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 September 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 November 2, 2020, there were 54,257,996 outstanding common shares of the registrant.

TABLE OF CONTENTS

FIRST MERCHANTS CORPORATION

		Page No.
Glossary of Defined Terms		3
Part I. Financial Information		
Item 1.	Financial Statements:	
	Consolidated Condensed Balance Sheets	4
	Consolidated Condensed Statements of Income	5
	Consolidated Condensed Statements of Comprehensive Income	6
	Consolidated Condensed Statements of Stockholders' Equity	7
	Consolidated Condensed Statements of Cash Flows	9
	Notes to Consolidated Condensed Financial Statements	10
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	42
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	61
Item 4.	Controls and Procedures	62
Part II. Other Information		
Item 1.	Legal Proceedings	63
Item 1A.	Risk Factors	63
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	64
Item 3.	Defaults Upon Senior Securities	64
Item 4.	Mine Safety Disclosures	64
Item 5.	Other Information	64
Item 6.	Exhibits	65
Signatures		66

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

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

CONSOLIDATED CONDENSED BALANCE SHEETS

	September 30, 2020 (Unaudited)	December 31, 2019
ASSETS		
Cash and cash equivalents	$ 164,632	$ 177,201
Interest-bearing deposits	273,936	118,263
Investment securities available for sale	1,824,160	1,790,025
Investment securities held to maturity (fair value of $1,152,518 and $827,566)	1,109,126	806,038
Loans held for sale	3,183	9,037
Loans, net of allowance for loan losses of $126,726 and $80,284	9,117,107	8,379,026
Premises and equipment	112,959	113,055
Federal Home Loan Bank stock	28,736	28,736
Interest receivable	52,992	48,901
Goodwill	543,918	543,918
Other intangibles	30,451	34,962
Cash surrender value of life insurance	291,543	288,206
Other real estate owned	6,942	7,527
Tax asset, deferred and receivable	21,762	12,165
Other assets	155,903	100,194
TOTAL ASSETS	$ 13,737,350	$ 12,457,254
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 2,187,607	$ 1,736,396
Interest-bearing	8,718,546	8,103,560
Total Deposits	10,906,153	9,839,956
Borrowings:		
Federal funds purchased	80,000	55,000
Securities sold under repurchase agreements	187,732	187,946
Federal Home Loan Bank advances	399,522	351,072
Subordinated debentures and other borrowings	118,320	138,685
Total Borrowings	785,574	732,703
Interest payable	5,038	6,754
Other liabilities	206,929	91,404
Total Liabilities	11,903,694	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, $0.125 stated value:		
Authorized - 100,000,000 shares		
Issued and outstanding - 53,891,733 and 55,368,482 shares	6,736	6,921
Additional paid-in capital	1,003,777	1,054,997
Retained earnings	757,550	696,520
Accumulated other comprehensive income	65,468	27,874
Total Stockholders' Equity	1,833,656	1,786,437
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 13,737,350	$ 12,457,254

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
INTEREST INCOME				
Loans receivable:				
Taxable	$ 84,162	$ 96,850	$ 268,126	$ 280,155
Tax exempt	5,395	4,500	16,069	12,897
Investment securities:				
Taxable	5,399	6,729	19,177	19,822
Tax exempt	10,931	8,335	30,285	22,660
Deposits with financial institutions	90	1,363	799	3,022
Federal Home Loan Bank stock	248	355	828	1,028
Total Interest Income	106,225	118,132	335,284	339,584
INTEREST EXPENSE				
Deposits	9,776	24,830	44,231	67,511
Federal funds purchased	5	15	118	225
Securities sold under repurchase agreements	83	385	527	1,057
Federal Home Loan Bank advances	1,749	1,894	5,317	5,400
Subordinated debentures and other borrowings	1,691	2,076	5,275	6,315
Total Interest Expense	13,304	29,200	55,468	80,508
NET INTEREST INCOME	92,921	88,932	279,816	259,076
Provision for loan losses	12,544	600	54,191	2,300
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	80,377	88,332	225,625	256,776
OTHER INCOME				
Service charges on deposit accounts	5,209	6,107	15,491	16,639
Fiduciary and wealth management fees	5,910	4,429	17,496	12,178
Card payment fees	3,996	5,158	16,000	14,813
Net gains and fees on sales of loans	5,841	2,227	12,878	5,258
Derivative hedge fees	1,715	1,684	4,696	3,952
Other customer fees	372	450	1,103	1,230
Increase in cash surrender value of life insurance	1,170	1,144	3,761	3,060
Gains on life insurance benefits	1	—	96	19
Net realized gains on sales of available for sale securities	1,817	393	9,497	3,376
Other income	132	524	1,425	1,918
Total Other Income	26,163	22,116	82,443	62,443
OTHER EXPENSES				
Salaries and employee benefits	39,187	38,942	114,128	104,679
Net occupancy	5,855	4,777	17,103	14,273
Equipment	4,956	4,030	13,789	11,789
Marketing	1,311	1,332	4,846	5,158
Outside data processing fees	3,776	4,435	10,593	12,048
Printing and office supplies	331	312	997	961
Intangible asset amortization	1,486	1,356	4,511	4,404
FDIC assessments	1,249	(668)	4,244	717
Other real estate owned and foreclosure expenses	717	294	1,906	2,362
Professional and other outside services	2,254	8,251	6,065	12,511
Other expenses	3,587	4,293	12,687	12,660
Total Other Expenses	64,709	67,354	190,869	181,562
INCOME BEFORE INCOME TAX	41,831	43,094	117,199	137,657
Income tax expense	5,621	6,337	13,734	21,027
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 36,210	$ 36,757	$ 103,465	$ 116,630
Per Share Data:				
Basic Net Income Available to Common Stockholders	$ 0.67	$ 0.71	$ 1.91	$ 2.33
Diluted Net Income Available to Common Stockholders	$ 0.67	$ 0.71	$ 1.91	$ 2.32
Cash Dividends Paid	$ 0.26	$ 0.26	$ 0.78	$ 0.74
Average Diluted Shares Outstanding (in thousands)	53,971	51,570	54,278	50,227

