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

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2020
OR
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _______ to _______

Commission File Number 0-17071

FIRST MERCHANTS CORPORATION

(Exact name of registrant as specified in its charter)

Indiana	**35-1544218**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 East Jackson Street, Muncie, IN	**47305-2814**
(Address of principal executive offices)	(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)

Title of Each Class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.125 stated value per share	FRME	Nasdaq Global Select Market

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 every interactive data file required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	☒	Accelerated Filer	☐	Non-Accelerated Filer	☐
Smaller Reporting Company	☐	Emerging Growth Company	☐		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 August 4, 2020, there were 54,124,467 outstanding common shares of the registrant.

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FIRST MERCHANTS CORPORATION

GLOSSARY OF DEFINED TERMS

FIRST MERCHANTS CORPORATION

ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Bank	First Merchants Bank, a wholly-owned subsidiary of the Corporation
CARES Act	Coronavirus Aid, Relief and Economic Security Act
CET1	Common Equity Tier 1
CMT	Constant Maturity Treasury
Corporation	First Merchants Corporation
COVID-19	2019 novel coronavirus disease, which was declared a pandemic by the World Health Organization on March 11, 2020.
Economic Impact Payments	Economic stimulus payments of up to $1,200 per adult and $500 per child, subject to eligibility requirements and certain limitations, as established under the CARES Act and distributed by the IRS.
ESPP	Employee Stock Purchase Plan
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FHLB	Federal Home Loan Bank
FOMC	Federal Open Market Committee, the monetary policymaking body of the Federal Reserve System.
FTE	Fully taxable equivalent
GAAP	Generally Accepted Accounting Principles
IRS	Internal Revenue Service
MBT	MBT Financial Corp., which was acquired by the Corporation on September 1, 2019
OREO	Other real estate owned
PPP	Paycheck Protection Program, which was established by the CARES Act and implemented by the Small Business Administration to provide small business loans.
PPPL Facility	Paycheck Protection Program Liquidity Facility, which was established by the Federal Reserve.
RSA	Restricted Stock Awards
TEFRA	Tax Equity and Fiscal Responsibility Act

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ITEM 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30, 2020 (Unaudited)	December 31, 2019
ASSETS		
Cash and cash equivalents	$ 229,759	$ 177,201
Interest-bearing time deposits	380,021	118,263
Investment securities available for sale	1,890,593	1,790,025
Investment securities held to maturity (fair value of $941,426 and $827,566)	898,786	806,038
Loans held for sale	901	9,037
Loans, net of allowance for loan losses of $121,119 and $80,284	9,177,422	8,379,026
Premises and equipment	112,548	113,055
Federal Home Loan Bank stock	28,736	28,736
Interest receivable	57,063	48,901
Goodwill	543,918	543,918
Other intangibles	31,937	34,962
Cash surrender value of life insurance	290,715	288,206
Other real estate owned	7,367	7,527
Tax asset, deferred and receivable	13,126	12,165
Other assets	156,486	100,194
TOTAL ASSETS	$ 13,819,378	$ 12,457,254
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 2,260,351	$ 1,736,396
Interest-bearing	8,705,637	8,103,560
Total Deposits	10,965,988	9,839,956
Borrowings:		
Federal funds purchased	—	55,000
Securities sold under repurchase agreements	181,150	187,946
Federal Home Loan Bank advances	400,817	351,072
Subordinated debentures and other borrowings	285,197	138,685
Total Borrowings	867,164	732,703
Interest payable	5,587	6,754
Other liabilities	171,544	91,404
Total Liabilities	12,010,283	10,670,817
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
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 - 100,000,000 shares		
Issued and outstanding - 53,795,500 and 55,368,482 shares	6,724	6,921
Additional paid-in capital	1,002,962	1,054,997
Retained earnings	735,439	696,520
Accumulated other comprehensive income	63,845	27,874
Total Stockholders' Equity	1,809,095	1,786,437
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 13,819,378	$ 12,457,254

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

PART I. FINANCIAL INFORMATION
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CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
INTEREST INCOME				
Loans receivable:				
Taxable	$ 87,312	$ 92,824	$ 183,964	$ 183,305
Tax exempt	5,359	4,244	10,674	8,397
Investment securities:				
Taxable	6,147	6,998	13,778	13,093
Tax exempt	10,019	7,454	19,354	14,325
Deposits with financial institutions	134	784	709	1,659
Federal Home Loan Bank stock	281	335	580	673
Total Interest Income	109,252	112,639	229,059	221,452
INTEREST EXPENSE				
Deposits	12,707	23,087	34,455	42,681
Federal funds purchased	2	117	113	210
Securities sold under repurchase agreements	92	342	444	672
Federal Home Loan Bank advances	1,794	1,692	3,568	3,506
Subordinated debentures and other borrowings	1,639	2,123	3,584	4,239
Total Interest Expense	16,234	27,361	42,164	51,308
NET INTEREST INCOME	93,018	85,278	186,895	170,144
Provision for loan losses	21,895	500	41,647	1,700
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	71,123	84,778	145,248	168,444
OTHER INCOME				
Service charges on deposit accounts	4,312	5,437	10,282	10,532
Fiduciary and wealth management fees	5,601	3,931	11,586	7,749
Card payment fees	6,097	4,829	12,004	9,655
Net gains and fees on sales of loans	3,674	1,736	7,037	3,031
Derivative hedge fees	1,042	1,487	2,981	2,268
Other customer fees	333	341	731	780
Increase in cash surrender value of life insurance	1,231	927	2,591	1,916
Gains on life insurance benefits	95	19	95	19
Net realized gains on sales of available for sale securities	3,068	1,843	7,680	2,983
Other income	1,028	1,064	1,293	1,394
Total Other Income	26,481	21,614	56,280	40,327
OTHER EXPENSES				
Salaries and employee benefits	35,698	32,709	74,941	65,737
Net occupancy	5,447	4,469	11,248	9,496
Equipment	4,489	4,117	8,833	7,759
Marketing	2,092	2,752	3,535	3,826
Outside data processing fees	2,618	3,929	6,817	7,613
Printing and office supplies	279	334	666	649
Intangible asset amortization	1,511	1,520	3,025	3,048
FDIC assessments	1,472	678	2,995	1,385
Other real estate owned and foreclosure expenses	684	903	1,189	2,068
Professional and other outside services	1,553	2,376	3,811	4,260
Other expenses	4,146	3,800	9,100	8,367
Total Other Expenses	59,989	57,587	126,160	114,208
INCOME BEFORE INCOME TAX	37,615	48,805	75,368	94,563
Income tax expense	4,623	7,749	8,113	14,690
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 32,992	$ 41,056	$ 67,255	$ 79,873
Per Share Data:				
Basic Net Income Available to Common Stockholders	$ 0.62	$ 0.83	$ 1.24	$ 1.62

Diluted Net Income Available to Common Stockholders	$	0.62	$	0.83	$	1.24	$	1.61
Cash Dividends Paid	$	0.26	$	0.26	$	0.52	$	0.48
Average Diluted Shares Outstanding (in thousands)		53,943		49,550		54,430		49,545

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	**2019**	**2020**	**2019**
Net income	$ 32,992	$ 41,056	$ 67,255	$ 79,873
Other comprehensive income (loss), net of tax:				
Unrealized holding gain (loss) on securities available for sale arising during the period, net of tax of $3,335, $4,822, $11,406, and $10,402	12,545	18,140	42,909	39,130
Unrealized gain (loss) on cash flow hedges arising during the period, net of tax of $31, $148, $306, and $230	(114)	(553)	(1,153)	(862)
Reclassification adjustment for net gains included in net income, net of tax of $595, $369, $1,538, and $596	(2,242)	(1,390)	(5,785)	(2,244)
Total other comprehensive income, net of tax	10,189	16,197	35,971	36,024
Comprehensive income	$ 43,181	$ 57,253	$ 103,226	$ 115,897

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Three Months Ended June 30, 2020							
	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Income	Total
Balances, March 31, 2020	125	$ 125	53,754,137	$ 6,719	$ 1,000,942	$ 716,518	$ 53,656	$ 1,777,960
Comprehensive income:								
Net income	—	—	—	—	—	32,992	—	32,992
Other comprehensive income, net of tax	—	—	—	—	—	—	10,189	10,189
Cash dividends on common stock ($.26 per share)	—	—	—	—	—	(14,071)	—	(14,071)
Share-based compensation	—	—	5,259	1	1,212	—	—	1,213
Stock issued under employee benefit plans	—	—	11,511	1	308	—	—	309
Stock issued under dividend reinvestment and stock purchase plan	—	—	15,897	2	433	—	—	435
Stock options exercised	—	—	9,000	1	75	—	—	76
Restricted shares withheld for taxes	—	—	(304)	—	(8)	—	—	(8)
Balances, June 30, 2020	125	$ 125	53,795,500	$ 6,724	$ 1,002,962	$ 735,439	$ 63,845	$ 1,809,095

	Three Months Ended June 30, 2019							
	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Loss	Total
Balances, March 31, 2019	125	$ 125	49,428,468	$ 6,179	$ 839,919	$ 611,220	$ (1,595)	$ 1,455,848
Comprehensive income:								
Net income	—	—	—	—	—	41,056	—	41,056
Other comprehensive income, net of tax	—	—	—	—	—	—	16,197	16,197
Cash dividends on common stock ($.26 per share)	—	—	—	—	—	(12,914)	—	(12,914)
Share-based compensation	—	—	4,978	1	843	—	—	844
Stock issued under employee benefit plans	—	—	5,908	—	188	—	—	188
Stock issued under dividend reinvestment and stock purchase plan	—	—	10,178	1	368	—	—	369
Stock options exercised	—	—	7,500	1	64	—	—	65
Restricted shares withheld for taxes	—	—	(438)	—	(17)	—	—	(17)
Balances, June 30, 2019	125	$ 125	49,456,594	$ 6,182	$ 841,365	$ 639,362	$ 14,602	$ 1,501,636

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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	Six Months Ended June 30, 2020							
	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Income	Total
Balances, December 31, 2019	125	$ 125	55,368,482	$ 6,921	$ 1,054,997	$ 696,520	$ 27,874	$ 1,786,437
Comprehensive income:								
Net income	—	—	—	—	—	67,255	—	67,255
Other comprehensive income, net of tax	—	—	—	—	—	—	35,971	35,971
Cash dividends on common stock ($.52 per share)	—	—	—	—	—	(28,336)	—	(28,336)
Repurchases of common stock	—	—	(1,634,437)	(204)	(55,708)	—	—	(55,912)
Share-based compensation	—	—	8,591	1	2,432	—	—	2,433
Stock issued under employee benefit plans	—	—	11,511	1	308	—	—	309
Stock issued under dividend reinvestment and stock purchase plan	—	—	31,607	4	859	—	—	863
Stock options exercised	—	—	10,050	1	82	—	—	83
Restricted shares withheld for taxes	—	—	(304)	—	(8)	—	—	(8)
Balances, June 30, 2020	125	$ 125	53,795,500	$ 6,724	$ 1,002,962	$ 735,439	$ 63,845	$ 1,809,095

	Six Months Ended June 30, 2019							
	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Loss	Total
Balances, December 31, 2018	125	$ 125	49,349,800	$ 6,169	$ 840,052	$ 583,336	$ (21,422)	$ 1,408,260
Comprehensive income:								
Net income	—	—	—	—	—	79,873	—	79,873
Other comprehensive loss, net of tax	—	—	—	—	—	—	36,024	36,024
Cash dividends on common stock ($.48 per share)	—	—	—	—	—	(23,847)	—	(23,847)
Share-based compensation	—	—	108,638	14	1,811	—	—	1,825
Stock issued under employee benefit plans	—	—	11,247	1	361	—	—	362
Stock issued under dividend reinvestment and stock purchase plan	—	—	18,686	2	707	—	—	709
Stock options exercised	—	—	11,200	1	104	—	—	105
Restricted shares withheld or taxes	—	—	(42,977)	(5)	(1,670)	—	—	(1,675)
Balances, June 30, 2019	125	$ 125	49,456,594	$ 6,182	$ 841,365	$ 639,362	$ 14,602	$ 1,501,636

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months Ended June 30,	
	June 30, 2020	June 30, 2019
Cash Flow From Operating Activities:		
Net income	$ 67,255	$ 79,873
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	41,647	1,700
Depreciation and amortization	5,435	4,379
Change in deferred taxes	(18,509)	(398)
Share-based compensation	2,433	1,825
Loans originated for sale	(322,288)	(183,498)
Proceeds from sales of loans held for sale	336,583	184,667
Gains on sales of loans held for sale	(6,159)	(2,245)
Gains on sales of securities available for sale	(7,680)	(2,983)
Increase in cash surrender of life insurance	(2,591)	(1,916)
Gains on life insurance benefits	(95)	(19)
Change in interest receivable	(8,162)	(4,269)
Change in interest payable	(1,167)	1,133
Other adjustments	28,006	4,759
Net cash provided by operating activities	114,708	83,008
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	(261,758)	(92,651)
Purchases of:		
Securities available for sale	(341,116)	(306,291)
Securities held to maturity	(221,711)	(238,559)
Proceeds from sales of securities available for sale	167,390	82,052
Proceeds from maturities of:		
Securities available for sale	135,398	53,910
Securities held to maturity	127,380	35,185
Net change in loans	(840,804)	(288,195)
Proceeds from the sale of other real estate owned	592	827
Proceeds from life insurance benefits	177	633
Other adjustments	(5,190)	(3,691)
Net cash used in investing activities	(1,239,642)	(756,780)
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	1,419,771	400,314
Certificates of deposit and other time deposits	(293,739)	164,421
Borrowings	467,056	533,010
Repayment of borrowings	(332,595)	(410,689)
Cash dividends on common stock	(28,336)	(23,847)
Stock issued under employee benefit plans	309	362
Stock issued under dividend reinvestment and stock purchase plans	863	709
Stock options exercised	83	105
Restricted shares withheld for taxes	(8)	(1,675)
Repurchase of common stock	(55,912)	—
Net cash provided by financing activities	1,177,492	662,710
Net Change in Cash and Cash Equivalents	52,558	(11,062)
Cash and Cash Equivalents, January 1	177,201	139,247
Cash and Cash Equivalents, June 30	$ 229,759	$ 128,185
Additional cash flow information:		
Interest paid	$ 43,331	$ 50,175
Income tax paid (refunded)	(300)	11,499
Loans transferred to other real estate owned	761	314
Fixed assets transferred to other real estate owned	262	965
Non-cash investing activities using trade date accounting	13,115	40,618
ROU assets obtained in exchange for new operating lease liabilities	1,398	23,384

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PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

NOTE 1

GENERAL

Financial Statement Preparation

The significant accounting policies followed by 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, 2019, 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 Annual Report on Form 10-K for the year ended December 31, 2019 filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2020, are not necessarily indicative of the results to be expected for the year. Reclassifications have been made to prior financial statements to conform to the current financial statement presentation. These reclassifications had no effect on net income. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and fair value of financial instruments. The uncertainties related to the coronavirus disease 2019 ("COVID-19") could cause significant changes to these estimates compared to what was known at the time these financial statements were prepared.

Impact of COVID-19

On January 30, 2020, the World Health Organization (“WHO”) announced that the outbreak of COVID-19 constituted a public health emergency of international concern. On March 11, 2020, WHO declared COVID-19 to be a global pandemic and, on March 13, 2020, the President of the United States declared the COVID-19 outbreak a national emergency. The health concerns relating to the COVID-19 outbreak and related governmental actions taken to reduce the spread of the virus have significantly impacted the global economy (including the states and local economies in which the Corporation operates), disrupted supply chains, lowered equity market valuations, and created significant volatility and disruption in financial markets. The outbreak has resulted in authorities implementing numerous measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter in place or total lock-down orders and business limitations and shutdowns. As a result of the shelter in place mandates in effect early in the second quarter of 2020, commercial activity throughout our geographic footprint, as well as nationally, decreased significantly. Most states have reopened, albeit under limited capacities and under other social distancing restrictions; however, commercial activity has not returned to the levels existing prior to the outbreak of the pandemic. Such measures have significantly contributed to rising unemployment and negatively impacted consumer and business spending. As a result, the demand for the Corporation’s products and services has been, and will continue to be, significantly impacted.

Recent Accounting Changes Adopted in 2020

FASB Accounting Standards Updates No. 2018-15 - *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*

Summary - The FASB issued Accounting Standards Update (ASU) No. 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract,* which reduces complexity for the accounting for costs of implementing a cloud computing service arrangement. This standard aligns the accounting for implementation costs of hosting arrangements, regardless of whether they convey a license to the hosted software. The ASU aligns the following requirements for capitalizing implementation costs:

- Those incurred in a hosting arrangement that is a service contract, and
- Those incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license).

For calendar-year public companies, the changes were effective for fiscal years ending after December 15, 2019. The Corporation adopted the standard in the first quarter of 2020 and adoption of the standard did not have a significant effect on the Corporation’s consolidated financial statements.

FASB Accounting Standards Updates No. 2018-14 - *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*

Summary - The FASB issued ASU No. 2018-14, *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans,* that applies to all employers that sponsor defined benefit pension or other postretirement plans. The amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans.

Disclosure Requirements Deleted

- The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year.
- The amount and timing of plan assets expected to be returned to the employer.
- Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan.
- For public entities, the effects of a one-percentage-point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of net periodic benefit costs and (b) benefit obligation for postretirement health care benefits.

Disclosure Requirements Added

- An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

The amendments also clarify the disclosure requirements in paragraph 715-20-50-3, which state that the following information for defined benefit pension plans should be disclosed:

- The projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets, and
- The accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets.

ASU No. 2018-14 is effective for fiscal years ending after December 15, 2020, for public business entities and for fiscal years ending after December 15, 2021, for all other entities. Early adoption is permitted for all entities. The Corporation adopted the standard in the first quarter of 2020 and adoption of the standard did not have a significant effect on the Corporation’s disclosures.

FASB Accounting Standards Updates No. 2018-13 - *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*

Summary - The FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement.* ASU No. 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820. Certain disclosure requirements related to transfers between Level 1 and Level 2 of the fair value hierarchy and Level 3 valuation process were removed from Topic 820. Disclosures were also added to Topic 820 for changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements.

In addition, the amendments eliminate "at a minimum" from the phrase “an entity shall disclose at a minimum” to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements.

The amendments in ASU No. 2018-13 were effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty were applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments were applied retrospectively to all periods presented upon their effective date. Early adoption was permitted. An entity was permitted to early adopt any removed or modified disclosures upon issuance of ASU No. 2018-13 and delay adoption of the additional disclosures until their effective date. The Corporation adopted the standard in the first quarter of 2020 and adoption of the standard did not have a significant effect on the Corporation’s disclosures.

FASB Accounting Standards Updates No. 2017-04 - *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.*

Summary - The FASB issued ASU No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill,* which simplifies how an entity is required to test goodwill for impairment. To simplify the subsequent measurement of goodwill, the ASU eliminates Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, the income tax effects of tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the qualitative impairment test is necessary.

The amendments were applied on a prospective basis. The Corporation adopted ASU No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill,* January 1, 2020 and assessed the recent economic impact and market conditions from the COVID-19 pandemic. Based upon factors considered in the assessment and the general uncertainty as to the full extent of the COVID-19 pandemic and its effect on economic recovery, the Corporation has determined that it is not more likely than not that the fair value of the Corporation is less than the carrying value. Therefore, the Corporation concluded goodwill was not impaired at June 30, 2020, the details of which are included in NOTE 6. GOODWILL of these Notes to Consolidated Condensed Financial Statements.

Guidance on Non-TDR Loan Modifications due to COVID-19

On March 22, 2020, a statement was issued by the Bank's banking regulators and titled the “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus” (the "Interagency Statement") that encourages financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations due to the effects of COVID-19. Additionally, Section 4013 of the CARES Act further provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates. The Interagency Statement was subsequently revised on April 7, 2020 to clarify the interaction of the original guidance with Section 4013 of the CARES Act, as well as setting forth the banking regulators’ views on consumer protection considerations. In accordance with such guidance, the Bank is offering short-term modifications made in response to COVID-19 to borrowers who are current and otherwise not past due. These include short-term, 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. During the six months ended June 30, 2020, modifications were completed on loans having a total aggregate balance of approximately $1.1 billion, or 12.1 percent of the loan portfolio. Details of the modifications are included in NOTE 4. LOANS AND ALLOWANCE of these Notes to Consolidated Condensed Financial Statements.

