  
Michael C. Rechin  
President and Chief Executive Officer  
(Principal Executive Officer)

FIRST MERCHANTS CORPORATION  
FORM 10Q

EXHIBIT-31.1

CERTIFICATIONS PURSUANT TO  
SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Michael C. Rechin, President and Chief Executive Officer of First Merchants Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Merchants Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2011  
Michael C. Rechin  
President and Chief Executive Officer  
(Principal Executive Officer)

by /s/ Michael C. Rechin

FIRST MERCHANTS CORPORATION  
FORM 10Q

EXHIBIT-31.2

CERTIFICATIONS PURSUANT TO  
SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Mark K. Hardwick, Executive Vice President and Chief Financial Officer of First Merchants Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Merchants Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or

persons performing the equivalent functions):

- a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2011

by: /s/ Mark K. Hardwick

Mark K. Hardwick

Executive Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)

FIRST MERCHANTS CORPORATION  
FORM 10Q

EXHIBIT-32

CERTIFICATIONS PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of First Merchants Corporation (the "Corporation") on Form 10-Q for the period ending September 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael C. Rechin, President and Chief Executive Officer of the Corporation, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o (d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: November 9, 2011  
Michael C. Rechin  
President and  
Chief Executive Officer  
(Principal Executive Officer)

by /s/ Michael C. Rechin

A signed copy of this written statement required by Section 906 has been provided to First Merchants Corporation and will be retained by First Merchants Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

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In connection with the quarterly report of First Merchants Corporation (the "Corporation") on Form 10-Q for the period ending September 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark K. Hardwick, Executive Vice President and Chief Financial Officer of the Corporation, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:



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(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o (d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: November 9, 2011

by /s/ Mark K. Hardwick

Mark K. Hardwick

Executive Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)

A signed copy of this written statement required by Section 906 has been provided to First Merchants Corporation and will be retained by First Merchants Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

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