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	**2019**	**2020**	**2019**
Net income	$ 36,210	$ 36,757	$ 103,465	$ 116,630
Other comprehensive income (loss), net of tax:				
Unrealized holding gain (loss) on securities available for sale arising during the period, net of tax of $749, $3,034, $12,156, and $13,436	2,819	11,415	45,729	50,545
Unrealized gain (loss) on cash flow hedges arising during the period, net of tax of $1, $37, $305, and $267	7	(141)	(1,146)	(1,003)
Reclassification adjustment for net gains included in net income, net of tax of $320, $61, $1,857, and $657	(1,203)	(228)	(6,989)	(2,472)
Total other comprehensive income, net of tax	1,623	11,046	37,594	47,070
Comprehensive income	$ 37,833	$ 47,803	$ 141,059	$ 163,700

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Three Months Ended September 30, 2020							
	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Income	Total
Balances, June 30, 2020	125	$ 125	53,795,500	$ 6,724	$ 1,002,962	$ 735,439	$ 63,845	$ 1,809,095
Comprehensive income:								
Net income	—	—	—	—	—	36,210	—	36,210
Other comprehensive income, net of tax	—	—	—	—	—	—	1,623	1,623
Cash dividends on common stock ($.26 per share)	—	—	—	—	—	(14,099)	—	(14,099)
Share-based compensation	—	—	107,929	14	1,121	—	—	1,135
Stock issued under employee benefit plans	—	—	7,128	1	150	—	—	151
Stock issued under dividend reinvestment and stock purchase plan	—	—	17,541	2	428	—	—	430
Restricted shares withheld for taxes	—	—	(36,365)	(5)	(884)	—	—	(889)
Balances, September 30, 2020	125	$ 125	53,891,733	$ 6,736	$ 1,003,777	$ 757,550	$ 65,468	$ 1,833,656

	Three Months Ended September 30, 2019							
	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Loss	Total
Balances, June 30, 2019	125	$ 125	49,456,594	$ 6,182	$ 841,365	$ 639,362	$ 14,602	$ 1,501,636
Comprehensive income:								
Net income	—	—	—	—	—	36,757	—	36,757
Other comprehensive income, net of tax	—	—	—	—	—	—	11,046	11,046
Cash dividends on common stock ($.26 per share)	—	—	—	—	—	(12,946)	—	(12,946)
Issuance of common stock related to acquisition	—	—	6,383,806	798	229,128	—	—	229,926
Repurchases of common stock	—	—	(516,016)	(65)	(18,976)	—	—	(19,041)
Share-based compensation	—	—	4,405	—	1,062	—	—	1,062
Stock issued under employee benefit plans	—	—	4,870	1	155	—	—	156
Stock issued under dividend reinvestment and stock purchase plan	—	—	10,263	1	399	—	—	400
Stock options exercised	—	—	1,750	1	15	—	—	16
Balances, September 30, 2019	125	$ 125	55,345,672	$ 6,918	$ 1,053,148	$ 663,173	$ 25,648	$ 1,749,012

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

Nine Months Ended September 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	—	—	—	—	—	103,465	—	103,465
Other comprehensive income, net of tax	—	—	—	—	—	—	37,594	37,594
Cash dividends on common stock ($.78 per share)	—	—	—	—	—	(42,435)	—	(42,435)
Repurchases of common stock	—	—	(1,634,437)	(204)	(55,708)	—	—	(55,912)
Share-based compensation	—	—	116,520	15	3,553	—	—	3,568
Stock issued under employee benefit plans	—	—	18,639	2	458	—	—	460
Stock issued under dividend reinvestment and stock purchase plan	—	—	49,148	6	1,287	—	—	1,293
Stock options exercised	—	—	10,050	1	82	—	—	83
Restricted shares withheld for taxes	—	—	(36,669)	(5)	(892)	—	—	(897)
Balances, September 30, 2020	125	$ 125	53,891,733	$ 6,736	$ 1,003,777	$ 757,550	$ 65,468	$ 1,833,656

Nine Months Ended September 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	—	—	—	—	—	116,630	—	116,630
Other comprehensive loss, net of tax	—	—	—	—	—	—	47,070	47,070
Cash dividends on common stock ($.74 per share)	—	—	—	—	—	(36,793)	—	(36,793)
Issuance of common stock related to acquisition	—	—	6,383,806	798	229,128	—	—	229,926
Repurchase of common stock	—	—	(516,016)	(65)	(18,976)	—	—	(19,041)
Share-based compensation	—	—	113,043	14	2,873	—	—	2,887
Stock issued under employee benefit plans	—	—	16,117	2	516	—	—	518
Stock issued under dividend reinvestment and stock purchase plan	—	—	28,949	3	1,106	—	—	1,109
Stock options exercised	—	—	12,950	2	119	—	—	121
Restricted shares withheld for taxes	—	—	(42,977)	(5)	(1,670)	—	—	(1,675)
Balances, September 30, 2019	125	$ 125	55,345,672	$ 6,918	$ 1,053,148	$ 663,173	$ 25,648	$ 1,749,012