New Accounting Pronouncements Not Yet Adopted

The Corporation continually monitors potential accounting changes and pronouncements. The following pronouncements have been deemed to have the most applicability to the Corporation's financial statements:

FASB Accounting Standards Update No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

Summary - The FASB issued Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This new guidance was issued to address concerns that current generally accepted accounting principles (GAAP) restricts the ability to record credit losses that are expected, but do not yet meet the “probable” threshold by replacing the current “incurred loss” model for recognizing credit losses with an “expected life of loan loss” model referred to as the Current Expected Credit Loss (CECL) model.

Under the CECL model, certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, are required to be presented at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the “incurred loss” model required under current GAAP, which delays recognition until it is probable a loss has been incurred. The change could materially affect how the allowance for loan losses is determined and cause a charge/credit to earnings through the provision for loan losses. Such could create volatility in earnings and could adversely affect the financial condition of the Corporation.

The ASU is effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Pursuant to the CARES Act and the related joint statement of federal banking regulators (which also became effective as of March 27, 2020), and consistent with guidance from the SEC and FASB, the Corporation has elected to delay implementation of ASU No. 2016-13, which would have become effective for the Corporation as of January 1, 2020. As discussed above, ASU No. 2016-13 provides for the replacement of the incurred loss model for recording the allowance for loan losses with CECL. However, as a result of the Corporation’s election, its second quarter 2020 financial statements have been prepared under the existing incurred loss model. The temporary relief applicable to the Corporation’s compliance with CECL ends on the earlier of: (1) the termination date of the national emergency concerning the COVID-19 outbreak, declared by the President of the United States on March 13, 2020, under the National Emergencies Act; or (2) December 31, 2020.

The Corporation has developed models that satisfy the requirements of the new standard which will be governed by a system of internal controls and a cross-functional working group consisting of accounting, finance, and credit administration personnel. The loan portfolio was pooled into ten loan segments with similar risk characteristics for which the probability of default/loss given default methodology will be applied. The Corporation intends to utilize a one-year economic forecast period then revert to historical macroeconomic levels for the remaining life of the portfolio. A baseline macroeconomic scenario, along with other scenarios, will be used to develop a range of estimated credit losses for which to determine the best estimate within.

The Corporation will record a one-time cumulative-effect adjustment to retained earnings, net of income taxes, on the consolidated balance sheet as of the beginning of the adoption period. If adopted with retrospective measurement to January 1, 2020, the allowance will increase by 55-65 percent from December 31, 2019 because it will cover expected credit losses over the life of the loan portfolio, which approximates four years, and it includes all purchased loans that were previously excluded from the allowance for loan losses calculation. CECL also requires the establishment of a reserve for potential losses from unfunded commitments that is recorded in other liabilities, separate from allowance for credit losses, which is estimated to be approximately $18 million.

FASB Accounting Standards Update No. 2019-11 - *Codification Improvements to (Topic 326): Financial Instruments - Credit Losses*

Summary - The FASB issued ASU No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments - Credit Losses* in order to address issues raised by stakeholders during the implementation of ASU No. 2016-13*, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses of Financial Instruments.*

Among other narrow-scope improvements, the new ASU clarifies guidance around how to report expected recoveries. “Expected recoveries” describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. While applying the credit losses standard, stakeholders questioned whether expected recoveries were permitted on assets that had already shown credit deterioration at the time of purchase (also known as PCD assets). In response to this question, the ASU permits organizations to record expected recoveries on PCD assets. In addition to other narrow technical improvements, the ASU also reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities.

The ASU includes effective dates and transition requirements that vary depending on whether or not an entity has already adopted ASU No. 2016-13. As discussed above, pursuant to the CARES Act, the Corporation elected to defer the adoption of CECL. The temporary relief applicable to the Corporation’s compliance with CECL ends on the earlier of: (1) the termination date of the national emergency concerning the COVID-19 outbreak, declared by the President of the United States on March 13, 2020, under the National Emergencies Act; or (2) December 31, 2020.

FASB Accounting Standards Updates - No. 2020-04 - *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

Summary - The FASB issued ASU No. 2020-04 to provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. LIBOR and other interbank offered rates are widely used benchmarks or reference rates in the United States and globally. Trillions of dollars in loans, derivatives, and other financial contracts reference LIBOR, the benchmark interest rate banks use to make short-term loans to each other. With global capital markets expected to move away from LIBOR and other interbank offered rates toward rates that are more observable or transaction based and less susceptible to manipulation, the FASB launched a broad project in late 2018 to address potential accounting challenges expected to arise from the transition. The new guidance provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. The ASU is intended to help stakeholders during the global market-wide reference rate transition period.

Entities may apply this ASU as of the beginning of an interim period that includes the March 12, 2020 issuance date of the ASU, through December 31, 2022. The Corporation expects to adopt the practical expedients included in the ASU prior to December 31, 2022. The Corporation is implementing a transition plan to identify and modify its loans and other financial instruments with attributes that are either directly or indirectly influenced by LIBOR. The Corporation is assessing ASU 2020-04 and its impact on the Corporation's transition away from LIBOR for its loans and other financial instruments.

NOTE 2
ACQUISITION

MBT Financial Corp.

On September 1, 2019, the Corporation acquired 100 percent of MBT. MBT, a Michigan corporation, merged with and into the Corporation, whereupon the separate corporate existence of MBT ceased and the Corporation survived. Immediately following the merger, MBT's wholly-owned subsidiary, Monroe Bank & Trust, merged with and into the Bank, with the Bank continuing as the surviving bank.

MBT was headquartered in Monroe, Michigan and had 20 banking centers serving the Monroe market. Pursuant to the merger agreement, each MBT shareholder received 0.275 shares of the Corporation's common stock for each outstanding share of MBT common stock held. The Corporation issued approximately 6.4 million shares of common stock, which was valued at approximately $229.9 million. The Corporation engaged in this transaction with the expectation that it would be accretive to income and add a new market area in Michigan that has a demographic profile consistent with many of the current Indiana and Ohio markets served by the Bank. Goodwill resulted from this transaction due to the expected synergies and economies of scale.

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Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change based on the timing of the transaction, the purchase price for the MBT acquisition is detailed in the following table. If, prior to the end of the one-year measurement period for finalizing the purchase price allocation, information becomes available about facts and circumstances that existed as of the acquisition date, which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

	Fair Value
Cash and cash equivalents	$ 10,222
Interest-bearing time deposits	281,228
Investment securities	212,235
Loans	732,578
Premises and equipment	21,664
Federal Home Loan Bank stock	4,148
Interest receivable	3,361
Cash surrender value of life insurance	59,545
Tax asset, deferred and receivable	5,205
Other assets	6,011
Deposits	(1,105,926)
Securities sold under repurchase agreements	(94,760)
Federal Home Loan Bank advances	(10,853)
Other liabilities	(9,807)
Net tangible assets acquired	114,851
Core deposit intangible	16,527
Goodwill	98,563
Purchase price	$ 229,941

Of the total purchase price, $16,527,000 was allocated to a core deposit intangible, which will be amortized over its estimated life of 10 years. The remaining purchase price was allocated to goodwill, which is not deductible for tax purposes.

Acquired loan data for MBT is included in the following table:

	Fair Value of Acquired Loans at Acquisition Date	Gross Contractual Amounts Receivable at Acquisition Date	Best Estimate at Acquisition Date of Contractual Cash Flows Not Expected to be Collected
Acquired receivables subject to ASC 310-30	$ 3,531	$ 6,840	$ 2,733
Acquired receivables not subject to ASC 310-30	$ 729,047	$ 907,210	$ 14,722

Purchased loans with evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments are accounted for under ASC 310-30, *Loans Acquired with Deteriorated Credit Quality*. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. The accretable portion of the fair value discount or premium is the difference between the expected cash flows and the net present value of expected cash flows, with such difference accreted into earnings over the term of the loans.

Pro Forma Financial Information

The results of operations of MBT have been included in the Corporation's consolidated financial statements since the acquisition date. The following table includes pro forma results for the year ended December 31, 2019 as if the MBT acquisition occurred as of the beginning of the period presented.

	2019
Total revenue (net interest income plus other income)	$ 474,891
Net income available to common shareholders	$ 161,228
Earnings per share:	
Basic	$ 2.89
Diluted	$ 2.88

(table dollar amounts in thousands, except share data)

The pro forma information includes adjustments for interest income on loans and investments, interest expense on deposits and borrowings, premises expense for banking centers acquired and amortization of intangibles arising from the transaction and the related income tax effects. The pro forma information for the year ended December 31, 2019 includes operating revenue from MBT of $19.7 million since the date of acquisition. Additionally $19.7 million, net of tax, of non-recurring expenses directly attributable to the MBT acquisition were included in the year ended December 31, 2019 pro forma information.

The pro forma information is presented for informational purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, or intended to be a projection of future results.

NOTE 3

INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at June 30, 2020				
U.S. Treasury	$ 598	$ 2	$ —	$ 600
U.S. Government-sponsored agency securities	2,385	68	—	2,453
State and municipal	1,026,917	67,439	138	1,094,218
U.S. Government-sponsored mortgage-backed securities	761,391	28,870	27	790,234
Corporate obligations	3,031	57	—	3,088
Total available for sale	1,794,322	96,436	165	1,890,593
Held to maturity at June 30, 2020				
U.S. Government-sponsored agency securities	10,100	3	—	10,103
State and municipal	374,214	23,779	43	397,950
U.S. Government-sponsored mortgage-backed securities	512,972	18,932	31	531,873
Foreign investment	1,500	—	—	1,500
Total held to maturity	898,786	42,714	74	941,426
Total Investment Securities	$ 2,693,108	$ 139,150	$ 239	$ 2,832,019

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2019				
U.S. Government-sponsored agency securities	$ 38,529	$ 346	$ —	$ 38,875
State and municipal	859,511	41,092	807	899,796
U.S. Government-sponsored mortgage-backed securities	842,349	10,378	1,404	851,323
Corporate obligations	31	—	—	31
Total available for sale	1,740,420	51,816	2,211	1,790,025
Held to maturity at December 31, 2019				
U.S. Government-sponsored agency securities	15,619	1	37	15,583
State and municipal	354,115	15,151	107	369,159
U.S. Government-sponsored mortgage-backed securities	434,804	6,921	401	441,324
Foreign investment	1,500	—	—	1,500
Total held to maturity	806,038	22,073	545	827,566
Total Investment Securities	$ 2,546,458	$ 73,889	$ 2,756	$ 2,617,591

The increase in unrealized gains from December 31, 2019 to June 30, 2020 is primarily due to interest rate declines. The longer term points on the yield curve have declined since year-end which increases the fair value of securities in the portfolio.

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The amortized cost and fair value of available for sale and held to maturity securities at June 30, 2020 and December 31, 2019, 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 June 30,2020:				
Due in one year or less	$ 1,947	$ 1,961	$ 12,191	$ 12,217
Due after one through five years	4,589	4,718	23,639	24,224
Due after five through ten years	49,425	52,485	95,694	101,354
Due after ten years	976,970	1,041,195	254,290	271,758
	1,032,931	1,100,359	385,814	409,553
U.S. Government-sponsored mortgage-backed securities	761,391	790,234	512,972	531,873
Total Investment Securities	$ 1,794,322	$ 1,890,593	$ 898,786	$ 941,426

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at December 31, 2019				
Due in one year or less	$ 1,134	$ 1,136	$ 9,920	$ 10,105
Due after one through five years	5,031	5,141	45,197	45,654
Due after five through ten years	74,745	76,920	84,153	88,844
Due after ten years	817,161	855,505	231,964	241,639
	898,071	938,702	371,234	386,242
U.S. Government-sponsored mortgage-backed securities	842,349	851,323	434,804	441,324
Total Investment Securities	$ 1,740,420	$ 1,790,025	$ 806,038	$ 827,566

The carrying value of securities pledged as collateral, to secure borrowings and for other purposes, was $1,100,278,000 at June 30, 2020, and $503,427,000 at December 31, 2019. In order to facilitate the funding of PPP loans, the Bank pledged securities to the Discount Window at the Federal Reserve Bank resulting in the increase in pledged securities at June 30, 2020 compared to December 31, 2019.

The book value of securities sold under agreements to repurchase amounted to $171,346,000 at June 30, 2020, and $182,856,000 at December 31, 2019.

Gross gains on the sales and redemptions of available for sale securities for the three and six months ended June 30, 2020 and 2019 are shown below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Sales and Redemptions of Available for Sale Securities:				
Gross gains	$ 3,068	$ 1,843	$ 7,680	$ 2,983
Gross losses	—	—	—	—

The following tables show the Corporation's gross unrealized losses and fair value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position at June 30, 2020, and December 31, 2019:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Available for Sale Securities at June 30, 2020						
State and municipal	$ 23,745	$ 138	$ —	$ —	$ 23,745	$ 138
U.S. Government-sponsored mortgage-backed securities	15,239	27	—	—	15,239	27
Total Temporarily Impaired Available for Sale Securities	38,984	165	—	—	38,984	165
Temporarily Impaired Held to Maturity Securities at June 30,2020						
State and municipal	2,633	43	—	—	2,633	43
U.S. Government-sponsored mortgage-backed securities	10,198	31	—	—	10,198	31
Total Temporarily Impaired Held to Maturity Securities	12,831	74	—	—	12,831	74
Total Temporarily Impaired Investment Securities	$ 51,815	$ 239	$ —	$ —	$ 51,815	$ 239

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	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Available for Sale Securities at December 31, 2019						
State and municipal	$ 76,273	$ 807	$ —	$ —	$ 76,273	$ 807
U.S. Government-sponsored mortgage-backed securities	127,673	1,326	20,796	78	148,469	1,404
Total Temporarily Impaired Available for Sale Securities	203,946	2,133	20,796	78	224,742	2,211
Temporarily Impaired Held to Maturity Securities at December 31, 2019						
U.S. Government-sponsored agency securities	3,016	4	12,467	33	15,483	37
State and municipal	22,947	107	—	—	22,947	107
U.S. Government-sponsored mortgage-backed securities	124,253	364	7,991	37	132,244	401
Total Temporarily Impaired Held to Maturity Securities	150,216	475	20,458	70	170,674	545
Total Temporarily Impaired Investment Securities	$ 354,162	$ 2,608	$ 41,254	$ 148	$ 395,416	$ 2,756

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost as indicated in the table below.

	June 30, 2020	December 31, 2019
Investments reported at less than historical cost:		
Historical cost	$ 52,054	$ 398,172
Fair value	51,815	395,416
Gross unrealized losses	$ 239	$ 2,756
Percent of the Corporation's investment portfolio	1.9%	15.2%

The Corporation's management believes the decline in fair value for these securities was 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 during the period the other-than-temporary-impairment ("OTTI") is identified. The Corporation’s management has evaluated all securities with unrealized losses for OTTI and concluded no OTTI existed at June 30, 2020.

In determining the fair value of the investment securities portfolio, the Corporation utilizes a third party for portfolio accounting services, including market value input, for those securities classified as Level 1 and Level 2 in the fair value hierarchy. The Corporation has obtained an understanding of what inputs are being used by the vendor in pricing the portfolio and how the vendor classified these securities based upon these inputs. From these discussions, the Corporation’s management is comfortable that the classifications are proper. The Corporation has gained trust in the data for two reasons: (a) independent spot testing of the data is conducted by the Corporation through obtaining market quotes from various brokers on a periodic basis; and (b) actual gains or loss resulting from the sale of certain securities has proven the data to be accurate over time. Fair value of securities classified as Level 3 in the valuation hierarchy was determined using a discounted cash flow model that incorporated market estimates of interest rates and volatility in markets that have not been active.

State and Municipal Securities

The unrealized losses on the Corporation's investments in securities of state and political subdivisions were caused by interest rate changes. 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. Because the Corporation does not intend to sell the investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Corporation does not consider those investments to be other-than-temporarily impaired at June 30, 2020. The state and municipal securities portfolio contains unrealized losses of $138,000 on thirteen securities and $43,000 on two securities in the available for sale and held to maturity portfolios, respectively. At June 30, 2020, the Corporation had little to no exposure to municipal bonds related to entertainment receipts, student housing, parking facilities, airports, nursing homes or public transit.

U.S. Government-Sponsored Mortgage-Backed Securities

The unrealized losses on the Corporation's investment in mortgage-backed securities were a result of interest rate changes. The Corporation expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Corporation does not intend to sell the investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Corporation does not consider those investments to be other-than-temporarily impaired at June 30, 2020. The mortgage-backed securities portfolio contains unrealized losses of $27,000 on one security in the available for sale portfolio and $31,000 on three securities in the held to maturity portfolio. All these securities are issued by a U.S. government-sponsored entity and have an implicit or explicit government guarantee. The slowing of prepayments and the forbearance programs resulting from the financial impacts of COVID-19 could increase bond duration and potentially improve market values on these securities.

(table dollar amounts in thousands, except share data)

NOTE 4

LOANS AND ALLOWANCE

Loans are stated at the amount of unpaid principal, reduced by deferred income (net of costs). Interest on loans is recognized using the simple interest method on the daily balances of the principal amounts outstanding. Loan origination fees, net of direct loan origination costs, and commitment fees are deferred and amortized as an adjustment to yield over the life of the loan, or over the commitment period, as applicable. The Corporation's primary lending focus is small business and middle market commercial, commercial real estate and residential real estate, which results in portfolio diversification. The following tables show the composition of the loan portfolio, the allowance for loan losses and credit quality characteristics by collateral classification, excluding loans held for sale. Loans held for sale as of June 30, 2020, and December 31, 2019, were $901,000 and $9,037,000, respectively.

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

	June 30, 2020	December 31, 2019
Commercial and industrial loans	$ 2,898,329	$ 2,109,879
Agricultural production financing and other loans to farmers	93,838	93,861
Real estate loans:		
Construction	640,560	787,568
Commercial and farmland	3,239,998	3,052,698
Residential	1,145,187	1,143,217
Home equity	532,314	588,984
Individuals' loans for household and other personal expenditures	123,611	135,989
Public finance and other commercial loans	624,704	547,114
Loans	9,298,541	8,459,310
Allowance for loan losses	(121,119)	(80,284)
Net Loans	$ 9,177,422	$ 8,379,026

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law, providing an approximately $2 trillion stimulus package that includes direct payments to individual taxpayers, economic stimulus to significantly impacted industry sectors, emergency funding for hospitals and providers, small business loans, increased unemployment benefits, and a variety of tax incentives.
For small businesses, eligible nonprofits and certain others, the CARES Act established a Paycheck Protection Program ("PPP"), which is administered by the Small Business Administration ("SBA"). On April 24, 2020, the Paycheck Protection Program and Health Care Enhancement Act was enacted. Among other things, this legislation amends the initial CARES Act program by raising the appropriation level for PPP loans from $349 billion to $670 billion. The PPP was further modified on June 5, 2020 with the adoption of the Paycheck Protection Program Flexibility Act (the Flexibility Act), which extended the maturity date for PPP loans from two years to five years for loans disbursed on or after the date of enactment of the Flexibility Act. For PPP loans disbursed prior to such enactment, the Flexibility Act permits the borrower and lender to mutually agree to extend the term of the loan to five years. The Bank has actively participated in assisting its customers with applications for resources through the program. PPP loans earn interest at a fixed rate of 1 percent and primarily have a two year term. The Bank anticipates that the majority of these loans will ultimately be forgiven, in whole or in part, by the SBA in accordance with the terms of the program. As of June 30, 2020, the Bank had funded over 5,000 PPP loans representing $882.9 million, which is net of deferred processing fees and costs of $24.6 million, and is primarily included in the commercial and industrial loan class. Under the terms of the PPP, the loans are fully guaranteed by the U.S. government. The Bank borrowed from the Paycheck Protection Program Liquidity Facility ("PPPL Facility") to supplement liquidity to fund the PPP loans. The outstanding balance of the PPPL Facility borrowings at June 30, 2020 was $166.9 million. Details of the borrowings from the PPPL Facility are included in the "LIQUIDITY" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations on this Form 10-Q.

Allowance, Credit Quality and Loan Portfolio

The original implementation date of the Current Expected Credit Loss (CECL) model for calculating the Allowance for Credit Losses guided by FASB Accounting Standards Update No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit losses on Financial Instruments was January 1, 2020. Pursuant to the CARES Act and the related joint statement of federal banking regulators (which also became effective as of March 27, 2020), and consistent with guidance from the SEC and FASB, the Corporation elected to delay implementation of ASU No. 2016-13. As discussed below, ASU No. 2016-13, provides for the replacement of the incurred loss model for recording the allowance for loan losses with CECL. However, as a result of the Corporation's election, its 2020 financial statements have been prepared under the existing incurred loss model. The temporary relief applicable to the Corporation's compliance with CECL ends on the earlier of: (1) the termination date of the national emergency concerning the COVID-19 outbreak, declared by the President of the United States on March 13, 2020, under the National Emergencies Act; or (2) December 31, 2020.

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The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. Management believes the allowance for loan losses is adequate to cover probable losses inherent in the loan portfolio at June 30, 2020. 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 to estimate the effect of uncertain matters. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examinations, and will increase or decrease as deemed necessary to ensure it 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, portfolio mix and collateral values.

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The allowance is increased by provision expense and decreased by charge-offs less recoveries. All charge-offs are approved by the Bank's senior credit officers and in accordance with established policies. The Bank charges off a loan when a determination is made that all or a portion of the loan is uncollectable. The amount provided for loan losses in a given period may be greater than or less than net loan losses experienced during the period, and is based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision amount is based on management's ongoing review and evaluation of the loan portfolio, including an internally administered loan "watch" list and independent loan reviews. 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 the current environment and economic conditions on the portfolio.

The allowance consists of specific impairment reserves as required by ASC 310-10-35, a component for historical losses in accordance with ASC 450 and the consideration of current environmental factors in accordance with ASC 450. 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.

The historical loss allocation for loans not deemed impaired according to ASC 450 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 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 but not impaired 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 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 ensure that losses inherent in the portfolio are reflected in the allowance for loan losses. The environmental component adjusts the historical loss allocations for non-impaired 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.

In conformance with ASC 805 and ASC 820, purchased loans are recorded at the acquisition date fair value. Such loans are included in the allowance to the extent a specific impairment is identified that exceeds the fair value adjustment on an impaired loan or the historical loss and environmental factor analysis indicates losses inherent in a purchased portfolio exceeds the fair value adjustment on the portion of the purchased portfolio not deemed impaired.

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The following tables summarize changes in the allowance for loan losses by loan segment for the three and six months ended June 30, 2020 and June 30, 2019:

	Three Months Ended June 30, 2020				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for loan losses:					
Balances, March 31, 2020	$ 38,431	$ 37,907	$ 5,752	$ 17,364	$ 99,454
Provision for losses	6,240	8,945	2,783	3,927	21,895
Recoveries on loans	106	107	56	48	317
Loans charged off	(99)	(41)	(146)	(261)	(547)
Balances, June 30, 2020	$ 44,678	$ 46,918	$ 8,445	$ 21,078	$ 121,119

	Six Months Ended June 30, 2020				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for loan losses:					
Balances, December 31, 2019	$ 32,902	$ 28,778	$ 4,035	$ 14,569	$ 80,284
Provision for losses	11,941	18,139	4,707	6,860	41,647
Recoveries on loans	549	225	98	118	990
Loans charged off	(714)	(224)	(395)	(469)	(1,802)
Balances, June 30, 2020	$ 44,678	$ 46,918	$ 8,445	$ 21,078	$ 121,119

	Three Months Ended June 30, 2019				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for loan losses:					
Balances, March 31, 2019	$ 33,069	$ 29,434	$ 4,026	$ 14,373	$ 80,902
Provision for losses	100	320	36	44	500
Recoveries on loans	344	778	100	212	1,434
Loans charged off	(311)	(1,001)	(92)	(158)	(1,562)
Balances, June 30, 2019	$ 33,202	$ 29,531	$ 4,070	$ 14,471	$ 81,274

	Six Months Ended June 30, 2019				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for loan losses:					
Balances, December 31, 2018	$ 32,657	$ 29,609	$ 3,964	$ 14,322	$ 80,552
Provision for losses	336	1,089	141	134	1,700
Recoveries on loans	886	1,023	218	312	2,439
Loans charged off	(677)	(2,190)	(253)	(297)	(3,417)
Balances, June 30, 2019	$ 33,202	$ 29,531	$ 4,070	$ 14,471	$ 81,274

The tables below show the Corporation’s allowance for loan losses and loan portfolio by loan segment as of the periods indicated.

	June 30, 2020				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance Balances:					
Individually evaluated for impairment	$ 7,466	$ 4,943	$ —	$ 590	$ 12,999
Collectively evaluated for impairment	37,212	41,975	8,445	20,488	108,120
Total Allowance for Loan Losses	$ 44,678	$ 46,918	$ 8,445	$ 21,078	$ 121,119
Loan Balances:					
Individually evaluated for impairment	$ 15,312	$ 26,512	$ 3	$ 3,453	$ 45,280
Collectively evaluated for impairment	3,600,395	3,847,884	123,608	1,673,093	9,244,980
Loans acquired with deteriorated credit quality	1,164	6,162	—	955	8,281
Loans	$ 3,616,871	$ 3,880,558	$ 123,611	$ 1,677,501	$ 9,298,541

(table dollar amounts in thousands, except share data)

	December 31, 2019				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance Balances:					
Individually evaluated for impairment	$ —	$ 231	$ —	$ 458	$ 689
Collectively evaluated for impairment	32,902	28,547	4,035	14,111	79,595
Total Allowance for Loan Losses	$ 32,902	$ 28,778	$ 4,035	$ 14,569	$ 80,284
Loan Balances:					
Individually evaluated for impairment	$ 457	$ 8,728	$ 4	$ 2,520	$ 11,709
Collectively evaluated for impairment	2,748,681	3,821,660	135,985	1,727,966	8,434,292
Loans acquired with deteriorated credit quality	1,716	9,878	—	1,715	13,309
Loans	$ 2,750,854	$ 3,840,266	$ 135,989	$ 1,732,201	$ 8,459,310

Loans individually evaluated for impairment are comprised of commercial and consumer loans deemed impaired in accordance with ASC 310-10. This includes loans acquired with deteriorated credit quality totaling $3,783,000 with $192,000 of related allowance for loan losses at June 30, 2020 and $2,819,000 with $124,000 related allowance for loan losses at December 31, 2019.

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

Commercial

Commercial lending is 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 tangible assets being financed such as equipment or real estate or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee. Other loans may be unsecured, secured but under-collateralized or otherwise made on the basis of the enterprise value of an organization. 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.

Consumer and Residential

With respect to residential loans that are secured by 1-4 family residences and are typically owner occupied, the Corporation generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are 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 on loans secured by 1-4 family residences can be impacted by changes in property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

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. When the interest accrual is discontinued, all unpaid accrued interest is reversed against earnings when considered uncollectable. Payments subsequently received on non-accrual 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.

(table dollar amounts in thousands, except share data)

The following table summarizes the Corporation’s non-accrual loans by loan class as of the periods indicated:

	June 30, 2020	December 31, 2019
Commercial and industrial loans	$ 16,354	$ 1,255
Agriculture production financing and other loans to farmers	—	183
Real estate loans:		
Construction	119	977
Commercial and farmland	25,405	7,007
Residential	5,773	5,062
Home equity	2,376	1,421
Individuals' loans for household and other personal expenditures	75	44
Total	$ 50,102	$ 15,949

Non-accrual loans increased $34.2 million from December 31, 2019, primarily due to three relationships that were moved to non-accrual during the second quarter of 2020. Two relationships totaling $17.0 million are in the senior living sector. The third relationship totaling $14.4 million is in the university logo apparel sports industry.

Impaired loans include loans deemed impaired according to the guidance set forth in ASC 310-10. Commercial loans under $500,000 and consumer loans, with the exception of troubled debt restructures, are not individually evaluated for impairment.

Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method for measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor, which includes selling costs if applicable, to the value. 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 ascertained by assessing, either singularly or some combination of, asset appraisals, accounts receivable aging reports, inventory listings and or customer financial statements. Both appraised values and values based on borrower’s financial information are discounted as considered appropriate based on age and quality of the information and current market conditions.

The following tables show the composition of the Corporation’s impaired loans, related allowance and interest income recognized while impaired by loan class as of the periods indicated:

	June 30, 2020		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	$ 5,024	$ 5,008	$ —
Real estate Loans:			
Commercial and farmland	9,675	7,602	—
Residential	75	59	—
Individuals' loans for household and other personal expenditures	3	3	—
Total	$ 14,777	$ 12,672	$ —
Impaired loans with related allowance:			
Commercial and industrial loans	$ 10,342	$ 10,304	$ 7,466
Real estate Loans:			
Commercial and farmland	19,650	18,910	4,943
Residential	3,134	3,009	520
Home equity	401	385	70
Total	$ 33,527	$ 32,608	$ 12,999
Total Impaired Loans	$ 48,304	$ 45,280	$ 12,999

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	December 31, 2019		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	$ 320	$ 320	$ —
Agriculture production financing and other loans to farmers	299	137	—
Real estate Loans:			
Construction	1,206	970	—
Commercial and farmland	8,037	5,849	—
Residential	93	76	—
Total	$ 9,955	$ 7,352	$ —
Impaired loans with related allowance:			
Real estate Loans:			
Commercial and farmland	$ 2,648	$ 1,909	$ 231
Residential	2,070	2,044	383
Home equity	417	400	75
Individuals' loans for household and other personal expenditures	4	4	—
Total	$ 5,139	$ 4,357	$ 689
Total Impaired Loans	$ 15,094	$ 11,709	$ 689

	Three Months Ended June 30, 2020		Six Months Ended June 30, 2020	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	$ 5,008	$ —	$ 5,008	$ —
Real estate Loans:				
Commercial and farmland	7,637	37	7,910	75
Residential	59	1	59	2
Individuals' loans for household and other personal expenditures	3	—	3	—
Total	$ 12,707	$ 38	$ 12,980	$ 77
Impaired loans with related allowance:				
Commercial and industrial loans	$ 10,304	$ —	$ 10,304	$ —
Real estate Loans:				
Commercial and farmland	18,910	—	19,156	—
Residential	3,020	19	3,032	38
Home equity	387	3	390	6
Total	$ 32,621	$ 22	$ 32,882	$ 44
Total Impaired Loans	$ 45,328	$ 60	$ 45,862	$ 121

	Three Months Ended June 30, 2019		Six Months Ended June 30, 2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	$ 1,013	$ —	$ 1,021	$ —
Agriculture production financing and other loans to farmers	668	—	672	—
Real estate Loans:				
Construction	7,314	—	7,792	—
Commercial and farmland	7,998	39	8,187	78
Residential	38	1	38	2
Home equity	49	—	49	—
Public finance and other commercial loans	353	—	353	—
Total	$ 17,433	$ 40	$ 18,112	$ 80
Impaired loans with related allowance:				
Commercial and industrial loans	$ 940	$ —	$ 940	$ —
Agriculture production financing and other loans to farmers	2,117	—	2,134	—
Real estate Loans:				
Commercial and farmland	157	—	164	—

Residential	2,021	16	2,029	32
Home equity	351	3	352	6
Individuals' loans for household and other personal expenditures	14	—	15	—
Total	$ 5,600	$ 19	$ 5,634	$ 38
Total Impaired Loans	$ 23,033	$ 59	$ 23,746	$ 118

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Impaired loans in the above tables do not include loans accounted for under ASC 310-30, or any other loan, unless deemed impaired in accordance with ASC 310-10.

As part of the ongoing 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, (iv) covenant failures and (v) the general national and local economic conditions.

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. 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. 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:
    - 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,
    - 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,
    - loans have a distinct possibility that the Corporation will sustain some loss if deficiencies are not corrected,
    - unusual courses of action are needed to maintain a high probability of repayment,
    - the borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments,
    - the Corporation is forced into a subordinated or unsecured position due to flaws in documentation,
    - loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms,
    - the Corporation is seriously contemplating foreclosure or legal action due to the apparent deterioration of the loan, and
    - 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 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 uncollectable 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 not 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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The following tables summarize 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-days or more 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. Loans that evidenced deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected are included in the applicable categories below.

	June 30, 2020							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	$ 2,722,071	$ 87,069	$ 89,189	$ —	$ —	$ —	$ —	$ 2,898,329
Agriculture production financing and other loans to farmers	78,645	6,082	9,111	—	—	—	—	93,838
Real estate Loans:								
Construction	590,889	791	20,229	—	—	28,536	115	640,560
Commercial and farmland	3,035,363	103,921	99,330	—	—	1,384	—	3,239,998
Residential	189,053	1,637	6,684	—	—	943,222	4,591	1,145,187
Home equity	20,214	—	1,342	—	—	508,457	2,301	532,314
Individuals' loans for household and other personal expenditures	—	—	—	—	—	123,524	87	123,611
Public finance and other commercial loans	624,655	49	—	—	—	—	—	624,704
Loans	$ 7,260,890	$ 199,549	$ 225,885	$ —	$ —	$ 1,605,123	$ 7,094	$ 9,298,541

	December 31, 2019							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	$ 1,956,985	$ 81,179	$ 71,715	$ —	$ —	$ —	$ —	$ 2,109,879
Agriculture production financing and other loans to farmers	78,558	5,626	9,677	—	—	—	—	93,861
Real estate Loans:								
Construction	749,249	1,613	1,634	—	—	35,072	—	787,568
Commercial and farmland	2,894,366	57,776	98,575	—	—	1,981	—	3,052,698
Residential	196,710	877	8,075	—	—	932,743	4,812	1,143,217
Home equity	24,211	257	682	—	—	562,507	1,327	588,984
Individuals' loans for household and other personal expenditures	—	—	—	—	—	135,944	45	135,989
Public finance and other commercial loans	547,114	—	—	—	—	—	—	547,114
Loans	$ 6,447,193	$ 147,328	$ 190,358	$ —	$ —	$ 1,668,247	$ 6,184	$ 8,459,310

(table dollar amounts in thousands, except share data)

The tables below show a past due aging of the Corporation's loan portfolio, by loan class, as of June 30, 2020, and December 31, 2019:

	June 30, 2020						
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans 90 Days or More Past Due And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total
Commercial and industrial loans	$ 2,871,366	$ 9,435	$ 1,038	$ 136	$ 16,354	$ 26,963	$ 2,898,329
Agriculture production financing and other loans to farmers	92,735	1,103	—	—	—	1,103	93,838
Real estate loans:							
Construction	634,706	5,235	500	—	119	5,854	640,560
Commercial and farmland	3,172,688	18,948	18,458	4,499	25,405	67,310	3,239,998
Residential	1,136,131	2,679	329	275	5,773	9,056	1,145,187
Home equity	526,096	2,110	1,673	59	2,376	6,218	532,314
Individuals' loans for household and other personal expenditures	123,126	227	171	12	75	485	123,611
Public finance and other commercial loans	624,704	—	—	—	—	—	624,704
Loans	$ 9,181,552	$ 39,737	$ 22,169	$ 4,981	$ 50,102	$ 116,989	$ 9,298,541

	December 31, 2019						
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans 90 Days or More Past Due And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total
Commercial and industrial loans	$ 2,105,445	$ 3,039	$ 136	$ 4	$ 1,255	$ 4,434	$ 2,109,879
Agriculture production financing and other loans to farmers	93,678	—	—	—	183	183	93,861
Real estate loans:							
Construction	784,961	1,630	—	—	977	2,607	787,568
Commercial and farmland	3,043,318	2,324	49	—	7,007	9,380	3,052,698
Residential	1,133,476	4,290	367	22	5,062	9,741	1,143,217
Home equity	584,023	2,960	538	42	1,421	4,961	588,984
Individuals' loans for household and other personal expenditures	135,399	440	105	1	44	590	135,989
Public finance and other commercial loans	547,114	—	—	—	—	—	547,114
Loans	$ 8,427,414	$ 14,683	$ 1,195	$ 69	$ 15,949	$ 31,896	$ 8,459,310

As shown in the tables above, the level of loan delinquencies increased in the 30-59, 60-89 and 90 days or more past due categories during the first six months of 2020. Four relationships totaling $28.6 million, which matured in May 2020 and were in the process of renewal at June 30, 2020, were included in the $25.1 million increase in the 30-59 days past due. Three real estate secured loans, totaling $17.8 million, accounted for 69 percent of the increase in the 60-89 days and 90 days or more past due categories. These loans were either well secured, in the process of collection, or under review for a deferral.

On occasion, borrowers experience declines in income and cash flow. As a result, these borrowers seek to reduce contractual cash outlays including debt payments. Concurrently, in an effort to preserve and protect its earning assets, specifically troubled loans, the Corporation works to maintain its relationship with certain customers who are experiencing financial difficulty by contractually modifying the borrower's debt agreement with the Corporation.

On March 22, 2020, a statement was issued by the Bank's banking regulators and titled the "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus" (the "Interagency Statement") that encourages financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations due to the effects of COVID-19. Additionally, Section 4013 of the CARES Act further provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates. The Interagency Statement was subsequently revised on April 7, 2020 to clarify the interaction of the original guidance with Section 4013 of the CARES Act, as well as setting forth the banking regulators' views on consumer protection considerations. In accordance with such guidance, the Bank is offering short-term modifications made in response to COVID-19 to borrowers who are current and otherwise not past due. These include short-term, typically 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Under the applicable guidance, none of these loans were considered troubled debt restructures at June 30, 2020. Details of the Corporation's modifications are included in the "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations on this Form 10-Q.

In certain loan restructuring situations, the Corporation may grant a concession to a debtor experiencing financial difficulty, resulting in a troubled debt restructuring. A concession is deemed to be granted when, as a result of the restructuring, the Corporation does not expect to collect all original 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 repaid.

(table dollar amounts in thousands, except share data)

The following tables summarize troubled debt restructures at the time of modification that occurred during the periods indicated:

	Three Months Ended June 30, 2020			Six Months Ended June 30, 2020		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Commercial and industrial loans	$ 654	$ 654	3	$ 654	$ 654	3
Real estate loans:						
Commercial and farmland	565	565	2	565	565	2
Residential	300	337	6	300	337	6
Total	$ 1,519	$ 1,556	11	$ 1,519	$ 1,556	11

	Three Months Ended June 30, 2019			Six Months Ended June 30, 2019		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Real estate loans:						
Residential	$ 171	$ 164	4	$ 261	$ 254	5
Total	$ 171	$ 164	4	$ 261	$ 254	5

The following tables summarize by modification type, the recorded investment of troubled debt restructures as of June 30, 2020 and 2019, that occurred during the periods indicated:

	Three Months Ended June 30, 2020			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	$ 652	$ —	$ —	$ 652
Real estate loans:				
Commercial and farmland	565	—	—	565
Residential	—	111	223	334
Total	$ 1,217	$ 111	$ 223	$ 1,551

	Six Months Ended June 30, 2020			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	$ 652	$ —	$ —	$ 652
Real estate loans:				
Commercial and farmland	565	—	—	565
Residential	—	111	223	334
Total	$ 1,217	$ 111	$ 223	$ 1,551

	Three Months Ended June 30, 2019			
	Term Modification	Rate Modification	Combination	Total Modification
Real estate loans:				
Residential	$ —	$ —	$ 164	$ 164
Total	$ —	$ —	$ 164	$ 164

	Six Months Ended June 30, 2019			
	Term Modification	Rate Modification	Combination	Total Modification
Real estate loans:				
Residential	$ —	$ 89	$ 164	$ 253
Total	$ —	$ 89	$ 164	$ 253

Commercial and industrial loans made up 42 percent of the post-modification balance of troubled debt restructured loans made in the three and six months ended June 30, 2020. Loans secured by residential real estate made up 100 percent of the post-modification balance of troubled debt restructured loans made in the three and six months ended June 30, 2019.

(table dollar amounts in thousands, except share data)

The following tables summarize troubled debt restructures that occurred during the twelve months ended June 30, 2020 and 2019, that subsequently defaulted during the period indicated and remained in default at period end. A loan is considered in default if it is 30-days or more past due.

	Three Months Ended June 30, 2020		Six Months Ended June 30, 2020	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Commercial and industrial loans	1	$ 268	1	$ 268
Total	1	$ 268	1	$ 268

	Three Months Ended June 30, 2019		Six Months Ended June 30, 2019	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Real estate loans:				
Residential	1	$ 62	1	$ 62
Total	1	$ 62	1	$ 62

For potential consumer loan restructures, impairment evaluation occurs prior to modification. Any subsequent impairment is typically addressed through the charge-off process, or may be addressed through a specific reserve. Consumer troubled debt loan restructures are generally included in the general historical allowance for loan loss at the post modification balance. Consumer non-accrual and delinquent troubled debt loan restructures are also considered in the calculation of the non-accrual and delinquency trend environmental allowance allocation. Consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process totaled $492,000 and $1,033,000 at June 30, 2020 and December 31, 2019, respectively.

Commercial troubled debt restructured loans that are risk graded special mention, substandard, doubtful or loss are individually evaluated for impairment under ASC 310. Any resulting specific reserves are included in the allowance for loan losses. Commercial troubled debt loan restructures 30-89 days delinquent are included in the calculation of the delinquency trend environmental allocation in the allowance for loan losses. With the exception of the acquired loans excluded from the allowance for loan losses, all commercial non-impaired loans, including non-accrual and 90-days or more delinquent, are included in the ASC 450 loss estimate.