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended	
	September 30, 2020	September 30, 2019
Cash Flow From Operating Activities:		
Net income	$ 103,465	$ 116,630
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	54,191	2,300
Depreciation and amortization	8,214	6,737
Change in deferred taxes	(17,015)	(1,097)
Share-based compensation	3,568	2,887
Loans originated for sale	(477,877)	(361,054)
Proceeds from sales of loans held for sale	494,945	362,084
Gains on sales of loans held for sale	(11,214)	(4,162)
Gains on sales of securities available for sale	(9,497)	(3,376)
Increase in cash surrender of life insurance	(3,761)	(3,060)
Gains on life insurance benefits	(96)	(19)
Change in interest receivable	(4,091)	(1,681)
Change in interest payable	(1,716)	2,191
Other adjustments	6,111	18,149
Net cash provided by operating activities	145,227	136,529
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	(155,673)	88,090
Purchases of:		
Securities available for sale	(355,407)	(435,804)
Securities held to maturity	(507,091)	(397,166)
Proceeds from sales of securities available for sale	206,704	102,840
Proceeds from maturities of:		
Securities available for sale	230,673	89,603
Securities held to maturity	201,272	67,791
Net change in loans	(793,033)	(352,716)
Net cash and cash equivalents received in acquisition	—	10,207
Proceeds from the sale of other real estate owned	959	1,571
Proceeds from life insurance benefits	520	816
Other adjustments	(8,380)	(6,064)
Net cash used in investing activities	(1,179,456)	(830,832)
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	1,651,095	729,495
Certificates of deposit and other time deposits	(584,898)	175,437
Borrowings	563,697	535,239
Repayment of borrowings	(510,826)	(626,971)
Cash dividends on common stock	(42,435)	(36,793)
Stock issued under employee benefit plans	460	518
Stock issued under dividend reinvestment and stock purchase plans	1,293	1,109
Stock options exercised	83	121
Restricted shares withheld for taxes	(897)	(1,675)
Repurchase of common stock	(55,912)	(19,041)
Net cash provided by financing activities	1,021,660	757,439
Net Change in Cash and Cash Equivalents	(12,569)	63,136
Cash and Cash Equivalents, January 1	177,201	139,247
Cash and Cash Equivalents, September 30	$ 164,632	$ 202,383
Additional cash flow information:		
Interest paid	$ 57,184	$ 78,260
Income tax paid (refunded)	32,367	19,335
Loans transferred to other real estate owned	761	6,902
Fixed assets transferred to other real estate owned	262	965
Non-cash investing activities using trade date accounting	66,205	13,893
ROU assets obtained in exchange for new operating lease liabilities	1,406	23,496
In conjunction with the acquisitions, liabilities were assumed as follows:		
Fair value of assets acquired	$ —	$ 1,450,741
Cash paid in acquisition	—	(15)
Less: Common stock issued	—	229,926
Liabilities assumed	$ —	$ 1,220,800

See NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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 nine months ended September 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 during 2020. 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 beginning 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.

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

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 consolidated financial statements.

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. At September 30, 2020, the Corporation performed a goodwill impairment test which included various valuation considerations including comparable peer data, precedent transaction comparables, discounted cash flow analysis, overall financial performance, share price of the Corporation's common stock and other factors. The testing resulted in a conclusion that it was not more likely than not that the fair value of the Corporation had declined below its carrying value; therefore, goodwill was not impaired at September 30, 2020. Goodwill assessments are highly sensitive to economic projections and the related assumptions used by management. In the event of a prolonged economic downturn or further deterioration in the economic outlook, continued assessments of our goodwill balance will likely be required in future periods. Details of the goodwill impairment test 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 troubled debt restructure 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 has offered short-term modifications made in response to COVID-19 to borrowers who were current and otherwise not past due. These included 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. As of September 30, 2020, approximately $176 million of loan balances remained in deferral. 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 of this Form 10-Q.

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 first, second and third quarter 2020 financial statements have been prepared under the existing incurred loss model. As the temporary relief applicable to the Corporation’s compliance with CECL will end no later than December 31, 2020, the Corporation will implement CECL during the fourth quarter of 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. As the temporary relief applicable to the Corporation’s compliance with CECL will end no later than December 31, 2020, the Corporation will implement CECL during the fourth quarter of 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 and move 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.

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 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.

	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

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 September 30, 2020				
U.S. Treasury	$ 300	$ —	$ —	$ 300
U.S. Government-sponsored agency securities	2,384	60	—	2,444
State and municipal	1,074,381	72,752	187	1,146,946
U.S. Government-sponsored mortgage-backed securities	645,089	25,306	—	670,395
Corporate obligations	4,031	44	—	4,075
Total available for sale	1,726,185	98,162	187	1,824,160
Held to maturity at September 30, 2020				
U.S. Government-sponsored agency securities	21,094	2	33	21,063
State and municipal	573,538	25,880	1,240	598,178
U.S. Government-sponsored mortgage-backed securities	512,994	18,788	3	531,779
Foreign investment	1,500	—	2	1,498
Total held to maturity	1,109,126	44,670	1,278	1,152,518
Total Investment Securities	$ 2,835,311	$ 142,832	$ 1,465	$ 2,976,678

	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 September 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.

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

The amortized cost and fair value of available for sale and held to maturity securities at September 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 September 30, 2020:				
Due in one year or less	$ 1,649	$ 1,659	$ 9,677	$ 9,758
Due after one through five years	4,571	4,728	25,872	26,925
Due after five through ten years	58,644	61,968	106,342	112,055
Due after ten years	1,016,232	1,085,410	454,241	472,001
	1,081,096	1,153,765	596,132	620,739
U.S. Government-sponsored mortgage-backed securities	645,089	670,395	512,994	531,779
Total Investment Securities	$ 1,726,185	$ 1,824,160	$ 1,109,126	$ 1,152,518

	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 $989,906,000 at September 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 September 30, 2020 compared to December 31, 2019.

The book value of securities sold under agreements to repurchase amounted to $177,543,000 at September 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 nine months ended September 30, 2020 and 2019 are shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Sales and Redemptions of Available for Sale Securities:				
Gross gains	$ 1,836	$ 393	$ 9,516	$ 3,376
Gross losses	19	—	19	—

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 September 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 September 30, 2020						
State and municipal	$ 22,515	$ 187	$ —	$ —	$ 22,515	$ 187
Total Temporarily Impaired Available for Sale Securities	22,515	187	—	—	22,515	187
Temporarily Impaired Held to Maturity Securities at September 30,2020						
U.S. Government-sponsored agency securities	20,961	33	—	—	20,961	33
State and municipal	101,136	1,240	—	—	101,136	1,240
U.S. Government-sponsored mortgage-backed securities	10,284	3	—	—	10,284	3
Foreign investment	1,498	2	—	—	1,498	2
Total Temporarily Impaired Held to Maturity Securities	133,879	1,278	—	—	133,879	1,278
Total Temporarily Impaired Investment Securities	$ 156,394	$ 1,465	$ —	$ —	$ 156,394	$ 1,465

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

	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.