NOTE 5

PURCHASED CREDIT IMPAIRED LOANS

Purchased Credit Impaired Loans are included in NOTE 4. LOANS AND ALLOWANCE of these Notes to Consolidated Condensed Financial Statements. As described in NOTE 4, purchased loans are recorded at the acquisition date fair value, which could result in a fair value discount or premium. Purchased loans with evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments are accounted for under ASC 310-30, *Loans Acquired with Deteriorated Credit Quality*. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. The accretable portion of the fair value discount or premium is the difference between the expected cash flows and the net present value of expected cash flows, with such difference accreted into earnings over the term of the loans.

The carrying amount of Purchased Credit Impaired Loans as of June 30, 2020 was $12.1 million with allowance for loan loss of $192,000. The carrying amount of Purchased Credit Impaired Loans as of December 31, 2019 was $16.1 million with $124,000 of related allowance for loan losses. As customer cash flow expectations improve, nonaccretable yield can be reclassified to accretable yield. The accretable yield, or income expected to be collected, and reclassifications from nonaccretable, are identified in the table below.

	Three Months Ended June 30, 2020	Six Months Ended June 30, 2020
Accretable yield beginning balance	$ 1,926	$ 2,132
Additions	—	$ —
Accretion	(1,033)	(1,418)
Reclassification from nonaccretable	653	839
Disposals	—	(7)
Accretable yield ending balance	$ 1,546	$ 1,546

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Accretable yield beginning balance	$ 2,064	$ 2,143
Additions	—	—
Accretion	(638)	(1,218)
Reclassification from nonaccretable	488	989
Disposals	—	—
Accretable yield ending balance	$ 1,914	$ 1,914

(table dollar amounts in thousands, except share data)

There were no loans acquired during the six months ended June 30, 2020 and 2019, for which it was probable that all contractually required payments would not be collected.

NOTE 6

GOODWILL

Goodwill is recorded on the acquisition date of an entity. During the one-year measurement period, the Corporation may record subsequent adjustments to goodwill for provisional amounts recorded at the acquisition date. The MBT acquisition on September, 1, 2019 resulted in $98,563,000 of goodwill, which includes a measurement period adjustment of $719,000. Details regarding the MBT acquisition are discussed in NOTE 2. ACQUISITION of these Notes to Consolidated Condensed Financial Statements. There have been no changes in goodwill since December 31, 2019, resulting in a goodwill balance of $543,918,000 as of June 30, 2020.

	2019
Balance, January 1	$ 445,355
Goodwill acquired	97,844
Measurement period adjustment	719
Balance, December 31	$ 543,918

The Corporation adopted ASU No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill,* January 1, 2020 and has assessed the recent economic impact and market conditions from the COVID-19 pandemic. In the assessment, the Corporation considered factors such as: (a) our market capitalization; (b) observable market transactions and control premium multiples; (c) changes to the regulatory environment; and (d) the nature and amount of government support that has been and is expected to be provided in the future. Additionally, the Corporation considered the general uncertainty as to the full extent of the COVID-19 pandemic and its effect on economic recovery. The Corporation concluded that it is not more likely than not that the fair value of the Corporation is less than the carrying value; therefore, goodwill was not impaired at June 30, 2020.

NOTE 7

CORE DEPOSIT INTANGIBLES

Core deposit intangibles are recorded on the acquisition date of an entity. During the one-year measurement period, the Corporation may record subsequent adjustments to these intangibles for provisional amounts recorded at the acquisition date. The MBT acquisition on September 1, 2019 resulted in a core deposit intangible of $16,527,000. Details regarding the MBT acquisition are discussed in NOTE 2. ACQUISITION of these Notes to Consolidated Condensed Financial Statements.

The carrying basis and accumulated amortization of recognized core deposit intangibles are noted below.

	June 30, 2020	December 31, 2019
Gross carrying amount	$ 102,396	$ 85,869
Core deposit intangibles acquired	—	16,527
Accumulated amortization	(70,459)	(67,434)
Total core deposit intangibles	$ 31,937	$ 34,962

The core deposit intangibles are being amortized primarily on an accelerated basis over their estimated useful lives, generally over a period of ten years. Intangible asset amortization expense for the three and six months ended June 30, 2020 was $1,511,000 and $3,025,000, respectively, compared to $1,520,000 and $3,048,000, respectively, for the three and six months ended June 30, 2019. Estimated future amortization expense is summarized as follows:

	Amortization Expense
2020	$ 2,962
2021	5,429
2022	5,027
2023	4,827
2024	4,241
After 2024	9,451
	$ 31,937

(table dollar amounts in thousands, except share data)

NOTE 8

DERIVATIVE FINANCIAL INSTRUMENTS

Risk Management Objective of Using Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Corporation enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash payments principally related to certain variable-rate liabilities. The Corporation also has derivatives that are a result of a service the Corporation provides to certain qualifying customers, and, therefore, are not used to manage interest rate risk in the Corporation's assets or liabilities. The Corporation manages a matched book with respect to its derivative instruments offered as a part of this service to its customers in order to minimize its net risk exposure resulting from such transactions.

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 these objectives, 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 June 30, 2020 and December 31, 2019, the Corporation had four interest rate swaps with a notional amount of $46.0 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 2020, $26.0 million of the interest rate swaps were used to hedge the variable cash outflows (LIBOR-based) associated with existing trust preferred securities when the outflows converted from a fixed rate to variable rate in September of 2012. In addition, the remaining $20.0 million of interest rate swaps were used to hedge the variable cash outflows (LIBOR-based) associated with two Federal Home Loan Bank advances. During the three and six months ended June 30, 2020 and 2019, 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 expects to reclassify $1,046,000 from accumulated other comprehensive income to interest expense.

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 June 30, 2020 and December 31, 2019, the notional amount of customer-facing swaps was approximately $817,463,000 and $692,287,000, respectively. These amounts are 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 June 30, 2020, and December 31, 2019.

	Asset Derivatives				Liability Derivatives			
	June 30, 2020		December 31, 2019		June 30, 2020		December 31, 2019	
	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	$ —	Other Assets	$ —	Other Liabilities	$ 2,547	Other Liabilities	$ 1,444
Derivatives not designated as hedging instruments:								
Interest rate contracts	Other Assets	$ 84,658	Other Assets	$ 27,855	Other Liabilities	$ 84,658	Other Liabilities	$ 27,855

(table dollar amounts in thousands, except share data)

The Corporation's derivative asset and derivative liability relating to interest rate contracts increased $56.8 million and $57.9 million, respectively, from December 31, 2019. The increases are primarily due to a $125.2 million increase in the related outstanding notional balance. Additionally, yield curve rates used for valuation purposes were lower at each term point as of June 30, 2020 compared to December 31, 2019. This was primarily the result of investors seeking the safety of U.S. Treasuries as containment efforts related to the COVID-19 outbreak began to significantly reduce economic activity.

The amount of gain (loss) recognized in other comprehensive income is included in the table below for the periods indicated.

	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivative (Effective Portion)			
	Three Months Ended		Six Months Ended	
Derivatives in Cash Flow Hedging Relationships	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Interest Rate Products	$ (145)	$ (701)	$ (1,459)	$ (1,092)

Effect of Derivative Instruments on the Income Statement

The Corporation did not recognize any gains or losses from derivative financial instruments in the Consolidated Condensed Statements of Income for the three and six months ended June 30, 2020 and 2019.

The amount of gain (loss) reclassified from other comprehensive income into income is included in the table below for the periods indicated.

Derivatives Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Reclassed from Other Comprehensive Income into Income (Effective Portion) Three Months Ended June 30, 2020	Three Months Ended June 30, 2019
Interest rate contracts	Interest Expense	$ (231)	$ (84)

Derivatives Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Reclassed from Other Comprehensive Income into Income (Effective Portion) Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
Interest rate contracts	Interest Expense	$ (357)	$ (143)

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-market values with policy limitations, credit ratings and collateral pledging.

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 adequately capitalized institution, then the Corporation could be required to terminate or fully collateralize all outstanding derivative contracts. Additionally, 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, then the Corporation could also be declared in default on its derivative obligations. As of June 30, 2020, the termination value of derivatives in a net liability position related to these agreements was $87,754,000. As of June 30, 2020, the Corporation has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of $80,855,000. While the Corporation did not breach any of these provisions as of June 30, 2020, if it had, the Corporation could have been required to settle its obligations under the agreements at their termination value.

NOTE 9

DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

The Corporation used fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820 applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances.

As defined in ASC 820, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants. It represents an exit price at the measurement date. Market participants are buyers and sellers, who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset or liability being measured. Current market conditions, including imbalances between supply and demand, are considered in determining fair value. The Corporation values its assets and liabilities in the principal market where it sells the particular asset or transfers the liability with the greatest volume and level of activity. In the absence of a principal market, the valuation is based on the most advantageous market for the asset or liability (i.e., the market where the asset could be sold or the liability transferred at a price that maximizes the amount to be received for the asset or minimizes the amount to be paid to transfer the liability).

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability. Inputs can be observable or unobservable. Observable inputs are those assumptions which market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Corporation. Unobservable inputs are assumptions based on the Corporation's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date. All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy which gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs for which there is little or no market activity (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation considers an input to be significant if it drives 10 percent or more of the total fair value of a particular asset or liability.

RECURRING MEASUREMENTS

Assets and liabilities are considered to be measured at fair value on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly or quarterly). Recurring valuation occurs at a minimum on the measurement date. Assets and liabilities are considered to be measured at fair value on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheet. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements which require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value. The fair value of assets or liabilities transferred in or out of Level 3 is measured on the transfer date, with any additional changes in fair value subsequent to the transfer considered to be realized or unrealized gains or losses.

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

Investment Securities

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. The Corporation currently has no securities classified within Level 1 of the hierarchy. Where significant observable inputs, other than Level 1 quoted prices, are available, securities are classified within Level 2 of the valuation hierarchy. Level 2 securities include U.S. treasury securities, government-sponsored agency and mortgage-backed securities, state and municipal securities and corporate obligations securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include state and municipal securities, government-sponsored mortgage-backed securities and corporate obligations securities. Level 3 fair value for 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 (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.

(table dollar amounts in thousands, except share data)

Interest Rate Derivative Agreements

See information regarding the Corporation's interest rate derivative products in NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS of these Notes to Consolidated Condensed Financial Statements. The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the ASC 820 fair value hierarchy in which the fair value measurements fall at June 30, 2020, and December 31, 2019.

		Fair Value Measurements Using:		
June 30, 2020	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale securities:				
U.S. Treasury	$ 600	$ —	$ 600	$ —
U.S. Government-sponsored agency securities	2,453	—	2,453	—
State and municipal	1,094,218	—	1,091,753	2,465
U.S. Government-sponsored mortgage-backed securities	790,234	—	790,230	4
Corporate obligations	3,088	—	3,057	31
Interest rate swap asset	84,658	—	84,658	—
Interest rate swap liability	87,205	—	87,205	—

		Fair Value Measurements Using:		
December 31, 2019	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale securities:				
U.S. Government-sponsored agency securities	$ 38,875	$ —	$ 38,875	$ —
State and municipal	899,796	—	896,938	2,858
U.S. Government-sponsored mortgage-backed securities	851,323	—	851,319	4
Corporate obligations	31	—	—	31
Interest rate swap asset	27,855	—	27,855	—
Interest rate swap liability	29,299	—	29,299	—

There were no gains or losses included in earnings that were attributable to the changes in unrealized gains or losses related to assets or liabilities held at June 30, 2020 or December 31, 2019.

Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying balance sheets using significant unobservable Level 3 inputs for the three and six months ended June 30, 2020 and 2019.

	Available for Sale Securities			
	Three Months Ended		**Six Months Ended**	
	June 30, 2020	**June 30, 2019**	**June 30, 2020**	**June 30, 2019**
Balance at beginning of the period	$ 2,528	$ 2,936	$ 2,892	$ 3,328
Included in other comprehensive income	(30)	37	(50)	80
Principal payments	2	2	(342)	(433)
Ending balance	$ 2,500	$ 2,975	$ 2,500	$ 2,975

Transfers Between Levels

There were no transfers in or out of Level 3 for the three and six months ended June 30, 2020 and 2019.

(table dollar amounts in thousands, except share data)

Nonrecurring Measurements

Following is a description of valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy for June 30, 2020, and December 31, 2019.

		Fair Value Measurements Using		
June 30, 2020	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans (collateral dependent)	$ 22,690	$ —	$ —	$ 22,690
Other real estate owned	464	—	—	464

		Fair Value Measurements Using		
December 31, 2019	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans (collateral dependent)	$ 5,653	$ —	$ —	$ 5,653
Other real estate owned	194	—	—	194

Impaired Loans (collateral dependent)

Loans for which it is probable that the Corporation will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. 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 2019 and 2020, certain impaired loans were partially charged off or re-evaluated. Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

Other Real Estate Owned

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 discounted cash flow analysis. Fair value on other collateral such as business assets is typically ascertained by assessing, either singularly or some combination of, asset appraisals, accounts receivable aging reports, inventory listings and or customer financial statements. Both appraised values and values based on borrower’s financial information are discounted as considered appropriate based on age and quality of the information and current market conditions.

(table dollar amounts in thousands, except share data)

Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements, other than goodwill, at June 30, 2020 and December 31, 2019.

June 30, 2020	Fair Value		Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	$	2,465	Discounted cash flow	Maturity/Call date	1 month to 15 yrs
				US Muni BQ curve	A- to BBB-
				Discount rate	1.5% - 4%
				Weighted-average coupon	3.87%
Corporate obligations and U.S. Government-sponsored mortgage-backed securities	$	35	Discounted cash flow	Risk free rate	3 month LIBOR
				plus premium for illiquidity	plus 200bps
				Weighted-average coupon	—%
Impaired loans (collateral dependent)	$	22,690	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 10%
				Weighted-average discount by loan balance	10%
Other real estate owned	$	464	Appraisals	Discount to reflect current market conditions	0% - 72%
				Weighted-average discount of other real estate owned balance	32%

December 31, 2019	**Fair Value**		**Valuation Technique**	**Unobservable Inputs**	**Range (Weighted-Average)**
State and municipal securities	$	2,858	Discounted cash flow	Maturity/Call date	1 month to 15 yrs
				US Muni BQ curve	A- to BBB-
				Discount rate	2% - 5%
				Weighted-average coupon	3.92%
Corporate obligations and U.S Government-sponsored mortgage-backed securities	$	35	Discounted cash flow	Risk free rate	3 month LIBOR
				plus premium for illiquidity	plus 200bps
				Weighted-average coupon	—%
Impaired loans (collateral dependent)	$	5,653	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 10%
				Weighted-average discount by loan balance	1%
Other real estate owned	$	194	Appraisals	Discount to reflect current market conditions	0% - 37%
				Weighted-average discount of other real estate owned balance	37%

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

State and Municipal Securities, Corporate Obligations and U.S. Government-sponsored Mortgage-Backed Securities

The significant unobservable inputs used in the fair value measurement of the Corporation's state and municipal securities, corporate obligations and U.S. Government-sponsored mortgage-backed securities are premiums for unrated securities and marketability discounts. Significant increases or decreases in either of those inputs in isolation would result in a significantly lower or higher fair value measurement. Generally, changes in either of those inputs will not affect the other input.

(table dollar amounts in thousands, except share data)

Fair Value of Financial Instruments

The following table presents estimated fair values of the Corporation’s financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2020, and December 31, 2019.

	June 30, 2020			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 229,759	$ 229,759	$ —	$ —
Interest-bearing time deposits	380,021	380,021	—	—
Investment securities available for sale	1,890,593	—	1,888,093	2,500
Investment securities held to maturity	898,786	—	920,146	21,280
Loans held for sale	901	—	901	—
Loans	9,177,422	—	—	9,253,762
Federal Home Loan Bank stock	28,736	—	28,736	—
Interest rate swap asset	84,658	—	84,658	—
Interest receivable	57,063	—	57,063	—
Liabilities:				
Deposits	$ 10,965,988	$ 9,566,516	$ 1,395,002	$ —
Borrowings:				
Securities sold under repurchase agreements	181,150	—	181,150	—
Federal Home Loan Bank advances	400,817	—	415,737	—
Subordinated debentures and other borrowings	285,197	—	276,306	—
Interest rate swap liability	87,205	—	87,205	—
Interest payable	5,587	—	5,587	—

	December 31, 2019			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 177,201	$ 177,201	$ —	$ —
Interest-bearing time deposits	118,263	118,263	—	—
Investment securities available for sale	1,790,025	—	1,787,132	2,893
Investment securities held to maturity	806,038	—	799,884	27,682
Loans held for sale	9,037	—	9,037	—
Loans	8,379,026	—	—	8,335,340
Federal Home Loan Bank stock	28,736	—	28,736	—
Interest rate swap asset	27,855	—	27,855	—
Interest receivable	48,901	—	48,901	—
Liabilities:				
Deposits	$ 9,839,956	$ 8,146,745	$ 1,675,202	$ —
Borrowings:				
Federal funds purchased	55,000	—	55,000	—
Securities sold under repurchase agreements	187,946	—	187,801	—
Federal Home Loan Bank advances	351,072	—	352,581	—
Subordinated debentures and other borrowings	138,685	—	123,571	—
Interest rate swap liability	29,299	—	29,299	—
Interest payable	6,754	—	6,754	—

(table dollar amounts in thousands, except share data)

NOTE 10

TRANSFERS ACCOUNTED FOR AS SECURED BORROWINGS

The collateral pledged for all repurchase agreements that are accounted for as secured borrowings as of June 30, 2020 and December 31, 2019 were:

	June 30, 2020				
	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
U.S. Government-sponsored mortgage-backed securities	$ 178,749	$ 750	$ —	$ 1,651	$ 181,150

	December 31, 2019				
	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
U.S. Government-sponsored mortgage-backed securities	$ 178,732	$ —	$ 7,672	$ 1,542	$ 187,946

NOTE 11

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in the balances of each component of accumulated other comprehensive income (loss), net of tax, as of June 30, 2020 and 2019:

	Accumulated Other Comprehensive Income (Loss)			
	Unrealized Gains (Losses) on Securities Available for Sale	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Defined Benefit Plans	Total
Balance at December 31, 2019	$ 38,872	$ (1,141)	$ (9,857)	$ 27,874
Other comprehensive income before reclassifications	42,909	(1,153)	—	41,756
Amounts reclassified from accumulated other comprehensive income	(6,067)	282	—	(5,785)
Period change	36,842	(871)	—	35,971
Balance at June 30, 2020	$ 75,714	$ (2,012)	$ (9,857)	$ 63,845
Balance at December 31, 2018	$ (6,343)	$ (559)	$ (14,520)	$ (21,422)
Other comprehensive income before reclassifications	39,130	(862)	—	38,268
Amounts reclassified from accumulated other comprehensive income	(2,357)	113	—	(2,244)
Period change	36,773	(749)	—	36,024
Balance at June 30, 2019	$ 30,430	$ (1,308)	$ (14,520)	$ 14,602

The following tables present the reclassification adjustments out of accumulated other comprehensive income (loss) that were included in net income in the Consolidated Condensed Statements of Income for the three and six months ended June 30, 2020 and 2019.

	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Three Months Ended June 30,		
Details about Accumulated Other Comprehensive Income (Loss) Components	2020	2019	Affected Line Item in the Statements of Income
Unrealized gains (losses) on available for sale securities [1]			
Realized securities gains reclassified into income	$ 3,068	$ 1,843	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(644)	(387)	Income tax expense
	$ 2,424	$ 1,456	
Unrealized gains (losses) on cash flow hedges [2]			
Interest rate contracts	$ (231)	$ (84)	Interest expense - subordinated debentures and term loans
Related income tax benefit	49	18	Income tax expense
	$ (182)	$ (66)	
Total reclassifications for the period, net of tax	$ 2,242	$ 1,390	

(table dollar amounts in thousands, except share data)

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Six Months Ended June 30, 2020	2019	Affected Line Item in the Statements of Income
Unrealized gains (losses) on available for sale securities [1]			
Realized securities gains reclassified into income	$ 7,680	$ 2,983	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(1,613)	(626)	Income tax expense
	$ 6,067	$ 2,357	
Unrealized gains (losses) on cash flow hedges [2]			
Interest rate contracts	$ (357)	$ (143)	Interest expense - subordinated debentures and term loans
Related income tax benefit	75	30	Income tax expense
	$ (282)	$ (113)	
Total reclassifications for the period, net of tax	$ 5,785	$ 2,244	

[1] For additional detail related to unrealized gains (losses) on available for sale securities and related amounts reclassified from accumulated other comprehensive income see NOTE 3. INVESTMENT SECURITIES of these Notes to Consolidated Condensed Financial Statements.
[2] For additional detail related to unrealized gains (losses) on cash flow hedges and related amounts reclassified from accumulated other comprehensive income see NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS of these Notes to Consolidated Condensed Financial Statements.