	September 30, 2020	December 31, 2019
Investments reported at less than historical cost:		
Historical cost	$ 157,859	$ 398,172
Fair value	156,394	395,416
Gross unrealized losses	$ 1,465	$ 2,756
Percent of the Corporation's investment portfolio	9.4 %	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 September 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, U.S. Government-Sponsored Agency Securities and Foreign Investment Securities

The unrealized losses on the Corporation's investments in securities of state and political subdivisions, U.S. Government-Sponsored Agency securities and foreign investment securities 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 September 30, 2020. The state and municipal securities portfolio contains unrealized losses of $187,000 on thirteen securities and $1,240,000 on seventy-one securities in the available for sale and held to maturity portfolios, respectively. At September 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. The U.S. Government-Sponsored Agency securities portfolio contains no unrealized losses in the available for sale portfolio, and unrealized losses of $33,000 on two securities in the held to maturity portfolio. The foreign investment securities portfolio contains no unrealized losses in the available for sale portfolio, and an unrealized loss of $2,000 on one security in the held to maturity portfolio.

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 September 30, 2020. The mortgage-backed securities portfolio contains no unrealized losses in the available for sale portfolio, and an unrealized loss of $3,000 on one security 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.

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 September 30, 2020, and December 31, 2019, were $3,183,000 and $9,037,000, respectively.

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

	September 30, 2020	December 31, 2019
Commercial and industrial loans	$ 2,875,331	$ 2,109,879
Agricultural production financing and other loans to farmers	83,090	93,861
Real estate loans:		
Construction	622,084	787,568
Commercial and farmland	3,248,506	3,052,698
Residential	1,146,406	1,143,217
Home equity	527,458	588,984
Individuals' loans for household and other personal expenditures	125,411	135,989
Public finance and other commercial loans	615,547	547,114
Loans	9,243,833	8,459,310
Allowance for loan losses	(126,726)	(80,284)
Net Loans	$ 9,117,107	$ 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 as, in accordance with the terms of the PPP, the loans are fully guaranteed by the SBA. As of September 30, 2020, the Bank had funded over 5,200 PPP loans, primarily in the commercial and industrial loan class, totaling $901.4 million, net of deferred processing fees and costs of $21.5 million. The Bank borrowed from the Paycheck Protection Program Liquidity Facility ("PPPL Facility") to supplement liquidity to fund the PPP loans in the second quarter 2020. At September 30, 2020, the Corporation did not have an outstanding balance with the PPPL Facility.

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. As the temporary relief applicable to the Corporation's compliance with CECL will end no later than December 31, 2020, the Corporation will implement CECL during the fourth quarter of 2020.

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

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 September 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.

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

	Three Months Ended September 30, 2020				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for loan losses:					
Balances, June 30, 2020	$ 44,678	$ 46,918	$ 8,445	$ 21,078	$ 121,119
Provision for losses	7,299	2,990	971	1,284	12,544
Recoveries on loans	197	46	54	130	427
Loans charged off	(6,827)	—	(92)	(445)	(7,364)
Balances, September 30, 2020	$ 45,347	$ 49,954	$ 9,378	$ 22,047	$ 126,726

	Nine Months Ended September 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	19,240	21,129	5,678	8,144	54,191
Recoveries on loans	746	271	152	248	1,417
Loans charged off	(7,541)	(224)	(487)	(914)	(9,166)
Balances, September 30, 2020	$ 45,347	$ 49,954	$ 9,378	$ 22,047	$ 126,726

	Three Months Ended September 30, 2019				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for loan losses:					
Balances, June 30, 2019	$ 33,202	$ 29,531	$ 4,070	$ 14,471	$ 81,274
Provision for losses	130	370	40	60	600
Recoveries on loans	149	143	105	199	596
Loans charged off	(480)	(1,078)	(109)	(232)	(1,899)
Balances, September 30, 2019	$ 33,001	$ 28,966	$ 4,106	$ 14,498	$ 80,571

	Nine Months Ended September 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	466	1,459	181	194	2,300
Recoveries on loans	1,035	1,166	323	511	3,035
Loans charged off	(1,157)	(3,268)	(362)	(529)	(5,316)
Balances, September 30, 2019	$ 33,001	$ 28,966	$ 4,106	$ 14,498	$ 80,571

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

	September 30, 2020				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance Balances:					
Individually evaluated for impairment	$ 601	$ 7,981	$ —	$ 557	$ 9,139
Collectively evaluated for impairment	44,746	41,973	9,378	21,490	117,587
Total Allowance for Loan Losses	$ 45,347	$ 49,954	$ 9,378	$ 22,047	$ 126,726
Loan Balances:					
Individually evaluated for impairment	$ 4,837	$ 44,203	$ 3	$ 3,441	$ 52,484
Collectively evaluated for impairment	3,568,432	3,819,629	125,408	1,670,423	9,183,892
Loans acquired with deteriorated credit quality	699	6,758	—	—	7,457
Loans	$ 3,573,968	$ 3,870,590	$ 125,411	$ 1,673,864	$ 9,243,833

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

	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 $3,738,000 with $116,000 of related allowance for loan losses at September 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.