NOTE 12

SHARE-BASED COMPENSATION

Stock options and RSAs have been issued to directors, officers and other management employees under the Corporation's 2009 Long-term Equity Incentive Plan, the 2019 Long-term Equity Incentive Plan, and the Equity Compensation Plan for Non-Employee Directors. The stock options, which have a ten year life, become 100 percent vested based on time ranging from one year 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. The RSAs issued to employees and non-employee directors provide for the issuance of shares of the Corporation's common stock at no cost to the holder and generally vest after 3 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. For non-employee directors, the RSAs vest only if the non-employee director remains as an active board member on the vesting date and, therefore, any unvested shares are forfeited. The RSAs for employees and non-employee directors are either immediately vested at retirement, disability or death, or, continue to vest after retirement, disability or death, depending on the plan under which the shares were granted.

The Corporation’s 2009 ESPP and 2019 ESPP provide 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. The 2009 ESPP expired on June 30, 2019.

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 and six months ended June 30, 2020 was $1,214,000 and $2,433,000, respectively, compared to $844,000 and $1,825,000, respectively, for the three and six months ended June 30, 2019. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying Consolidated Condensed Statements of Income.

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 0.4 percent for the six months ended June 30, 2020, based on historical experience.

PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

The following table summarizes the components of the Corporation's share-based compensation awards recorded as an expense and the income tax benefit of such awards.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Stock and ESPP Options				
Pre-tax compensation expense	$ 12	$ 25	$ 53	$ 36
Income tax benefit	(29)	(41)	(29)	(57)
Stock and ESPP option expense, net of income taxes	$ (17)	$ (16)	$ 24	$ (21)
Restricted Stock Awards				
Pre-tax compensation expense	$ 1,202	$ 819	$ 2,380	$ 1,789
Income tax benefit	(236)	(186)	(493)	(726)
Restricted stock awards expense, net of income taxes	$ 966	$ 633	$ 1,887	$ 1,063
Total Share-Based Compensation				
Pre-tax compensation expense	$ 1,214	$ 844	$ 2,433	$ 1,825
Income tax benefit	(265)	(227)	(522)	(783)
Total share-based compensation expense, net of income taxes	$ 949	$ 617	$ 1,911	$ 1,042

As of June 30, 2020, unrecognized compensation expense related to RSAs was $5,595,000 and is expected to be recognized over a weighted-average period of 1.21 years. The Corporation did not have any unrecognized compensation expense related to stock options as of June 30, 2020.

Stock option activity under the Corporation's stock option plans as of June 30, 2020 and changes during the six months ended June 30, 2020, were as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2020	59,350	$ 13.51		
Exercised	(10,050)	$ 8.29		
Outstanding June 30, 2020	49,300	$ 14.57	2.32	$ 640,876
Vested and Expected to Vest at June 30,2020	49,300	$ 14.57	2.32	$ 640,876
Exercisable at June 30, 2020	49,300	$ 14.57	2.32	$ 640,876

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 six months of 2020 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 June 30, 2020. The amount of aggregate intrinsic value will change based on the fair market value of the Corporation's common stock.

The aggregate intrinsic value of stock options exercised during the six months ended June 30, 2020 and 2019 was $197,000 and $308,000, respectively. Cash receipts of stock options exercised during this same period were $83,000 and $105,000, respectively.

The following table summarizes information on unvested RSAs outstanding as of June 30, 2020:

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested RSAs at January 1, 2020	351,048	$ 40.67
Granted	14,657	$ 27.00
Vested	(8,591)	$ 40.09
Forfeited	(525)	$ 40.44
Unvested RSAs at June 30, 2020	356,589	$ 40.62

The grant date fair value of ESPP options was estimated to be approximately $12,000 at the beginning of the April 1, 2020 quarterly offering period. The ESPP options vested during the three months ending June 30, 2020, leaving no unrecognized compensation expense related to unvested ESPP options at June 30, 2020.

(table dollar amounts in thousands, except share data)

NOTE 13

INCOME TAX

The following table summarizes the major components creating differences between income taxes at the federal statutory and the effective tax rate recorded in the consolidated statements of income for the three and six months ended June 30, 2020 and 2019:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Reconciliation of Federal Statutory to Actual Tax Expense:				
Federal statutory income tax at 21%	$ 7,899	$ 10,249	$ 15,827	$ 19,858
Tax-exempt interest income	(3,199)	(2,403)	(6,221)	(4,670)
Share-based compensation	(6)	(41)	(6)	(391)
Tax-exempt earnings and gains on life insurance	(278)	(199)	(564)	(406)
Tax credits	(89)	(63)	(150)	(141)
CARES Act - NOL carryback rate differential	—	—	(1,178)	—
Other	296	206	405	440
Actual Tax Expense	$ 4,623	$ 7,749	$ 8,113	$ 14,690
Effective Tax Rate	12.3%	15.9%	10.8%	15.5%

NOTE 14

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 the weighted-average shares outstanding during the reporting period and all potentially dilutive common shares. Potentially dilutive common shares include stock options and RSAs issued under the Corporation's share-based compensation plans. Potentially dilutive common shares are excluded from the computation of diluted earnings per share in the periods where the effect would be antidilutive.

The following table reconciles basic and diluted net income per share for the three and six months ended June 30, 2020 and 2019.

	Three Months Ended June 30,					
	2020			2019		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Net income available to common stockholders	$ 32,992	53,762,913	$ 0.62	$ 41,056	49,432,167	$ 0.83
Effect of potentially dilutive stock options and restricted stock awards		179,654			117,720	
Diluted net income per share	$ 32,992	53,942,567	$ 0.62	$ 41,056	49,549,887	$ 0.83

	Six Months Ended June 30,					
	2020			2019		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Net income available to common stockholders	$ 67,255	54,247,493	$ 1.24	$ 79,873	49,400,770	$ 1.62
Effect of potentially dilutive stock options and restricted stock awards		182,026			144,382	
Diluted net income per share	$ 67,255	54,429,519	$ 1.24	$ 79,873	49,545,152	$ 1.61

For the three and six months ended June 30, 2020 and 2019, there were no stock options with an option price greater than the average market price of the common shares.

NOTE 15

GENERAL LITIGATION AND REGULATORY EXAMINATIONS

The Corporation is subject to claims and lawsuits that arise primarily in the ordinary course of business. Additionally, the Corporation is subject to periodic examinations by various regulatory agencies. It is the general opinion of management that the disposition or ultimate resolution of such claims, lawsuits, and examinations will not have a material adverse effect on the consolidated financial position, results of operations and cash flow of the Corporation.

A discussion of the Bank’s Settlement Agreement and Agreed Order with the United States Department of Justice is contained in the "REGULATORY DEVELOPMENTS" section of Part I, Item 2. Management’s Discussion & Analysis of this Quarterly Report on Form 10-Q.

PART I: FINANCIAL INFORMATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 Quarterly Report on 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;
- the severity and duration of the COVID-19 pandemic and its impact on general economic and financial market conditions and our business, results of operations, and financial condition;
- adverse developments in our loan and investment portfolios;
- our participation as a lender in the PPP;
- 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 bank;
- acquisitions of other businesses by us and integration of such acquired businesses;
- our ability to implement and comply with the Settlement Agreement and Agreed Order entered into with the United States Department of Justice ("DOJ") related to our fair lending practices;
- 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.

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 those 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, 2019. 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. The uncertainties related to COVID-19 could cause significant changes to these estimates compared to what was known at the time these financial statements were prepared.

We believe there have been no significant changes during the three and six months ended June 30, 2020, 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, 2019.

PART I: FINANCIAL INFORMATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 (the "Bank"), which opened for business in Muncie, Indiana, in March 1893. The Bank also operates First Merchants Private Wealth Advisors (a division of First Merchants Bank). The Bank includes 127 banking locations in thirty Indiana, two Illinois, two Ohio and two Michigan counties. In addition to its traditional branch network, the Corporation offers comprehensive electronic and mobile delivery channels to its customers. 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, savings and demand deposits; making consumer, commercial, agri-business and real estate mortgage loans; providing personal and corporate trust services; offering full-service brokerage and private wealth management; and providing letters of credit, repurchase agreements and other corporate services.

REQUIREMENTS FOR BANK HOLDING COMPANIES WITH $10 BILLION OR MORE IN ASSETS

Various federal banking laws and regulations, including rules adopted by the Federal Reserve pursuant to the requirements of the Dodd-Frank Act, impose heightened requirements on certain large banks and bank holding companies. Most of these rules apply primarily to bank holding companies with at least $50 billion in total consolidated assets, but certain rules also apply to banks and bank holding companies with at least $10 billion in total consolidated assets. As the quarter ended December 31, 2019 was the fourth consecutive quarter that the Bank reported assets exceeding $10 billion, effective as of April 1, 2020, the Bank and its affiliates became subject to the supervisory and enforcement authority of the Consumer Financial Protection Bureau (the "CFPB"). The CFPB, an independent federal agency created under the Dodd-Frank Act, was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, primarily with authority over banks and their affiliates with assets of more than $10 billion. Prior to April 1, 2020, the Bank had been subject to the primary federal regulatory oversight and supervision of the FDIC. The Bank continues to be subject to the oversight, supervision and examination of the Indiana DFI.

The Bank's deposit accounts are insured up to the applicable limits by the Deposit Insurance Fund (the "DIF") of the FDIC. As such, the Bank is subject to deposit insurance premiums and assessments to maintain the DIF. Under the FDIC's risk-based assessment system, insured institutions with at least $10 billion in assets, such as the Bank, are assessed on the basis of a scoring system that measures an institution's financial performance, its ability to withstand stress, and the relative magnitude of potential losses to the FDIC in the event of the institution's failure. The Bank's FDIC assessment has increased as a result of being subject to this new method for calculating its deposit insurance premiums.

As provided by the Durbin Amendment to the Dodd-Frank Act, financial institutions with more than $10 billion in assets become subject to capped interchange fees in July of the year following the year-end assessment in which the $10 billion threshold was met. As a result, the Bank was subject to these interchange fee restrictions as of July 1, 2020.

COVID-19, THE CARES ACT AND RELATED REGULATORY ACTIONS

Impact of COVID-19

On January 30, 2020, the World Health Organization ("WHO") announced that the outbreak of the novel coronavirus disease 2019 ("COVID-19") constituted a public health emergency of international concern. On March 11, 2020, WHO declared COVID-19 to be a global pandemic and, on March 13, 2020, the President of the United States declared the COVID-19 outbreak a national emergency. The health concerns relating to the COVID-19 outbreak and related governmental actions taken to reduce the spread of the virus have significantly impacted the global economy (including the states and local economies in which we operate), disrupted supply chains, lowered equity market valuations, and created significant volatility and disruption in financial markets. The outbreak has resulted in authorities implementing numerous measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter in place or total lock-down orders and business limitations and shutdowns. Such measures have significantly contributed to rising unemployment and negatively impacted consumer and business spending. As a result of the shelter in place mandates in effect early in the second quarter of 2020, commercial activity throughout our geographic footprint, as well as nationally, decreased significantly. Most states have reopened, albeit under limited capacities and under other social distancing restrictions; however, commercial activity has not returned to the levels existing prior to the outbreak of the pandemic.

The ultimate impact of COVID-19 on the Corporation will depend on numerous factors and future developments that are highly uncertain and cannot be predicted with confidence. It is unknown how long the COVID-19 pandemic will last, or when restrictions on individuals and businesses will be lifted and businesses and their employees will be able to resume normal activities. Additional information may emerge regarding the severity of COVID-19 and additional actions may be taken by federal, state and local governments to contain COVID-19 or treat its impact. Changes in the behavior of customers, businesses and their employees as a result of COVID-19 pandemic, including social distancing practices, even after formal restrictions have been lifted, are also unknown. As a result of COVID-19 and the actions taken to contain it or reduce its impact, we may experience changes in the demand for our products and services, changes in the value of collateral securing outstanding loans, reductions in the credit quality of borrowers and the inability of borrowers to repay loans in accordance with their terms. Our commercial and consumer customers are experiencing varying degrees of financial distress, which is expected to continue throughout the remainder of 2020, especially if positive cases continue to increase and further economic shutdowns are mandated. These and similar factors and events may have substantial negative effects on the business, financial condition and results of operations of the Corporation and its customers.

PART I: FINANCIAL INFORMATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We have taken deliberate actions to ensure that we have the balance sheet strength to serve our clients and communities, including increases in liquidity and managing our assets and liabilities in order to maintain a strong capital position. Additionally, in response to the COVID-19 pandemic, we have taken a number of actions to offer various forms of support to our customers, employees and communities that have experienced impacts from this development. The Corporation contributed approximately $1 million to non-profit organizations in our communities on the front lines of fighting the COVID-19 pandemic. In response to social distancing protocols, we have modified office locations by installing protective barriers, required the use of personal protective equipment and incurred additional cleaning and janitorial expense to disinfect banking centers and office locations. Additionally, we have enhanced mobile and online services, such as increased mobile deposit limits, to allow more transactions to be completed outside the banking centers. We have also provided customer alerts focused on COVID-19 scams and fraud education and prevention.

Interest Rates

On March 3, 2020, the Federal Open Market Committee ("FOMC") reduced the target federal funds rate by 50 basis points to 1.00 percent to 1.25 percent. This rate was further reduced to a target range of 0 percent to 0.25 percent on March 16, 2020. Additionally, there was a decline in one-month LIBOR from 99 basis points as of March 31, 2020 to 16 basis points on June 30, 2020. These reductions in interest rates and other effects of the COVID-19 outbreak are likely to negatively impact the Corporation's net interest income.

The CARES Act and the Paycheck Protection Program

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law, providing an approximately $2 trillion stimulus package that includes direct payments to individual taxpayers, economic stimulus to significantly impacted industry sectors, emergency funding for hospitals and providers, small business loans, increased unemployment benefits, and a variety of tax incentives.
For small businesses, eligible nonprofits and certain others, the CARES Act established a Paycheck Protection Program ("PPP"), which is administered by the Small Business Administration ("SBA"). On April 24, 2020, the Paycheck Protection Program and Health Care Enhancement Act was enacted. Among other things, this legislation amends the initial CARES Act program by raising the appropriation level for PPP loans from $349 billion to $670 billion. The PPP was further modified on June 5, 2020 with the adoption of the Paycheck Protection Program Flexibility Act (the Flexibility Act), which extended the maturity date for PPP loans from two years to five years for loans disbursed on or after the date of enactment of the Flexibility Act. For PPP loans disbursed prior to such enactment, the Flexibility Act permits the borrower and lender to mutually agree to extend the term of the loan to five years. The Bank has actively participated in assisting its customers with applications for resources through the program. PPP loans earn interest at a fixed rate of 1 percent and primarily have a two-year term. The Bank anticipates that the majority of these loans will ultimately be forgiven, in whole or in part, by the SBA in accordance with the terms of the program. Under the terms of the PPP, the loans are fully guaranteed by the U.S. government. As of June 30, 2020, the Bank had funded over 5,000 PPP loans representing $882.9 million, which is net of deferred processing fees and costs of $24.6 million. The weighted-average deferred processing fee on PPP loans was approximately 3.28 percent and is recognized over the term of the loan. If a loan is forgiven by the SBA or paid off by the borrower prior to maturity, any unamortized portion of the fee will be recognized immediately. During the second quarter of 2020, the Corporation recognized $2.7 million in PPP loan related deferred processing fees (net of amortization of related deferred origination costs) as a yield adjustment and this amount is included in interest income on loans.

Main Street Business Lending Program

On April 9, 2020, the Federal Reserve announced its proposed Main Street emergency lending initiative as an additional measure to provide much-needed financial support to small and mid-sized businesses adversely impacted by the COVID-19 pandemic. The Main Street programs are intended to provide credit flows to financial institutions so that they can provide loans to eligible small and mid-sized businesses. The funds available through the Main Street programs amount to $600 billion. Under this initiative, which was modified and supplemented by the Federal Reserve on April 30, 2020, three loan facilities have been established: (i) the Main Street New Loan Facility (the "MSNLF), (ii) the Main Street Priority Loan Facility (the "MSPLF"); and (iii) the Main Street Expanded Loan Facility (the "MSELF"), each of which was authorized by the Federal Reserve under Section 13(3) of the Federal Reserve Act. All three facilities use the same eligible lender and eligible borrower criteria, and have many of the same features, including the same maturity, interest rate, deferral of principal and interest for one year, and ability of the borrower to prepay without penalty. As required by the CARES Act, Main Street loans are full-recourse to the borrower and are not forgivable. The loan types differ in amounts and other terms, including in how they interact with the eligible borrower's existing outstanding debt. The proposed minimum loan amounts under the MSNLF and the MSPLF have been set at $250,000. The minimum loan amount under the MSELF has been set at $10 million. The maximum loan amount under all three programs is dependent upon the borrower's financial position. The Bank may participate in some or all of these programs.

Paycheck Protection Program Liquidity Facility

To provide liquidity to small business lenders and the broader credit markets, to help stabilize the financial system, and to provide economic relief to small businesses nationwide, the Federal Reserve authorized each of the Federal Reserve Banks to participate in the Paycheck Protection Program Liquidity Facility (the "PPPL Facility"), pursuant to the Federal Reserve Act. Under the PPPL Facility, each of the Federal Reserve Banks will extend non-recourse loans to eligible financial institutions such as the Bank to fund loans guaranteed by the SBA under the PPP. The Bank has until September 30, 2020 to access funds under the PPPL Facility, unless otherwise extended by the Federal Reserve and the Department of the Treasury. The Bank borrowed from the PPPL Facility to supplement liquidity to fund the PPP loans and as of June 30, 2020 the outstanding balance of such borrowings was $166.9 million. Details of the borrowings from the PPPL Facility are included in the "LIQUIDITY" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Loan Modifications and Troubled Debt Restructures

On March 22, 2020, a statement was issued by the Bank's banking regulators and titled the “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus” (the "Interagency Statement") that encourages financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations due to the effects of COVID-19. Additionally, Section 4013 of the CARES Act further provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates. The Interagency Statement was subsequently revised on April 7, 2020 to clarify the interaction of the original guidance with Section 4013 of the CARES Act, as well as setting forth the banking regulators’ views on consumer protection considerations. In accordance with such guidance, the Bank is offering short-term modifications made in response to COVID-19 to borrowers who are current and otherwise not past due. These include short-term, 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. During the six months ended June 30, 2020, modifications were completed on loans having a total aggregate balance of approximately $1.1 billion, or 12.1 percent of the loan portfolio. Details of the modifications are included in "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Optional Delay of CECL Implementation

Pursuant to the CARES Act and the related joint statement of federal banking regulators (which also became effective as of March 27, 2020), and consistent with guidance from the SEC and FASB, the Corporation has elected to delay implementation of *Accounting Standards Update (“ASU”) No. 2016-13, Financial Instruments - Credit Losses (Topic 326)*, which would have become effective for the Corporation as of January 1, 2020. As discussed in NOTE 1. GENERAL of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q, ASU 2016-13, provides for the replacement of the incurred loss model for recording the allowance for loan losses with CECL. However, as a result of the Corporation’s election, its first and second quarter 2020 financial statements have been prepared under the existing incurred loss model. The temporary relief applicable to the Corporation’s compliance with CECL ends on the earlier of: (1) the termination date of the national emergency concerning the COVID-19 outbreak, declared by the President of the United States on March 13, 2020, under the National Emergencies Act; or (2) December 31, 2020.

Regulatory Capital

CECL Model. As part of the March 27, 2020 joint statement of federal banking regulators discussed above, an interim final rule that allows banking organizations to mitigate the effects of the CECL accounting standard on their regulatory capital was also announced. Banking organizations that are required under GAAP to adopt CECL during 2020 can elect to mitigate the estimated cumulative regulatory capital effects of CECL for up to two years. This two-year delay is in addition to the three-year transition period that federal banking regulators had already made available. While the Corporation has elected to delay implementation of ASU No. 2016-13 as described above, it expects to take advantage of the additional time permitted by this interim final rule, which will largely delay the effects of CECL on its regulatory capital through December 31, 2021. Beginning on January 1, 2022, the Corporation will be required to phase in 25 percent of the previously deferred estimated capital impact of CECL, with an additional 25 percent to be phased in at the beginning of each subsequent year until fully phased in by January 1, 2025. Under the interim final rule, the amount of adjustments to regulatory capital that can be deferred until the phase-in period includes both the initial impact of our adoption of CECL, and 25 percent of subsequent changes in our allowance for credit losses during each quarter following implementation of CECL until December 31, 2021.