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

	September 30, 2020	December 31, 2019
Commercial and industrial loans	$ 5,947	$ 1,255
Agriculture production financing and other loans to farmers	—	183
Real estate loans:		
Construction	126	977
Commercial and farmland	43,030	7,007
Residential	4,914	5,062
Home equity	2,674	1,421
Individuals' loans for household and other personal expenditures	48	44
Public finance and other commercial loans	—	—
Total	$ 56,739	$ 15,949

Non-accrual loans increased $40.8 million from December 31, 2019. An increase of $36.0 million was attributed to the commercial and farmland segment, specifically non-owner occupied commercial real estate, as three relationships were moved to non-accrual during the second and third quarters of 2020. These three relationships involve four properties, three of which total $31.2 million in the senior living sector and the fourth totaled $3.4 million in the self-storage sector. Additionally, $4.7 million of the increase in non-accrual loans was in the commercial and industrial loans segment. This largest portion of this increase was due to the addition of a $2.8 million loan 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:

	September 30, 2020		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	$ 10,975	$ 3,819	$ —
Agriculture production financing and other loans to farmers	63	—	—
Real estate Loans:			
Commercial and farmland	12,385	10,782	—
Residential	74	58	—
Individuals' loans for household and other personal expenditures	3	3	—
Total	$ 23,500	$ 14,662	$ —
Impaired loans with related allowance:			
Commercial and industrial loans	$ 1,019	$ 1,018	$ 601
Real estate Loans:			
Commercial and farmland	34,207	33,421	7,981
Residential	3,045	2,908	475
Home equity	501	475	82
Total	$ 38,772	$ 37,822	$ 9,139
Total Impaired Loans	$ 62,272	$ 52,484	$ 9,139

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

	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 September 30, 2020		Nine Months Ended September 30, 2020	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	$ 8,625	$ —	$ 9,225	$ —
Real estate Loans:				
Commercial and farmland	10,812	37	11,059	113
Residential	58	1	59	2
Individuals' loans for household and other personal expenditures	3	—	3	—
Total	$ 19,498	$ 38	$ 20,346	$ 115
Impaired loans with related allowance:				
Commercial and industrial loans	$ 1,018	$ —	$ 1,018	$ —
Real estate Loans:				
Commercial and farmland	33,390	—	33,543	—
Residential	2,921	18	2,951	53
Home equity	482	4	488	11
Total	$ 37,811	$ 22	$ 38,000	$ 64
Total Impaired Loans	$ 57,309	$ 60	$ 58,346	$ 179

	Three Months Ended September 30, 2019		Nine Months Ended September 30, 2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	$ 877	$ —	$ 881	$ —
Agriculture production financing and other loans to farmers	1,012	—	1,014	—
Real estate Loans:				
Construction	—	—	339	—
Commercial and farmland	8,075	39	8,651	117
Residential	189	—	190	2
Total	$ 10,153	$ 39	$ 11,075	$ 119
Impaired loans with related allowance:				
Commercial and industrial loans	$ 329	$ —	$ 329	$ —
Agriculture production financing and other loans to farmers	2,100	—	2,123	—
Real estate Loans:				
Commercial and farmland	1,324	—	1,324	—
Residential	2,072	15	2,095	47
Home equity	346	3	350	9
Individuals' loans for household and other personal expenditures	4	—	5	—
Total	$ 6,175	$ 18	$ 6,226	$ 56
Total Impaired Loans	$ 16,328	$ 57	$ 17,301	$ 175

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

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.

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

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.

	September 30, 2020							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	$ 2,651,863	$ 130,786	$ 92,682	$ —	$ —	$ —	$ —	$ 2,875,331
Agriculture production financing and other loans to farmers	70,380	4,810	7,900	—	—	—	—	83,090
Real estate Loans:								
Construction	570,635	10,830	14,362	—	—	26,135	122	622,084
Commercial and farmland	3,018,791	109,661	118,721	—	—	1,333	—	3,248,506
Residential	195,916	1,522	6,337	—	—	938,731	3,900	1,146,406
Home equity	14,218	57	929	—	—	509,676	2,578	527,458
Individuals' loans for household and other personal expenditures	—	—	—	—	—	125,363	48	125,411
Public finance and other commercial loans	615,473	74	—	—	—	—	—	615,547
Loans	$ 7,137,276	$ 257,740	$ 240,931	$ —	$ —	$ 1,601,238	$ 6,648	$ 9,243,833

	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

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

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

	September 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	$ 2,864,852	$ 4,529	$ —	$ 3	$ 5,947	$ 10,479	$ 2,875,331
Agriculture production financing and other loans to farmers	81,990	—	—	1,100	—	1,100	83,090
Real estate loans:							
Construction	614,383	7,575	—	—	126	7,701	622,084
Commercial and farmland	3,194,394	964	9,978	140	43,030	54,112	3,248,506
Residential	1,137,688	2,743	1,000	61	4,914	8,718	1,146,406
Home equity	522,680	1,467	611	26	2,674	4,778	527,458
Individuals' loans for household and other personal expenditures	124,926	249	188	—	48	485	125,411
Public finance and other commercial loans	615,547	—	—	—	—	—	615,547
Loans	$ 9,156,460	$ 17,527	$ 11,777	$ 1,330	$ 56,739	$ 87,373	$ 9,243,833

	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 total loan delinquencies has increased $14.7 million during the first nine months of 2020. The increases were primarily related to the 60-89 days past due commercial and farmland category, which increased $9.9 million due to one relationship, and the 30-59 days past due construction category, which increased $5.9 million due primarily to one $7.5 million relationship.

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 troubled debt restructure 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 has offered short-term modifications made in response to COVID-19 to borrowers who were current and otherwise not past due. These included 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. These loans are not considered troubled debt restructures under the applicable guidance at September 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 of 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.

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

	Three Months Ended September 30, 2020			Nine Months Ended September 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
Real estate loans:						
Commercial and farmland	—	—	—	565	565	2
Residential	2,314	2,326	30	2,614	2,663	36
Home equity	307	307	2	307	307	2
Individuals' loans for household and other personal expenditures	19	19	2	19	19	2
Total	$ 2,640	$ 2,652	34	$ 4,159	$ 4,208	45

	Three Months Ended September 30, 2019			Nine Months Ended September 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	$ 195	$ 185	3	$ 456	$ 439	8
Total	$ 195	$ 185	3	$ 456	$ 439	8

Loans secured by residential real estate made up 88 percent and 63 percent of the post-modification balance of troubled debt restructured loans made in the three and nine months ended September 30, 2020, respectively. 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 nine months ended September 30, 2019.