PPP Loans and PPPL Facility. On April 9, 2020, federal banking regulators issued an interim final rule to modify the Basel III regulatory capital rules applicable to banking organizations to allow those organizations participating in the PPP to neutralize the regulatory capital effects of participating in the program. The interim final rule, which became effective on April 13, 2020, clarifies that PPP loans receive a zero percent risk weight for purposes of determining risk-weighted assets and the CET1, Tier 1 and Total Risk-Based capital ratios. At June 30, 2020, risk-weighted assets included $882.9 million of PPP loans at a zero risk weight. Additionally, in order to facilitate use of the PPPL Facility, the agencies have clarified that banking organizations, including the Corporation and the Bank, are permitted to assign a zero percent risk weight to PPP loans pledged to the PPPL Facility for purposes of determining risk-weighted assets and risk-based capital ratios, and to exclude such pledged PPP loans from total average assets for purposes of determining the leverage ratio. At June 30, 2020, approximately $138.4 million of average PPP loans pledged to the PPPL Facility were excluded from total assets for the leverage ratio.

RESULTS OF OPERATIONS

Executive Summary

The Corporation reported second quarter 2020 net income of $33.0 million, compared to $41.1 million during the second quarter of 2019. Diluted earnings per share for the second quarter totaled $0.62 per share, compared to $0.83 per diluted share during the same period in 2019. Year-to-date net income totaled $67.3 million, compared to $79.9 million during the same period of 2019. Diluted earnings per share for the six months ended June 30, 2020 was $1.24 per share, compared to $1.61 per share during the same period in 2019.

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As of June 30, 2020, total assets equaled $13.8 billion, an increase of $1.4 billion, or 10.9 percent, from December 31, 2019. The Corporation's total loan portfolio increased $831.1 million, or 9.8 percent from December 31, 2019. The Corporation originated approximately $882.9 million of PPP loans, which were primarily included in the commercial and industrial loan class. The largest loan segments that experienced a decrease were construction real estate and home equity loans. Additional details of the changes in the Corporation's loans and other earning assets are discussed within NOTE 4. LOANS AND ALLOWANCE of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q, and the "EARNING ASSETS" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Interest-bearing time deposits increased $261.8 million from December 31, 2019 due to excess liquidity from deposit growth and an increase in wholesale funding. Additionally, total investment securities increased $193.3 million from December 31, 2019 as a portion of the excess liquidity from deposit growth and additional wholesale funding was used to invest in the bond portfolio. Also contributing to the increase in investment securities was a $46.7 million increase in net unrealized gains on the available for sale portfolio. The net increase in unrealized gains from December 31, 2019 to June 30, 2020 is primarily due to interest rate declines in 2020 as the longer term points on the yield curve have declined since year-end, which increases the fair value of securities in the portfolio.

The Corporation’s allowance for loan losses totaled $121.1 million as of June 30, 2020 and equaled 1.30 percent of total loans. The Corporation's provision expense and net charge-offs for the three months ended June 30, 2020 were $21.9 million and $230,000, respectively, compared to provision expense and net charge-offs of $500,000 and $128,000, respectively, during the same period of 2019. For the six months ended June 30, 2020, the Corporation's provision expense and net charge-offs were $41.6 million and $812,000, respectively, compared to provision expense and net charge-offs of $1.7 million and $978,000 during the same period in 2019. The increase in the allowance for loan losses and provision expense primarily reflects our view of increased credit risk related to the COVID-19 pandemic.

Non-accrual loans totaled $50.1 million, an increase of $34.2 million from December 31, 2019. The increase is primarily due to three customer relationships moving to non-accrual in the second quarter that total $31.4 million, two of which were in the senior living space and one in the university logo apparel industry. Details of the Allowance for Loan Losses and non-performing loans are discussed within the “LOAN QUALITY/PROVISION FOR LOAN LOSSES” section of this Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The Corporation's other assets increased $56.3 million from December 31, 2019. The Corporation's derivative asset (recorded in other assets) and derivative liability (recorded in other liabilities) related to interest rate contracts increased $56.8 million and $57.9 million, respectively, from December 31, 2019. The increases are primarily due to a $125.2 million increase in the related outstanding notional balance. Additionally, yield curve rates used for valuation purposes were lower at each term point as of June 30, 2020 compared to December 31, 2019. This was primarily the result of investors seeking the safety of U.S. Treasuries as containment efforts related to the COVID-19 outbreak began to significantly reduce economic activity.

As of June 30, 2020, total deposits equaled $11.0 billion, an increase of $1.1 billion from December 31, 2019. The Corporation experienced increases from December 31, 2019 in demand and savings accounts of $1.0 billion and $382.0 million, respectively. A portion of the increase is due to PPP loans that have remained on deposit, in addition to consumer Economic Impact Payments from the IRS that have also remained on deposit. Offsetting these increases were decreases in certificates of deposit and brokered deposits of $202.0 million and $91.7 million, respectively, from December 31, 2019.

Total borrowings increased $134.5 million as of June 30, 2020, compared to December 31, 2019. The Bank borrowed from the PPPL Facility to supplement liquidity to fund the PPP loans. The outstanding balance of the PPPL Facility borrowings at June 30, 2020 was $166.9 million. Additionally, Federal Home Loan Bank advances increased $49.7 million compared to December 31, 2019. Offsetting this increase, the Corporation redeemed $20.0 million of subordinated debentures. Of the redemptions, $10.0 million was for a partial redemption of debentures held by First Merchants Capital Trust II (“FMC Trust”) and the remaining $10.0 million was for a complete redemption of debentures held by Grabill Capital Trust I ("Grabill Trust"). Both FMC Trust and Grabill Trust used the proceeds from the redemptions to concurrently redeem like amounts of their capital (preferred) securities, each with an aggregate principal redemption price of $10.0 million. The common securities of FMC Trust are, and the common securities of Grabill Trust were, held by the Corporation (recorded in other assets). Subsequent to the redemption of its capital securities, Grabill Trust was dissolved.

The Corporation's other liabilities as of June 30, 2020 increased $80.1 million compared to December 31, 2019. The Corporation postponed the first two estimated corporate income tax payments in 2020 as allowed by the IRS, which resulted in an increase in the accrued federal income tax liability by $17.4 million when compared to December 31, 2019. The Corporation also accrued $13.1 million of trade date accounting related to investment securities purchases as of June 30, 2020, of which, there was no accrual at December 31, 2019. Additionally, as noted above, the derivative hedge liability increased $57.9 million from December 31, 2019.

The Corporation was able to maintain all regulatory capital ratios in excess of the regulatory definition of “well-capitalized.” Details of the Stock Repurchase Program and regulatory capital ratios are discussed within the “CAPITAL” section of this Management’s Discussion and Analysis of Financial Condition and Results of Operations.

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NET INTEREST INCOME

Net interest income is the most significant component of our earnings, comprising 77 percent of revenues for the six months ended June 30, 2020. Net interest income and margin are influenced by many factors, primarily the volume and mix of earning assets, funding sources, and interest rate fluctuations. Other factors include the level of accretion income on purchased loans, prepayment risk on mortgage and investment-related assets, and the composition and maturity of earning assets and interest-bearing liabilities. Loans typically generate more interest income than investment securities with similar maturities. Funding from customer deposits generally costs less than wholesale funding sources. Factors such as general economic activity, Federal Reserve Board monetary policy, and price volatility of competing alternative investments, can also exert significant influence on our ability to optimize the mix of assets and funding and the net interest income and margin.

Net interest income is the excess of interest received from earning assets over interest paid on interest-bearing liabilities. For analytical purposes, net interest income is also presented on an FTE basis in the tables that follow to reflect what tax-exempt assets would need to yield in order to achieve the same after-tax yield as a taxable asset. The federal statutory rate of 21 percent was used for all periods, adjusted for the TEFRA interest disallowance applicable to certain tax-exempt obligations. The FTE analysis portrays the income tax benefits associated with tax-exempt assets and helps to facilitate a comparison between taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully taxable equivalent basis. Therefore, management believes these measures provide useful information for both management and investors by allowing them to make peer comparisons.

For the three and six months ended June 30, 2020, the increase in earning assets from the same periods in 2019 was primarily attributable to the September 2019 MBT acquisition, an increase in loans as a result of $882.9 million of PPP loans and excess liquidity generated from growth in deposits and wholesale funding that was used to invest in the securities portfolio. Details regarding the MBT acquisition and changes in earning assets are discussed in NOTE 2. ACQUISITION of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q and the "EARNING ASSETS" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

In the second quarter of 2020, asset yields decreased 114 basis points FTE compared to the same period in 2019. This decrease was primarily a result of the FOMC's interest rate decreases of 50 basis points on March 3, 2020 and 100 basis points on March 16, 2020 at the Committee's special meetings related to COVID-19 and the decline in one-month LIBOR from 99 basis points as of March 31, 2020 to 16 basis points on June 30, 2020. Moreover, the addition of $883 million of PPP loans negatively impacted margin by 6 basis points. Interest costs decreased 76 basis points, contributing to a 38 basis point FTE decrease in net interest spread as compared to the same period in 2019. Interest costs have decreased as management aggressively moved deposit rates down, coupled with a decline in wholesale funding rates. Interest-bearing deposit and borrowing costs decreased from 1.32 percent and 2.79 percent, respectively, during the three months ended June 30, 2019, to 0.59 percent and 1.55 percent, respectively, during the same period in 2020. Net interest margin, on a tax equivalent basis, decreased to 3.19 percent for the second quarter of 2020 compared to 3.71 percent during the same period in 2019.

The Corporation recognized fair value accretion income on purchased loans, which is included in interest income, of $3.7 million, which accounted for 12 basis points of net interest margin in the second quarter of 2020. Comparatively, the Corporation recognized $2.2 million of accretion income for the second quarter of 2019, or 9 basis points of net interest margin.

In the six months ended June 30, 2020 asset yields decreased 84 basis points FTE compared to the same period in 2019. This decrease was primarily a result of the FOMC's interest rate decreases of 50 basis points on March 3, 2020 and 100 basis points on March 16, 2020 at the Committee's special meetings related to COVID-19 and the decline in one-month LIBOR from 240 basis points as of June 30, 2019 to 16 basis points on June 30, 2020. Interest costs decreased 48 basis points, contributing to a 36 basis point FTE decrease in net interest spread as compared to the same period in 2019. Interest costs have decreased as management aggressively moved deposit rates down, coupled with a decline in wholesale funding rates. Interest-bearing deposit and borrowing costs decreased from 1.26 percent and 2.76 percent, respectively, during the six months ended June 30, 2019 to 0.82 percent and 1.86 percent, respectively, during the same period in 2020. Net interest margin, on a tax equivalent basis, decreased to 3.32 percent for the six months ended June 30, 2020 compared to 3.78 percent during the same period in 2019.

The Corporation recognized fair value accretion income on purchased loans, which is included in interest income, of $7.2 million, which accounted for 12 basis points of net interest margin for the six months ended June 30, 2020. Comparatively, the Corporation recognized $4.5 million of accretion income for the six months ended June 30, 2019, or 10 basis points of net interest margin.

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The following tables presents the Corporation's average balance sheet, interest income/interest expense, and the average rate as a percent of average earning assets/liabilities for the three months ended June 30, 2020, and 2019.

(Dollars in Thousands)	Three Months Ended					
	June 30, 2020			June 30, 2019		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Interest-bearing time deposits	$ 378,489	$ 134	0.14%	$ 144,626	$ 784	2.17%
Federal Home Loan Bank stock	28,736	281	3.91	24,588	335	5.45
Investment Securities: (1)						
Taxable	1,282,080	6,147	1.92	1,054,068	6,998	2.66
Tax-Exempt (2)	1,317,527	12,682	3.85	910,295	9,435	4.15
Total Investment Securities	2,599,607	18,829	2.90	1,964,363	16,433	3.35
Loans held for sale	12,630	131	4.15	11,430	127	4.44
Loans: (3)						
Commercial	6,890,010	69,463	4.03	5,419,169	74,638	5.51
Real Estate Mortgage	887,257	10,122	4.56	766,528	8,686	4.53
Installment	724,165	7,596	4.20	677,133	9,373	5.54
Tax-Exempt (2)	666,548	6,784	4.07	511,055	5,372	4.20
Total Loans	9,180,610	94,096	4.10	7,385,315	98,196	5.32
Total Earning Assets	12,187,442	113,340	3.72%	9,518,892	115,748	4.86%
Net unrealized gain (loss) on securities available for sale	56,807			12,841		
Allowance for loan losses	(106,858)			(81,691)		
Cash and cash equivalents	303,491			130,987		
Premises and equipment	113,528			91,563		
Other assets	1,100,912			827,356		
Total Assets	$ 13,655,322			$ 10,499,948		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing deposits	$ 3,951,819	$ 4,186	0.42%	$ 2,935,925	$ 8,541	1.16%
Money market deposits	1,673,104	1,696	0.41	1,220,020	3,509	1.15
Savings deposits	1,521,312	596	0.16	1,164,901	2,525	0.87
Certificates and other time deposits	1,498,002	6,229	1.66	1,652,203	8,512	2.06
Total Interest-bearing Deposits	8,644,237	12,707	0.59	6,973,049	23,087	1.32
Borrowings	909,258	3,527	1.55	613,446	4,274	2.79
Total Interest-bearing Liabilities	9,553,495	16,234	0.68	7,586,495	27,361	1.44
Noninterest-bearing deposits	2,145,672			1,348,410		
Other liabilities	160,646			85,789		
Total Liabilities	11,859,813			9,020,694		
Stockholders' Equity	1,795,509			1,479,254		
Total Liabilities and Stockholders' Equity	$ 13,655,322	16,234		$ 10,499,948	27,361	
Net Interest Income (FTE)		$ 97,106			$ 88,387	
Net Interest Spread (FTE) (4)			3.04%			3.42%
Net Interest Margin (FTE):						
Interest Income (FTE) / Average Earning Assets			3.72%			4.86%
Interest Expense / Average Earning Assets			0.53%			1.15%
Net Interest Margin (FTE) (5)			**3.19%**			**3.71%**

(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustments. Annualized amounts are computed utilizing a 30/360 day basis.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 21 percent for 2020 and 2019. These totals equal $4,088 and $3,109 for the three months ended June 30, 2020 and 2019, respectively.

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

(4) Net Interest Spread (FTE) is interest income expressed as a percentage of average earning assets minus interest expense expressed as a percentage of average interest-bearing liabilities.

(5) Net Interest Margin (FTE) is interest income expressed as a percentage of average earning assets minus interest expense expressed as a percentage of average earning assets.

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(Dollars in Thousands)	Six Months Ended					
	June 30, 2020			June 30, 2019		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Federal Funds Sold						
Interest-bearing time deposits	$ 269,174	$ 709	0.53%	$ 145,277	$ 1,659	2.28%
Federal Reserve and Federal Home Loan Bank stock	28,736	580	4.04	24,588	673	5.47
Investment Securities: (1)						
Taxable	1,325,313	13,778	2.08	978,654	13,093	2.68
Tax-Exempt (2)	1,263,122	24,499	3.88	869,914	18,133	4.17
Total Investment Securities	2,588,435	38,277	2.96	1,848,568	31,226	3.38
Loans held for sale	14,924	324	4.34	10,697	239	4.47
Loans: (3)						
Commercial	6,562,673	146,415	4.46	5,364,884	147,394	5.49
Real Estate Mortgage	878,956	20,524	4.67	755,070	17,008	4.51
Installment	741,889	16,701	4.50	671,125	18,664	5.56
Tax-Exempt (2)	655,149	13,511	4.12	506,370	10,629	4.20
Total Loans	8,853,591	197,475	4.46	7,308,146	193,934	5.31
Total Earning Assets	11,739,936	237,041	4.04%	9,326,579	227,492	4.88%
Net unrealized gain on securities available for sale	52,732			3,963		
Allowance for loan losses	(94,009)			(81,301)		
Cash and cash equivalents	231,624			124,143		
Premises and equipment	113,670			92,395		
Other assets	1,070,327			825,426		
Total Assets	$ 13,114,280			$ 10,291,205		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing deposits	$ 3,770,530	$ 12,461	0.66%	$ 2,813,541	$ 15,560	1.11%
Money market deposits	1,604,474	5,479	0.68	1,179,765	6,291	1.07
Savings deposits	1,473,183	2,424	0.33	1,157,852	4,792	0.83
Certificates and other time deposits	1,582,322	14,091	1.78	1,609,130	16,038	1.99
Total Interest-bearing Deposits	8,430,509	34,455	0.82	6,760,288	42,681	1.26
Borrowings	828,721	7,709	1.86	624,192	8,627	2.76
Total Interest-bearing Liabilities	9,259,230	42,164	0.91	7,384,480	51,308	1.39
Noninterest-bearing deposits	1,907,582			1,369,832		
Other liabilities	141,505			82,260		
Total Liabilities	11,308,317			8,836,572		
Stockholders' Equity	1,805,963			1,454,633		
Total Liabilities and Stockholders' Equity	$ 13,114,280	42,164		$ 10,291,205	51,308	
Net Interest Income (FTE)		$ 194,877			$ 176,184	
Net Interest Spread (FTE) (4)			3.13%			3.49%
Net Interest Margin (FTE):						
Interest Income (FTE) / Average Earning Assets			4.04%			4.88%
Interest Expense / Average Earning Assets			0.72%			1.10%
Net Interest Margin (FTE) (5)			**3.32%**			**3.78%**

(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustments. Annualized amounts are computed utilizing a 30/360 day basis.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 21 percent for 2020 and 2019. These totals equal $7,982 and $6,040 for the six months ended June 30, 2020 and 2019, respectively.

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

(4) Net Interest Spread (FTE) is interest income expressed as a percentage of average earning assets minus interest expense expressed as a percentage of average interest-bearing liabilities.

(5) Net Interest Margin (FTE) is interest income expressed as a percentage of average earning assets minus interest expense expressed as a percentage of average earning assets.

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NON-INTEREST INCOME

Non-interest income increased $4.9 million, or 22.5 percent, in the second quarter of 2020, compared to the second quarter of 2019. The larger customer base resulting from the MBT acquisition on September 1, 2019, in addition to organic growth, resulted in an increase in customer related line items such as fiduciary and wealth management fees and card payment fees of $2.9 million in the second quarter of 2020 when compared to the same period in 2019. Additionally, the larger customer base and the low mortgage interest rate environment combined to produce an increase of $1.9 million in net gains and fees on sales of loans. Details of the Corporation's 2019 acquisition can be found in NOTE 2. ACQUISITION of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q. Finally, net realized gains on the sales of available for sale securities increased by $1.2 million in the second quarter of 2020 when compared to the same period in 2019.

These increases were partially offset by a decrease in service charges on deposit accounts of $1.1 million in the second quarter of 2020 when compared to the same period in 2019 mainly due to higher than normal customer deposit balances as a result of stimulus funds received in response to the COVID-19 pandemic. This resulted in significantly lower non-sufficient funds and overdraft fees during the quarter ended June 30, 2020.

During the first six months of 2020, non-interest income increased $16.0 million, or 39.6 percent, compared to the same period in 2019. The MBT acquisition on September 1, 2019 resulted in an increase in customer related line items such as fiduciary and wealth management fees and card payment fees of $6.2 million. Additionally, the larger customer base and the low mortgage interest rate environment combined to produce an increase of $4.0 million in net gains and fees on sales of loans. Finally, net realized gains on the sales of available for sale securities increased by $4.7 million and derivative hedge fees increased by $713,000 in the first six months of 2020 when compared to the same period in 2019.

NON-INTEREST EXPENSE

Non-interest expense increased $2.4 million, or 4.2 percent, in the second quarter of 2020, compared to the second quarter of 2019. The acquisition of MBT was the largest contributing factor to the increase. The larger franchise and growth in our customer base resulted in increases in most non-interest expense categories with the largest increases in salaries and employee benefits, net occupancy and equipment accounting for $4.3 million of the increase. The Corporation also incurred $1.4 million of additional expense in the second quarter of 2020 compared to the same period of 2019 related to actions taken in response to the COVID-19 pandemic which included approximately $1.0 million recorded in marketing expense for donations to non-profit organizations in our communities on the front lines of the COVID-19 pandemic efforts and approximately $400,000 in net occupancy costs in response to social distancing and cleaning protocols. Finally, FDIC assessment expense increased $794,000 in the second quarter of 2020 when compared to the same period in 2019 as a result of the the Corporation's FDIC assessment changing to the calculation applicable to banks over $10 billion in total assets.

These increases were partially offset by a decrease in outside data processing fees of $1.3 million in the second quarter of 2020 compared to the same period of 2019 mainly related to sunsetting of a debit card rewards program. Additionally, the increase in marketing expense noted above from the COVID-19 related donations was offset by the fair lending settlement expense of $1.2 million incurred in the second quarter of 2019. Finally, professional and other outside services decreased $823,000 in the second quarter of 2020 when compared to the same period in 2019 primarily due to 2019 containing professional fees related to the MBT acquisition.