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

	Three Months Ended September 30, 2020			
	Term Modification	Rate Modification	Combination	Total Modification
Real estate loans:				
Residential	$ 2,266	$ 51	$ —	$ 2,317
Home equity	212	95	—	307
Individuals' loans for household and other personal expenditures	17	—	—	17
Total	$ 2,495	$ 146	$ —	$ 2,641

	Nine Months Ended September 30, 2020			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	$ 585	$ —	$ —	$ 585
Real estate loans:				
Commercial and farmland	106	—	—	106
Residential	2,266	161	221	2,648
Home Equity	212	95	—	307
Individuals' loans for household and other personal expenditures	17	—	—	17
Total	$ 3,186	$ 256	$ 221	$ 3,663

	Three Months Ended September 30, 2019			
	Term Modification	Rate Modification	Combination	Total Modification
Real estate loans:				
Residential	$ —	$ —	$ 184	$ 184
Total	$ —	$ —	$ 184	$ 184

	Nine Months Ended September 30, 2019			
	Term Modification	Rate Modification	Combination	Total Modification
Real estate loans:				
Residential	$ —	$ 88	$ 345	$ 433
Total	$ —	$ 88	$ 345	$ 433

The following tables summarize troubled debt restructures that occurred during the twelve months ended September 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 September 30, 2020		Nine Months Ended September 30, 2020	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Commercial and industrial loans	1	$ 317	2	$ 585
Real estate loans:				
Commercial and farmland	1	106	1	106
Total	2	$ 423	3	$ 691

	Three Months Ended September 30, 2019		Nine Months Ended September 30, 2019	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Real estate loans:				
Commercial and farmland	1	$ 85	1	$ 85
Total	1	$ 85	1	$ 85

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 $5,059,000 and $1,033,000 at September 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 September 30, 2020 was $11.2 million with allowance for loan loss of $116,000. 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 September 30, 2020	Nine Months Ended September 30, 2020
Accretable yield beginning balance	$ 1,546	$ 2,132
Additions	—	$ —
Accretion	(793)	(2,211)
Reclassification from nonaccretable	511	1,350
Disposals	—	(7)
Accretable yield ending balance	$ 1,264	$ 1,264

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Accretable yield beginning balance	$ 1,914	$ 2,143
Additions	576	576
Accretion	(420)	(1,638)
Reclassification from nonaccretable	374	1,363
Disposals	(165)	(165)
Accretable yield ending balance	$ 2,279	$ 2,279

The following table presents loans acquired, as of the acquisition date, during the nine months ended September 30, 2019, for which it was probable that all contractually required payments would not be collected. There were no loans acquired during the nine months ended September 30, 2020.

	MBT
Contractually required payments receivable at acquisition date	$ 6,840
Nonaccretable difference	2,733
Expected cash flows at acquisition date	4,107
Accretable difference	576
Basis in loans at acquisition date	$ 3,531

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 September 30, 2020.

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

The Corporation reviews goodwill annually for impairment, or more frequently if events or circumstances indicate the carrying value might be impaired. The impairment analysis compares the estimated fair value of the Corporation (the reporting unit) with the Corporation's net book value. The Corporation performed its annual impairment test of goodwill as of October 1, 2019. On January 1, 2020, the Corporation adopted ASU No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill*. Subsequent to the October 1, 2019 impairment test and adoption of ASU 2017-04, the Corporation experienced a decline in market capitalization as a result of a decline in the share price of the Corporation's common stock. At March 31, 2020 and June 30, 2020, the Corporation assessed the economic impact and market conditions from the COVID-19 pandemic. Additionally, the Corporation assessed the general uncertainty as to the full extent of the COVID-19 pandemic and its effect on economic recovery and concluded goodwill was not impaired in either period.

At September 30, 2020, the Corporation performed an additional goodwill impairment test which included various valuation considerations including comparable peer data, precedent transaction comparables, discounted cash flow analysis, overall financial performance, share price of the Corporation's common stock and other factors. The testing resulted in a conclusion that it was not more likely than not that the fair value of the Corporation had declined below its carrying value; therefore, goodwill was not impaired at September 30, 2020. Goodwill assessments are highly sensitive to economic projections and the related assumptions used by management. In the event of a prolonged economic downturn or further deterioration in the economic outlook, continued assessments of our goodwill balance will likely be required in future periods.

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.

	September 30, 2020	December 31, 2019
Gross carrying amount	$ 102,396	$ 85,869
Core deposit intangibles acquired	—	16,527
Accumulated amortization	(71,945)	(67,434)
Total core deposit intangibles	$ 30,451	$ 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 nine months ended September 30, 2020 was $1,486,000 and $4,511,000, respectively, compared to $1,356,000 and $4,404,000, respectively, for the three and nine months ended September 30, 2019. Estimated future amortization expense is summarized as follows:

	Amortization Expense
2020	$ 1,476
2021	5,429
2022	5,027
2023	4,827
2024	4,241
After 2024	9,451
	$ 30,451

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 September 30, 2020, the Corporation had three interest rate swaps with a notional amount of $36.0 million that were designated as cash flow hedges. As of 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. A $10.0 million interest rate swap used to hedge the variable cash outflows associated with a Federal Home Loan Bank advance matured in the third quarter of 2020.

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 $10.0 million of interest rate swaps were used to hedge the variable cash outflows (LIBOR-based) associated with one Federal Home Loan Bank advance. During the three and nine months ended September 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 $1,016,000 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 September 30, 2020 and December 31, 2019, the notional amount of customer-facing swaps was approximately $878,640,000 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 September 30, 2020, and December 31, 2019.