Non-interest expense increased $12.0 million, or 10.5 percent, in the first six months of 2020, compared to the same period in 2019. The MBT acquisition on September 1, 2019 resulted in increases in most non-interest expense categories with the largest increases in salaries and employee benefits, net occupancy and equipment accounting for an increase of $12.0 million. Additionally, FDIC assessment expense increased $1.6 million as a result of the Corporation's FDIC assessment changing to the calculation applicable to banks over $10 billion in total assets. The Corporation also incurred $1.4 million of additional expense in the first six months of 2020 compared to the same period of 2019 related to actions taken in response to the COVID-19 pandemic which included approximately $1.0 million recorded in marketing expense for donations to non-profit organizations in our communities on the front lines of the COVID-19 pandemic efforts and approximately $400,000 in net occupancy costs in response to social distancing and cleaning protocols.

The increases noted above were partially offset by a decrease in outside data processing fees of $796,000 in the first six months of 2020 when compared to the same period on 2019. While the larger franchise created by the acquisition of MBT, as well as organic growth, caused outside data processing fees to increase, the increase was more than offset by a decrease of $1.5 million related to the sunsetting of a debit rewards program. In addition, the increase noted above in marketing expense was offset by a decrease of $1.2 million related to the fair lending settlement expense incurred in 2019. Finally, other real estate owned and foreclosure expense decreased $879,000 in the first six months of 2020 when compared to the same period in 2019.

INCOME TAXES

Income tax expense for the second quarter of 2020 was $4,623,000 on pre-tax net income of $37,615,000. For the same period in 2019, income tax expense was $7,749,000 on pre-tax net income of $48,805,000. The effective income tax rates for the second quarter of 2020 and 2019 were 12.3 percent and 15.9 percent, respectively.

Income tax expense for the six months ended June 30, 2020 was $8,113,000 on pre-tax net income of $75,368,000. For the same period in 2019, income tax expense was $14,690,000 on pre-tax net income of $94,563,000. The effective tax rates for the six months ended June 30, 2020 and 2019 were 10.8 percent and 15.5 percent, respectively.

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The lower effective income tax rates during the three and six months ended June 30, 2020 when compared to the same period in 2019 was primarily driven by two factors. First, the abnormally high level of loan provision expense resulting from the economic impact of the COVID-19 pandemic has, and likely will continue, to distort the normal relationship of taxable income to tax-exempt income. Secondly, the CARES Act provided the opportunity to carryback certain federal net operating losses. The Corporation's net operating loss had previously been valued at the current statutory rate of 21 percent. As such, the Corporation booked a tax benefit of $1,178,000 in the first quarter of 2020 in recognition of the rate differential between the current rate and the rate in effect during the period to which the net operating loss will be carried back.

The detailed reconciliation of federal statutory to actual tax expense is shown in NOTE 13. INCOME TAX of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

CAPITAL

Stockholders' Equity

On September 1, 2019, the Corporation acquired 100 percent of MBT. Pursuant to the merger agreement, each MBT shareholder received 0.275 shares of the Corporation's common stock for each outstanding share of MBT common stock held. The Corporation issued approximately 6.4 million shares of common stock, which was valued at approximately $229.9 million. Details regarding the MBT acquisition are discussed in NOTE 2. ACQUISITION of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

Stock Repurchase Program

On September 3, 2019, the Board of Directors of the Corporation approved a stock repurchase program of up to 3 million shares of the Corporation's outstanding common stock; provided, however, that the total aggregate investment in shares repurchased under the program may not exceed $75 million. On a share basis, the amount of common stock subject to the repurchase program represents approximately 5 percent of the Corporation's outstanding shares. During the first quarter of 2020, the Corporation repurchased 1,634,437 of its common shares for $55.9 million at an average price of $34.21, which resulted in the aggregate investment in share repurchases to equal $75.0 million, the maximum allowable under the plan.

Regulatory Capital

Capital adequacy is an important indicator of financial stability and performance. 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 four ratios that are calculated according to the regulations: total risk-based capital, tier 1 risk-based capital, CET1, 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.

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. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and tier 1 capital to risk-weighted assets, and of tier 1 capital to average assets, or leverage ratio, all of which are calculated as defined in the
regulations. 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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Basel III was effective for the Corporation on January 1, 2015 and requires the Corporation and the Bank to maintain the minimum capital and leverage ratios as defined in the regulation and as illustrated in the table below. Under Basel III, the Corporation and Bank elected to opt-out of including accumulated other comprehensive income in regulatory capital. As of June 30, 2020, the Bank met all capital adequacy requirements to be considered well capitalized under the fully phased-in Basel III capital rules. There is no threshold for well capitalized status for bank holding companies. The Corporation's and Bank's actual and required capital ratios as of June 30, 2020 and December 31, 2019 were as follows:

			Prompt Corrective Action Thresholds			
	Actual		Basel III Minimum Capital Required		Well Capitalized	
June 30, 2020	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total risk-based capital to risk-weighted assets						
First Merchants Corporation	$ 1,410,246	14.18%	$ 1,044,339	10.50%	N/A	N/A
First Merchants Bank	1,370,061	13.73	1,047,607	10.50	$ 997,721	10.00%
Tier 1 capital to risk-weighted assets						
First Merchants Corporation	$ 1,224,127	12.31%	$ 845,417	8.50%	N/A	N/A
First Merchants Bank	1,248,942	12.52	848,062	8.50	$ 798,176	8.00%
CET1 capital to risk-weighted assets						
First Merchants Corporation	$ 1,177,879	11.84%	$ 696,226	7.00%	N/A	N/A
First Merchants Bank	1,248,942	12.52	698,404	7.00	$ 648,518	6.50%
Tier 1 capital to average assets						
First Merchants Corporation	$ 1,224,127	9.45%	$ 517,986	4.00%	N/A	N/A
First Merchants Bank	1,248,942	9.66	517,075	4.00	$ 646,344	5.00%

			Prompt Corrective Action Thresholds			
	Actual		Basel III Minimum Capital Required		Well Capitalized	
December 31, 2019	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total risk-based capital to risk-weighted assets						
First Merchants Corporation	$ 1,400,617	14.29%	$ 1,028,930	10.50%	N/A	N/A
First Merchants Bank	1,267,649	12.87	1,033,926	10.50	$ 984,691	10.00%
Tier 1 capital to risk weighted assets						
First Merchants Corporation	$ 1,255,333	12.81%	$ 832,943	8.50%	N/A	N/A
First Merchants Bank	1,187,365	12.06	836,988	8.50	$ 787,753	8.00%
CET1 capital to risk-weighted assets						
First Merchants Corporation	$ 1,188,970	12.13%	$ 685,953	7.00%	N/A	N/A
First Merchants Bank	1,187,365	12.06	689,284	7.00	$ 640,049	6.50%
Tier 1 capital to average assets						
First Merchants Corporation	$ 1,255,333	10.54%	$ 476,383	4.00%	N/A	N/A
First Merchants Bank	1,187,365	9.99	475,564	4.00	$ 594,455	5.00%

On April 9, 2020, federal banking regulators issued an interim final rule to modify the Basel III regulatory capital rules applicable to banking organizations to allow those organizations participating in the PPP to neutralize the regulatory capital effects of participating in the program. The interim final rule, which became effective April 13, 2020, clarifies that PPP loans receive a zero percent risk weight for purposes of determining risk-weighted assets and the CET1, Tier 1 and Total Risk-Based capital ratios. At June 30, 2020, risk-weighted assets included $882.9 million of PPP loans at a zero risk weight. Additionally, in order to facilitate use of the PPPL Facility, the agencies have clarified that banking organizations, including the Corporation and the Bank, are permitted to assign a zero percent risk weight to PPP loans pledged to the PPPL Facility for purposes of determining risk-weighted assets and the leverage ratio. At June 30, 2020, the leverage ratio included approximately $138.4 million of average PPP loans pledged to the PPPL Facility at a zero risk weight.

Management believes that all of the above capital ratios are meaningful measurements for evaluating the safety and soundness of the Corporation. Traditionally, the banking regulators have assessed bank and bank holding company capital adequacy based on both the amount and the composition of capital, the calculation of which is prescribed in federal banking regulations. The Federal Reserve focuses its assessment of capital adequacy on a component of Tier 1 capital known as CET1. Because the Federal Reserve has long indicated that voting common shareholders' equity (essentially Tier 1 risk-based capital less preferred stock and non-controlling interest in subsidiaries) generally should be the dominant element in Tier 1 risk-based capital, this focus on CET1 is consistent with existing capital adequacy categories. 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.

	June 30, 2020		December 31, 2019	
(Dollars in thousands, except per share amounts)	First Merchants Corporation	First Merchants Bank	First Merchants Corporation	First Merchants Bank
Total Risk-Based Capital				
Total Stockholders' Equity (GAAP)	$ 1,809,095	$ 1,882,807	$ 1,786,437	$ 1,787,006
Adjust for Accumulated Other Comprehensive (Income) Loss [1]	(63,845)	(66,941)	(27,874)	(30,495)
Less: Preferred Stock	(125)	(125)	(125)	(125)
Add: Qualifying Capital Securities	46,248	—	66,363	—
Less: Disallowed Goodwill and Intangible Assets	(567,246)	(566,799)	(569,468)	(569,021)
Total Tier 1 Capital (Regulatory)	1,224,127	1,248,942	1,255,333	1,187,365
Qualifying Subordinated Debentures	65,000	—	65,000	—
Allowance for Loan Losses Includible in Tier 2 Capital	121,119	121,119	80,284	80,284
Total Risk-Based Capital (Regulatory)	$ 1,410,246	$ 1,370,061	$ 1,400,617	$ 1,267,649
Net Risk-Weighted Assets (Regulatory)	$ 9,946,087	$ 9,977,205	$ 9,799,329	$ 9,846,913
Average Assets (Regulatory)	$ 12,949,645	$ 12,926,872	$ 11,909,571	$ 11,889,092
Total Risk-Based Capital Ratio (Regulatory)	14.18%	13.73%	14.29%	12.87%
Tier 1 Capital to Risk-Weighted Assets	12.31%	12.52%	12.81%	12.06%
Tier 1 Capital to Average Assets	9.45%	9.66%	10.54%	9.99%
CET1 Capital Ratio				
Total Tier 1 Capital (Regulatory)	$ 1,224,127	$ 1,248,942	$ 1,255,333	$ 1,187,365
Less: Qualified Capital Securities	(46,248)	—	(66,363)	—
CET1 Capital (Regulatory)	$ 1,177,879	$ 1,248,942	$ 1,188,970	$ 1,187,365
Net Risk-Weighted Assets (Regulatory)	$ 9,946,087	$ 9,977,205	$ 9,799,329	$ 9,846,913
CET1 Capital Ratio (Regulatory)	11.84%	12.52%	12.13%	12.06%

[1] Includes net unrealized gains or losses on available for sale securities, net gains or losses on cash flow hedges, and amounts resulting from the application of the applicable accounting guidance for defined benefit and other postretirement plans.

Additionally, management believes the following tables are also meaningful when considering performance measures of the Corporation. Non-GAAP financial measures such as tangible common equity to tangible assets, return on average tangible capital and return on average tangible assets are important measures of the strength of the Corporation's capital and ability to generate earnings on tangible common equity invested by our shareholders. These non-GAAP measures provide useful supplemental information and may assist investors in analyzing the
Corporation's financial position without regard to the effects of intangible assets and preferred stock. Disclosure of these measures also allows analysts and banking regulators to assess our capital adequacy on these same bases.

Because these measures are not defined in GAAP or federal banking regulations, they are considered non-GAAP financial measures. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although these non-GAAP financial measures are frequently used by investors to evaluate a company, they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

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The Corporation had a strong capital position as evidenced by the tangible common equity to tangible assets ratio of 9.31 percent at June 30, 2020, and 10.16 percent at December 31, 2019.

	Tangible Common Equity to Tangible Assets (non-GAAP)	
(Dollars in thousands, except per share amounts)	June 30, 2020	December 31, 2019
Total Stockholders' Equity (GAAP)	$ 1,809,095	$ 1,786,437
Less: Cumulative preferred stock (GAAP)	(125)	(125)
Less: Intangible assets (GAAP)	(575,855)	(578,881)
Tangible common equity (non-GAAP)	$ 1,233,115	$ 1,207,431
Total assets (GAAP)	$ 13,819,378	$ 12,457,254
Less: Intangible assets (GAAP)	(575,855)	(578,881)
Tangible assets (non-GAAP)	$ 13,243,523	$ 11,878,373
Stockholders' Equity to Assets (GAAP)	13.09%	14.34%
Tangible common equity to tangible assets (non-GAAP)	9.31%	10.16%
Tangible common equity (non-GAAP)	$ 1,233,115	$ 1,207,431
Plus: Tax Benefit of intangibles (non-GAAP)	6,597	7,257
Tangible common equity, net of tax (non-GAAP)	$ 1,239,712	$ 1,214,688
Common Stock outstanding	53,796	55,368
Book Value (GAAP)	$ 33.63	$ 32.26
Tangible book value - common (non-GAAP)	$ 23.04	$ 21.94

The following table details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures for the three and six months ended June 30, 2020 and 2019.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share amounts)	2020	2019	2020	2019
Average goodwill (GAAP)	$ 543,919	$ 445,354	$ 543,919	$ 445,354
Average core deposit intangible (GAAP)	32,876	22,226	33,606	23,018
Average deferred tax on CDI (GAAP)	(6,815)	(4,565)	(6,972)	(4,727)
Intangible adjustment (non-GAAP)	$ 569,980	$ 463,015	$ 570,553	$ 463,645
Average stockholders' equity (GAAP)	$ 1,795,509	$ 1,479,254	$ 1,805,963	$ 1,454,633
Average cumulative preferred stock (GAAP)	(125)	(125)	(125)	(125)
Intangible adjustment (non-GAAP)	(569,980)	(463,015)	(570,553)	(463,645)
Average tangible capital (non-GAAP)	$ 1,225,404	$ 1,016,114	$ 1,235,285	$ 990,863
Average assets (GAAP)	$ 13,655,322	$ 10,499,948	$ 13,114,280	$ 10,291,205
Intangible adjustment (non-GAAP)	(569,980)	(463,015)	(570,553)	(463,645)
Average tangible assets (non-GAAP)	$ 13,085,342	$ 10,036,933	$ 12,543,727	$ 9,827,560
Net income available to common stockholders (GAAP)	$ 32,991	$ 41,056	$ 67,255	$ 79,873
CDI amortization, net of tax (GAAP)	1,194	1,202	2,390	2,409
Tangible net income available to common stockholders (non-GAAP)	$ 34,185	$ 42,258	$ 69,645	$ 82,282
Per Share Data:				
Diluted net income available to common stockholders (GAAP)	$ 0.61	$ 0.83	$ 1.24	$ 1.61
Diluted tangible net income available to common stockholders (non-GAAP)	$ 0.63	$ 0.85	$ 1.28	$ 1.66
Ratios:				
Return on average GAAP capital (ROE)	7.35%	11.10%	7.45%	10.98%
Return on average tangible capital	11.16%	16.64%	11.28%	16.61%
Return on average assets (ROA)	0.97%	1.56%	1.03%	1.55%
Return on average tangible assets	1.04%	1.68%	1.11%	1.67%

Return on average tangible capital is tangible net income available to common stockholders (annualized) expressed as a percentage of average tangible capital. Return on average tangible assets is tangible net income available to common stockholders (annualized) expressed as a percentage of average tangible assets.

LOAN QUALITY/PROVISION FOR LOAN LOSSES

The Corporation’s primary lending focus is small business and middle market commercial, commercial real estate and residential real estate, 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. Consumer loans are typically underwritten with statistical decision-making tools and are managed throughout their life cycle on a portfolio basis.

Loan Quality

The quality of the loan portfolio and the amount of non-performing loans may increase or decrease as a result of acquisitions, organic portfolio growth, 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 internal factors specific to a particular borrower, such as the actions of a customer's internal management.

At June 30, 2020, non-performing loans totaled $51.2 million, an increase of $34.4 million from December 31, 2019. Loans not accruing interest income totaled $50.1 million at June 30, 2020, an increase of $34.2 million from December 31, 2019, primarily due to three relationships that were moved to non-accrual during the second quarter of 2020. Two relationships totaling $17.0 million are in the senior living sector. The third relationship totaling $14.4 million is in the university logo sports apparel industry. The Corporation’s coverage ratio of allowance for loan losses to non-accrual loans decreased from 503.4 percent at December 31, 2019 to 241.7 percent at June 30, 2020. Troubled debt restructures totaled $1.1 million at June 30, 2020, an increase of $245,000 from December 31, 2019. See additional information regarding the allowance for loan losses in the “Provision for Loan Losses” section of this Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Other real estate owned and repossessions, totaling $7.4 million at June 30, 2020, decreased $118,000 from December 31, 2019. For other real estate owned, current appraisals are obtained to determine fair value as management continues to aggressively market these real estate assets.

Impaired loans include loans deemed impaired according to the guidance set forth in ASC 310-10. Commercial loans under $500,000 and consumer loans, with the exception of troubled debt restructures, are not individually evaluated for impairment. 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 June 30, 2020, impaired loans totaled $45.3 million, an increase of $33.6 million from the December 31, 2019 balance of $11.7 million. Also at June 30, 2020, a specific allowance for losses was not deemed necessary for impaired loans totaling $12.7 million as there were no identified losses on these credits. An allowance of $13.0 million was recorded for the remaining balance of these impaired loans totaling $32.6 million, and was included in the Corporation’s allowance for loan losses.

The Corporation's non-performing assets plus accruing loans 90-days or more delinquent and impaired loans are presented in the table below.

(Dollars in Thousands)	June 30, 2020	December 31, 2019
Non-Performing Assets:		
Non-accrual loans	$ 50,102	$ 15,949
Renegotiated loans	1,086	841
Non-performing loans (NPL)	51,188	16,790
OREO and Repossessions	7,409	7,527
Non-performing assets (NPA)	58,597	24,317
Loans 90-days or more delinquent and still accruing	4,981	69
NPAs and loans 90-days or more delinquent	$ 63,578	$ 24,386
Impaired Loans	$ 45,280	$ 11,709

The non-accrual balances in the table above include troubled debt loan restructures totaling $1.2 million and $709,000 as of June 30, 2020 and December 31, 2019, respectively.

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

(Dollars in Thousands)	June 30, 2020	December 31, 2019
Non-performing assets and loans 90-days or more delinquent:		
Commercial and industrial loans	$ 16,557	$ 1,259
Agricultural production financing and other loans to farmers	—	183
Real estate loans:		
Construction	6,333	7,191
Commercial and farmland	30,990	7,103
Residential	7,111	6,810
Home equity	2,458	1,795
Individuals' loans for household and other personal expenditures	87	45
Public finance and other commercial loans	42	—
Non-performing assets and loans 90-days or more delinquent:	$ 63,578	$ 24,386

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On March 22, 2020, a statement was issued by the Bank's banking regulators and titled the "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus" (the "Interagency Statement") that encourages financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations due to the effects of COVID-19. Additionally, Section 4013 of the CARES Act further provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates. The Interagency Statement was subsequently revised on April 7, 2020 to clarify the interaction of the original guidance with Section 4013 of the CARES Act, as well as setting forth the banking regulators' views on consumer protection considerations. In accordance with such guidance, the Bank is offering short-term modifications made in response to COVID-19 borrowers who are current and otherwise not past due. These include short-term, 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. The following table summarizes modifications that occurred in the period indicated:

	Six Months Ended June 30, 2020	
	Recorded Balance	Number of Loans
Commercial and industrial loans	$ 175,409	697
Agriculture production financing and other loans to farmers	329	5
Real estate loans:		
Construction	35,665	21
Commercial and farmland	811,144	867
Residential	95,313	648
Home equity	3,081	66
Individuals' loans for household and other personal expenditures	3,047	263
Public finance and other commercial loans	45	1
Total	$ 1,124,033	2,568

Approximately 95 percent of the loan balances modified were granted for commercial loan customers and the remaining modifications were granted to consumers, primarily for mortgage loans. The commercial modifications, which were concentrated in the hotel, restaurant and food service, dental and lessors of real estate industries, totaled $720 million, or 64 percent of the total modification balance.

Although the Corporation believes its underwriting and loan review procedures are appropriate for the various kinds of loans it makes, its results of operations and financial condition could be adversely affected in the event the quality of its loan portfolio declines. Deterioration in the economic environment including residential and commercial real estate values may result in increased levels of loan delinquencies and credit losses.