	Asset Derivatives				Liability Derivatives			
	September 30, 2020		December 31, 2019		September 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	$ 2,244	Other Liabilities	$ 1,444
Derivatives not designated as hedging instruments:								
Interest rate contracts	Other Assets	$ 82,010	Other Assets	$ 27,855	Other Liabilities	$ 82,010	Other Liabilities	$ 27,855

The Corporation's derivative asset and derivative liability relating to interest rate contracts increased $54.2 million and $55.0 million, respectively, from December 31, 2019. The increases are primarily due to a $176.4 million increase in the related outstanding notional balance. Additionally, yield curve rates used for valuation purposes were lower at each term point as of September 30, 2020 compared to December 31, 2019. This was primarily the result of investors seeking the safety of U.S. Treasuries, coupled with Federal Reserve purchases 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		Nine Months Ended	
Derivatives in Cash Flow Hedging Relationships	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Interest Rate Products	$ 8	$ (178)	$ (1,451)	$ (1,270)

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 nine months ended September 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 September 30, 2020	Three Months Ended September 30, 2019
Interest rate contracts	Interest Expense	$ (294)	$ (104)

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)	
		Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019
Interest rate contracts	Interest Expense	$ (651)	$ (247)

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 September 30, 2020, the termination value of derivatives in a net liability position related to these agreements was $81,962,000. As of September 30, 2020, the Corporation has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of $75,415,000. While the Corporation did not breach any of these provisions as of September 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.

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

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.

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 September 30, 2020, and December 31, 2019.

		Fair Value Measurements Using:		
September 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	$ 300	$ —	$ 300	$ —
U.S. Government-sponsored agency securities	2,444	—	2,444	—
State and municipal	1,146,946	—	1,144,494	2,452
U.S. Government-sponsored mortgage-backed securities	670,395	—	670,391	4
Corporate obligations	4,075	—	4,044	31
Interest rate swap asset	82,010	—	82,010	—
Interest rate swap liability	84,254	—	84,254	—

		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 September 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 nine months ended September 30, 2020 and 2019.

	Available for Sale Securities			
	Three Months Ended		Nine Months Ended	
	September 30, 2020	**September 30, 2019**	**September 30, 2020**	**September 30, 2019**
Balance at beginning of the period	$ 2,500	$ 2,975	$ 2,892	$ 3,328
Included in other comprehensive income	75	6	25	85
Principal payments	(88)	(85)	(430)	(517)
Ending balance	$ 2,487	$ 2,896	$ 2,487	$ 2,896

Transfers Between Levels

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

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 September 30, 2020, and December 31, 2019.

		Fair Value Measurements Using		
September 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)	$ 34,418	$ —	$ —	$ 34,418
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.

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 September 30, 2020 and December 31, 2019.

September 30, 2020	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	$ 2,452	Discounted cash flow	Maturity/Call date	1 month to 15 years
			US Muni BQ curve	A- to BBB-
			Discount rate	1.5% - 4%
			Weighted-average coupon	4 %
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)	$ 34,418	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 10%
			Weighted-average discount by loan balance	7%
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 years
			US Muni BQ curve	A- to BBB-
			Discount rate	2% - 5%
			Weighted-average coupon	4 %
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.

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 September 30, 2020, and December 31, 2019.

	September 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	$ 164,632	$ 164,632	$ —	$ —
Interest-bearing deposits	273,936	273,936	—	—
Investment securities available for sale	1,824,160	—	1,821,673	2,487
Investment securities held to maturity	1,109,126	—	1,131,014	21,504
Loans held for sale	3,183	—	3,183	—
Loans	9,117,107	—	—	9,198,466
Federal Home Loan Bank stock	28,736	—	28,736	—
Interest rate swap asset	82,010	—	82,010	—
Interest receivable	52,992	—	52,992	—
Liabilities:				
Deposits	$ 10,906,153	$ 9,797,840	$ 1,108,656	$ —
Borrowings:				
Federal funds purchased	80,000	—	80,000	—
Securities sold under repurchase agreements	187,732	—	187,732	—
Federal Home Loan Bank advances	399,522	—	413,532	—
Subordinated debentures and other borrowings	118,320	—	108,427	—
Interest rate swap liability	84,254	—	84,254	—
Interest payable	5,038	—	5,038	—

	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 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	—

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

NOTE 10

TRANSFERS ACCOUNTED FOR AS SECURED BORROWINGS

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

	September 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	$ 186,081	$ —	$ 1,651	$ —	$ 187,732

	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 September 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	45,729	(1,146)	—	44,583
Amounts reclassified from accumulated other comprehensive income	(7,503)	514	—	(6,989)
Period change	38,226	(632)	—	37,594
Balance at September 30, 2020	$ 77,098	$ (1,773)	$ (9,857)	$ 65,468
Balance at December 31, 2018	$ (6,343)	$ (559)	$ (14,520)	$ (21,422)
Other comprehensive income before reclassifications	50,545	(1,003)	—	49,542
Amounts reclassified from accumulated other comprehensive income	(2,667)	195	—	(2,472)
Period change	47,878	(808)	—	47,070
Balance at September 30, 2019	$ 41,535	$ (1,367)	$ (14,520)	$ 25,648

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 nine months ended September 30, 2020 and 2019.

	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Three Months Ended September 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	$ 1,817	$ 393	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(382)	(83)	Income tax expense
	$ 1,435	$ 310	
Unrealized gains (losses) on cash flow hedges [2]			
Interest rate contracts	$ (294)	$ (104)	Interest expense - subordinated debentures and term loans
Related income tax benefit	62	22	Income tax expense
	$ (232)	$ (82)	
Total reclassifications for the period, net of tax	$ 1,203	$ 228	

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

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Nine Months Ended September 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	$ 9,497	$ 3,376	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(1,994)	(709)	Income tax expense
	$ 7,503	$ 2,667	
Unrealized gains (losses) on cash flow hedges [2]			
Interest rate contracts	$ (651)	$ (247)	Interest expense - subordinated debentures and term loans
Related income tax benefit	137	52	Income tax expense
	$ (514)	$ (195)	
Total reclassifications for the period, net of tax	$ 6,989	$ 2,472	

[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 nine months ended September 30, 2020 was $1,135,000 and $3,568,000, respectively, compared to $1,062,000 and $2,887,000, respectively, for the three and nine months ended September 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 nine months ended September 30, 2020, based on historical experience.