Provision and Allowance for Loan Losses

As noted in the "COVID-19, THE CARES ACT AND RELATED REGULATORY ACTIONS" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations, the Corporation elected to defer the adoption of CECL and to continue to use the incurred loss model for calculating the Allowance for Loan and Lease Losses. The allowance is maintained through the provision for loan losses, which is a charge against earnings. Based on management's judgment as to the appropriate level of the allowance for loan losses, the amount provided in any period may be greater or less than net loan losses for the same period. The determination of the provision amount and the adequacy of the allowance in any period is based on management's continuing review and evaluation of the loan portfolio, including an internally administered loan "watch" list and independent loan reviews. The evaluation also takes into consideration identified credit problems, portfolio growth, management's judgment as to the impact of current economic conditions on the portfolio and the possibility of losses inherent in the loan portfolio that are not specifically identified.

In conformance with ASC 805 and ASC 820, purchased loans are recorded at the acquisition date fair value. Such loans are included in the allowance to the extent a specific impairment is identified that exceeds the fair value adjustment on an impaired loan. An allowance may also be necessary if the historical loss and environmental factor analysis indicates losses inherent in a purchased portfolio exceed the fair value adjustment on the portion of the purchased portfolio not deemed impaired.

The Corporation's total loan balance increased $831.1 million from December 31, 2019 to $9.3 billion at June 30, 2020. PPP loans accounted for $882.9 million of the total loan balance at June 30, 2020. At June 30, 2020, the allowance for loan and lease losses totaled $121.1 million, which represents an increase of $21.7 million from March 31, 2020, and an increase of $40.8 million from December 31, 2019. As a percent of loans, the allowance for loan losses was 1.30 percent at June 30, 2020 compared to 1.15 percent at March 31, 2020 and 0.95 percent at December 31, 2019. When excluding PPP loans of $882.9 million, the allowance for loan losses as a percentage of total loans was 1.44 percent as of June 30, 2020. Under the terms of the PPP, the loans are fully guaranteed by the U.S. government.

The allowance was increased primarily due an increase in the national and local economic conditions qualitative factor and to an increase in impairment. Continuing uncertainty surrounding the current economic climate prompted by the COVID-19 pandemic and governmental actions taken to reduce the spread of the virus have contributed to a significantly higher level of unemployment which has negatively impacted consumer and business spending. In addition, impairment increased primarily due to specific reserves for three relationships that were moved to non-accrual during the second quarter of 2020. Impairment of $7.4 million was recorded on one university logo sports apparel relationship and $4.9 million was recorded for two senior living industry relationships. See discussion of the impact of the COVID-19 pandemic in the "COVID-19, THE CARES ACT AND RELATED REGULATORY ACTIONS" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

PART I: FINANCIAL INFORMATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The provision for loan losses for the three months and six months ended June 30, 2020 was $21.9 million and $41.6 million, respectively. Comparatively, the provision for loan losses for the three months and six months ended June 30, 2019 was $500,000 and $1.7 million, respectively. The year-over-year increase in the provision for loan losses primarily reflects our view of increased credit risk related to the COVID-19 pandemic. Specific reserves on impaired loans increased $12.3 million from $689,000 at December 31, 2019, to $13.0 million at June 30, 2020.

Net charge-offs totaling $230,000 and $812,000, respectively, were recognized for the three and six months ended June 30, 2020. Comparatively, net charge-offs totaled $128,000 and $978,000, respectively, for the same periods in 2019. For the three and six months ended June 30, 2020, there were no individual charge-offs or recoveries greater than $500,000. For the six months ended June 30, 2019, there were two individual charge-offs greater than $500,000 that totaled $1,954,000. For the three and six months ended June 30, 2019 there was one individual recovery of $738,000. The distribution of the net charge-offs (recoveries) for the three and six months ended June 30, 2020 and 2019 are reflected in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	2020	2019	2020	2019
Net charge-offs (Recoveries):				
Commercial and industrial loans	$ 31	$ (30)	$ 160	$ (153)
Agricultural production financing and other loans to farmers	(38)	(3)	5	16
Real estate loans:				
Construction	—	(738)	(37)	219
Commercial and farmland	(66)	961	36	948
Residential	38	(26)	31	54
Home equity	175	(28)	320	(69)
Individuals' loans for household and other personal expenditures	90	(8)	297	35
Public finance and other commercial loans	—	—	—	(72)
Total net charge-offs	$ 230	$ 128	$ 812	$ 978

Management continually evaluates the commercial loan portfolio 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 for loan losses 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 the Corporation ensures 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 the 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.

The principal source of asset-funded liquidity is investment securities classified as available for sale, the market values of which totaled $1.9 billion at June 30, 2020, an increase of $100.6 million, or 5.6 percent, from December 31, 2019. 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 and that are maturing in one year or less totaled $12.2 million at June 30, 2020. In addition, other types of assets such as cash and interest-bearing deposits with other banks, federal funds sold and loans maturing within one year are sources of liquidity.

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. Federal funds purchased and securities sold under agreements to repurchase are also considered a source of liquidity. In addition, FHLB advances are utilized as funding sources. At June 30, 2020, total borrowings from the FHLB were $400.8 million The Bank has pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at June 30, 2020 was $671.6 million.

The required payments related to operating leases and borrowings at June 30, 2020 are as follows:

(Dollars in Thousands)	Remaining 2020	2021	2022	2023	2024	2025 and after	ASC 805 fair value adjustments at acquisition	Total
Operating leases	$ 1,820	$ 3,453	$ 3,331	$ 2,937	$ 2,867	$ 10,277	$ —	$ 24,685
Securities sold under repurchase agreements	181,150	—	—	—	—	—	—	181,150
Federal Home Loan Bank advances	21,250	55,097	75,097	115,097	97	134,179	—	400,817
Subordinated debentures and other borrowings	—	—	166,936	—	—	122,012	(3,751)	285,197
Total	$ 204,220	$ 58,550	$ 245,364	$ 118,034	$ 2,964	$ 266,468	$ (3,751)	$ 891,849

The increase in subordinated debentures and other borrowings was a result of the Bank accessing the PPPL Facility to supplement liquidity to fund PPP loans. As of June 30, 2020, the outstanding balance of such borrowings was $166.9 million and the interest rate was fixed at 35 basis points. The term of the borrowings corresponded with the PPP loans that were pledged as collateral, which were all two year loans. The maturity date of the PPPL Facility borrowings accelerated if the underlying PPP loan was to go into default and the Bank was to sell the PPP loan to the SBA in order to realize the SBA's guarantee. Additionally, the maturity date of the PPPL Facility borrowings accelerated to the extent of any loan forgiveness reimbursement received by the Bank from the SBA. The PPPL Facility borrowings carried no prepayment penalty and the Bank chose to pay back all PPPL Facility borrowings during July of 2020.

On March 16, 2020, the Corporation partially redeemed $10.0 million of its subordinated debentures, with an interest rate of 3.45 percent, all of which were held by First Merchants Capital Trust II (“FMC Trust”). As a result, FMC Trust used the proceeds from such partial redemption to concurrently redeem a like amount of its capital securities at an aggregate principal redemption price of $10.0 million. Debentures issued by the Corporation in the principal amount of $41.7 million remain outstanding with a maturity date of September 15, 2037.

On April 23, 2020, the Corporation redeemed $10.0 million of its subordinated debentures, with an interest rate of 4.41 percent, all of which were held by Grabill Capital Trust I ("Grabill Trust"). As a result, Grabill Trust used the proceeds from such complete redemption to concurrently redeem all of its capital securities at an aggregate principal redemption price of $10.0 million. Subsequently, Grabill Trust was dissolved.

Also, 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. These activities primarily consist of traditional off-balance sheet credit-related financial instruments such as loan commitments and standby letters of credit.

Summarized credit-related financial instruments at June 30, 2020 are as follows:

(Dollars in Thousands)	June 30, 2020
Amounts of commitments:	
Loan commitments to extend credit	$ 3,147,145
Standby and commercial letters of credit	29,852
	$ 3,176,997

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.

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 management 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. Management believes that the Corporation's liquidity and interest sensitivity position at June 30, 2020, remained adequate to meet the Corporation’s primary goal of achieving optimum interest margins while avoiding undue interest rate risk.

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 twelve-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, interest-bearing and demand deposits, reflect management's best estimate of expected future behavior. Historical retention rate assumptions are applied to non-maturity deposits for modeling purposes.

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of June 30, 2020, 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 drivers are at or near historical lows due to the FOMC's rate reductions in March 2020 in response to COVID-19. Total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management have the following results:

	June 30, 2020	
	RISING	FALLING
Driver Rates	(200 Basis Points)	(100 Basis Points)
Prime	200	—
Federal funds	200	—
One-year CMT	200	(8)
Three-year CMT	200	—
Five-year CMT	200	—
CD's	200	(19)
FHLB advances	200	(1)

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 June 30, 2020. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

	June 30, 2020		
		RISING	FALLING
(Dollars in Thousands)	Base	(200 Basis Points)	(100 Basis Points)
Net interest income	$ 335,261	$ 357,664	$ 339,228
Variance from base		$ 22,403	$ 3,966
Percent of change from base		6.7%	1.2%

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of December 31, 2019, 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. 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:

	December 31, 2019	
	RISING	FALLING
Driver Rates	(200 Basis Points)	(100 Basis Points)
Prime	200	(100)
Federal funds	200	(100)
One-year CMT	200	(100)
Three-year CMT	200	(100)
Five-year CMT	200	(100)
CD's	200	(24)
FHLB advances	200	(89)

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 December 31, 2019. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

	December 31, 2019		
		RISING	FALLING
(Dollars in Thousands)	Base	(200 Basis Points)	(100 Basis Points)
Net interest income	$ 368,024	$ 389,367	$ 355,191
Variance from base		$ 21,343	$ (12,833)
Percent of change from base		5.8%	(3.5)%

PART I: FINANCIAL INFORMATION
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 June 30, 2020 and December 31, 2019. Earning assets increased by $1.3 billion during the six months ended June 30, 2020.

Interest-bearing time deposits and investment securities increased $261.8 million and $193.3 million, respectively, since December 31, 2019 primarily as a result of excess liquidity generated from deposit growth and additional wholesale funding during the same period. Also contributing to the increase in investment securities was a $46.7 million increase in net unrealized gains on the available for sale portfolio. The net increase in unrealized gains from December 31, 2019 to June 30, 2020 is primarily due to interest rate declines in 2020 as the longer term points on the yield curve have declined since year-end, which increases the fair value of securities in the portfolio.

Loans and loans held for sale increased $831.1 million from December 31, 2019. The Corporation originated approximately $882.9 million of PPP loans, which were primarily included in the commercial and industrial loan class. The largest loan segments that experienced a decrease was construction real estate and home equity loans. Additional details of the changes in the Corporation's loan portfolio are discussed within NOTE 4. LOANS AND ALLOWANCE of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

(Dollars in Thousands)	June 30, 2020	December 31, 2019
Interest-bearing time deposits	$ 380,021	$ 118,263
Investment securities available for sale	1,890,593	1,790,025
Investment securities held to maturity	898,786	806,038
Loans held for sale	901	9,037
Loans	9,298,541	8,459,310
Federal Home Loan Bank stock	28,736	28,736
Total	$ 12,497,578	$ 11,211,409

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 the Corporation, and that address is (http://www.sec.gov).

PART I: FINANCIAL INFORMATION
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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”.

PART I: FINANCIAL INFORMATION
ITEM 4. CONTROLS AND PROCEDURES

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.

PART II: OTHER INFORMATION
ITEM 1., ITEM 1A., ITEM 2., ITEM 3., ITEM 4. AND ITEM 5.
(table dollar amounts in thousands, except share data)

ITEM 1. LEGAL PROCEEDINGS

There are no pending legal proceedings, other than litigation incidental to the ordinary business of the Corporation or its subsidiaries, of a material nature to which the Corporation or its subsidiaries is a party or of which any of their properties are subject. Further, there are no material legal proceedings in which any director, officer, principal shareholder, or affiliate of the Corporation, or any associate of any such director, officer or principal shareholder, is a party, or has a material interest, adverse to the Corporation or any of its subsidiaries.

None of the routine legal proceedings, individually or in the aggregate, in which the Corporation or its affiliates are involved are expected to have a material adverse impact on the financial position or the results of operations of the Corporation.

ITEM 1A. RISK FACTORS

Except for the additional risk factors set forth below, there have been no material changes to the risk factors previously disclosed in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2019.

The ongoing COVID-19 pandemic and measures intended to prevent its spread have adversely impacted the Corporation’s business and financial results, and the ultimate impact will depend on future developments, which are highly uncertain and cannot be predicted, including the severity and duration of the pandemic and further actions taken by governmental authorities and other third parties to contain and treat the virus.

In March 2020, the World Health Organization declared novel coronavirus disease 2019 (COVID-19) as a global pandemic. Also in March 2020, the President of the Unites States declared the COVID-19 outbreak a national emergency. The health concerns relating to the COVID-19 outbreak and related governmental actions taken to reduce the spread of the virus have significantly impacted the global economy (including the states and local economies in which we operate), disrupted supply chains, lowered equity market valuations, and created significant volatility and disruption in financial markets. The outbreak has resulted in authorities implementing numerous measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter in place or total lock-down orders and business limitations and shutdowns. Such measures have significantly contributed to rising unemployment and negatively impacted consumer and business spending. As a result, the demand for the Corporation’s products and services has been, and will continue to be, significantly impacted. Furthermore, the pandemic has caused, and could continue to influence, the recognition of credit losses in the Corporation’s loan portfolios and increases in the Corporation’s allowance for credit losses as our customers are negatively impacted by the economic downturn. In addition, governmental actions have resulted in decreased interest rates and yields, which may lead to decreases in the Corporation’s net interest income and non-interest income.

As our banking regulators have encouraged us to work prudently with borrowers who are unable to meet their contractual payment obligations due to the effects of COVID-19, the Bank has implemented certain hardship relief programs (including payment deferrals, fee waivers, extensions of repayment terms, and other delays in payment). As a result, the Bank has made numerous short-term loan modifications for customers who are current and otherwise not past due. As provided under the CARES Act, these qualified loan modifications are currently exempt by law from classification as troubled debt restructures as defined by GAAP. The potential adverse impact resulting from the inability of customers to repay loans on a timely basis cannot be determined at this time. However, the extent of such impact, as reflected in the Corporation's financial statements, may be muted by these loan modifications, which would have the effect of delaying loan loss recognition until after any applicable deferral period.

The spread of COVID-19 has caused the Corporation to modify is business practices (including developing work from home and social distancing plans for our employees), and we may take further actions as may be required by government authorities or as we determine are in the best interests of our employees, customers and business partners. There is no certainty that such measures will be sufficient to mitigate the risks posed by the virus or will otherwise be satisfactory to government authorities. Furthermore, the Corporation’s business operations have been, and may again in the future be, disrupted due to vendors and third-party service providers being unable to work or provide services effectively, including because of illness, quarantines, government actions, or other restrictions in connection with the pandemic.

The extent to which the coronavirus outbreak impacts the Corporation’s business, results of operations and financial condition, as well as its regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain and are difficult to predict, including, but not limited to, the duration and spread of the outbreak, its severity, actions taken by governmental authorities and other third parties to contain and treat the virus, and how quickly and to what extent normal economic and operating conditions can resume. Moreover, the effects of the COVID-19 pandemic may heighten many of the other risks described in the section entitled “Risk Factors” in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2019, and any subsequent Quarterly Report on Form 10-Q or Current Report on Form 8-K. While we do not yet know the full extent of the COVID-19 impact, the negative effects on the Corporation’s business, results of operations and financial condition could be material.

PART II: OTHER INFORMATION
ITEM 1., ITEM 1A., ITEM 2., ITEM 3., ITEM 4. AND ITEM 5.
(table dollar amounts in thousands, except share data)

As a participating lender in the Small Business Administration's Paycheck Protection Program (the "PPP" or "program"), the Corporation and the Bank are subject to additional risks of litigation from the Bank's clients or other parties in connection with the Bank's processing of loans for the PPP and risks that the SBA may not fund some or all PPP loan guaranties.

On March 27, 2020, the CARES Act was enacted, which included a $349 billion loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses, eligible nonprofits and certain others can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. Under the terms of the program, loans are to be fully guaranteed by the SBA. The Bank is participating as a lender in the PPP. Because of the short timeframe between the passing of the CARES Act and the April 3, 2020 opening of the PPP, there is some ambiguity in the laws, rules and guidance regarding the operation of the program, which exposes the Corporation to risks relating to noncompliance with the PPP. On or about April 16, 2020, the SBA notified lenders that the $349 billion earmarked for the PPP was exhausted. Congress has approved additional funding for the program and the related new legislation was enacted on April 24, 2020. Since the opening of the PPP, several larger banks have been subject to litigation relating to the policies and procedures that they used in processing applications for the program. The Corporation and the Bank may be exposed to the risk of litigation: (1) from both customers and non-customers that have approached the Bank in connection with PPP loans and its policies and procedures used in processing applications for the program; and (2) from agents of the PPP borrowers claiming they are entitled to a portion of the Bank's loan processing fees as a result of their assisting borrowers with their PPP loan applications. If any such litigation is filed against the Corporation or the Bank and is not resolved in a manner favorable to the Corporation or the Bank, it may result in significant financial liability or adversely affect the Corporation's reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP-related litigation could have a material adverse impact on our business, financial condition and results of operations.

The Bank also has credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced by the Bank, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the program. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by the Corporation, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from the Bank.

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 three months ended June 30, 2020.

Period	Total Number of Shares Purchased (i)	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
April, 2020	—	$ —	—	—
May, 2020	—	$ —	—	—
June, 2020	304	$ 26.16	—	—

(i) The shares repurchased were pursuant to net settlement by employees in satisfaction of income tax withholding obligations incurred through the vesting of the Corporation's restricted stock awards.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

a. None

b. None

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PART II: OTHER INFORMATION
ITEM 6. EXHIBITS

ITEM 6. EXHIBITS

Exhibit No:	Description of Exhibits:
3.1	First Merchants Corporation Articles of Incorporation, as amended (Incorporated by reference to registrant's Form 8-K filed on May 2, 2017) (SEC No. 000-17071)
3.2	Bylaws of First Merchants Corporation dated August 11, 2016 (Incorporated by reference to registrant's Form 10-K filed on March 1, 2017) (SEC No. 000-17071)
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) (SEC No. 000-17071)
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007) (SEC No. 000-17071)
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007) (SEC No. 000-17071)
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) (SEC No. 000-17071)
4.5	First Merchants Corporation Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to registrant's Prospectus filed pursuant to Rule 424(b)(3) on July 17, 2020) (SEC No. 333-229527)
4.6	Upon request, the registrant agrees to furnish supplementally to the Commission a copy of the instruments defining the rights of holders of its (a) 5.00% Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of $5 million and (b) 6.75% Fixed-to-Floating Rate Subordinated Notes due 2028 in aggregate principal amount of $65 million.
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 (2)
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document (1)
101.SCH	Inline XBRL Taxonomy Extension Schema Document (1)
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document (1)
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document (1)
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document (1)
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document (1)
104	Cover Page Interactive Data File (formatted as Inline XBRL and included in Exhibit 101)

(1) Filed herewith.

(2) Furnished herewith.

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)
August 7, 2020	By: /s/ Michael C. Rechin Michael C. Rechin President and Chief Executive Officer (Principal Executive Officer)
August 7, 2020	By: /s/ Mark K. Hardwick Mark K. Hardwick Executive Vice President, Chief Financial Officer and Chief Operating Officer (Principal Financial and Accounting Officer)

PART II: OTHER INFORMATION
ITEM 6. EXHIBITS

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.

August 7, 2020

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

PART II: OTHER INFORMATION
ITEM 6. EXHIBITS

EXHIBIT-31.2

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

CERTIFICATION

I, Mark K. Hardwick, Executive Vice President, Chief Financial Officer and Chief Operating 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.

8/7/2020

By: /s/ Mark K. Hardwick
Mark K. Hardwick
Executive Vice President,
Chief Financial Officer and Chief Operating Officer
(Principal Financial and Accounting Officer)

PART II: OTHER INFORMATION
ITEM 6. EXHIBITS

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 June 30, 2020, 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.

August 7, 2020

By: /s/ Michael C. Rechin
Michael C. Rechin
President and
Chief Executive Officer
(Principal Executive 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.

In connection with the Quarterly Report of First Merchants Corporation (the “Corporation”) on Form 10-Q for the period ending June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Mark K. Hardwick, Executive Vice President, Chief Financial Officer and Chief Operating 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.

August 7, 2020

By: /s/ Mark K. Hardwick
Mark K. Hardwick
Executive Vice President,
Chief Financial Officer and Chief Operating 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.