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 September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Stock and ESPP Options				
Pre-tax compensation expense	$ 23	$ 36	$ 76	$ 72
Income tax expense (benefit)	—	—	(29)	(57)
Stock and ESPP option expense, net of income taxes	$ 23	$ 36	$ 47	$ 15
Restricted Stock Awards				
Pre-tax compensation expense	$ 1,112	$ 1,026	$ 3,492	$ 2,815
Income tax expense (benefit)	149	(226)	(344)	(951)
Restricted stock awards expense, net of income taxes	$ 1,261	$ 800	$ 3,148	$ 1,864
Total Share-Based Compensation				
Pre-tax compensation expense	$ 1,135	$ 1,062	$ 3,568	$ 2,887
Income tax expense (benefit)	149	(226)	(373)	(1,008)
Total share-based compensation expense, net of income taxes	$ 1,284	$ 836	$ 3,195	$ 1,879

As of September 30, 2020, unrecognized compensation expense related to RSAs was $7,726,000 and is expected to be recognized over a weighted-average period of 1.91 years. The Corporation did not have any unrecognized compensation expense related to stock options as of September 30, 2020.

Stock option activity under the Corporation's stock option plans as of September 30, 2020 and changes during the nine months ended September 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 September 30, 2020	49,300	$ 14.57	2.06	$ 423,463
Vested and Expected to Vest at September 30,2020	49,300	$ 14.57	2.06	$ 423,463
Exercisable at September 30, 2020	49,300	$ 14.57	2.06	$ 423,463

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the first nine months of 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 September 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 nine months ended September 30, 2020 and 2019 was $197,000 and $355,000, respectively. Cash receipts of stock options exercised during this same period were $83,000 and $121,000, respectively.

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

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested RSAs at January 1, 2020	351,048	$ 40.67
Granted	135,292	$ 26.89
Vested	(116,520)	$ 40.46
Forfeited	(525)	$ 40.44
Unvested RSAs at September 30, 2020	369,295	$ 36.17

The grant date fair value of ESPP options was estimated to be approximately $23,000 at the beginning of the July 1, 2020 quarterly offering period. The ESPP options vested during the three months ending September 30, 2020, leaving no unrecognized compensation expense related to unvested ESPP options at September 30, 2020.

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 nine months ended September 30, 2020 and 2019:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Reconciliation of Federal Statutory to Actual Tax Expense:				
Federal statutory income tax at 21%	$ 8,785	$ 9,050	$ 24,612	$ 28,908
Tax-exempt interest income	(3,403)	(2,637)	(9,624)	(7,307)
Share-based compensation	382	(11)	376	(402)
Tax-exempt earnings and gains on life insurance	(246)	(241)	(810)	(647)
Tax credits	(55)	(61)	(205)	(202)
CARES Act - NOL carryback rate differential	—	—	(1,178)	—
Other	158	237	563	677
Actual Tax Expense	$ 5,621	$ 6,337	$ 13,734	$ 21,027
Effective Tax Rate	13.4 %	14.7 %	11.7 %	15.3 %

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 nine months ended September 30, 2020 and 2019.

	Three Months Ended September 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	$ 36,210	53,843,508	$ 0.67	$ 36,757	51,433,227	$ 0.71
Effect of potentially dilutive stock options and restricted stock awards		127,090			136,330	
Diluted net income per share	$ 36,210	53,970,598	$ 0.67	$ 36,757	51,569,557	$ 0.71

	Nine Months Ended September 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	$ 103,465	54,111,848	$ 1.91	$ 116,630	50,085,701	$ 2.33
Effect of potentially dilutive stock options and restricted stock awards		166,034			141,679	
Diluted net income per share	$ 103,465	54,277,882	$ 1.91	$ 116,630	50,227,380	$ 2.32

For the three and nine months ended September 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.

NOTE 16
SUBSEQUENT EVENT

On November 6, 2020, the Bank entered into a definitive agreement with Hoosier Trust Company, an Indiana trust company (“Hoosier”), pursuant to which Hoosier will merge with and into the Bank. The consideration to be paid to the shareholders of Hoosier at closing is $3,225,000 in cash. The merger, which remains subject to required regulatory approvals, is expected to close in the first quarter of 2021.

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 nine months ended September 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 125 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 continued 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 fully 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 range for the 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 15 basis points on September 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 SBA. On October 8, 2020, the SBA announced a streamlined forgiveness process for PPP loans of $50,000 or less. As of September 30, 2020, the Bank had over 5,200 PPP loans representing $901.4 million, which is net of deferred processing fee income and costs of $21.5 million. The weighted-average deferred processing fee on PPP loans was approximately 3.26 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 three and nine months ended September 30, 2020, the Corporation recognized interest income on loans of $3.8 million and $6.7 million, respectively, from PPP loan related deferred processing fee income as a yield adjustment. As of November 2, 2020, approximately 200 loans totaling $129.3 million have been submitted to the SBA for forgiveness and 60 loans totaling $35.1 million have been approved by the SBA for full forgiveness.

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 for "for profit" entities: (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 were initially set at $250,000, but were lowered to $100,000 by the Federal Reserve effective October 30, 2020. 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 December 31, 2020 to access funds under the PPPL Facility, unless further extended by the Federal Reserve and the Department of the Treasury. At September 30, 2020, the Corporation did not have an outstanding balance with the PPPL Facility.

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

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 troubled debt restructure 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 has offered short-term modifications made in response to COVID-19 to borrowers who were current and otherwise not past due. These included 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. As of September 30, 2020, $176 million in loan balances remained in deferral. 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, second and third quarter 2020 financial statements have been prepared under the existing incurred loss model. As the temporary relief applicable to the Corporation’s compliance with CECL will end no later than December 31, 2020, the Corporation will implement CECL during the fourth quarter of 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 September 30, 2020, risk-weighted assets included $901.4 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 allowed to neutralize the regulatory effects of PPP covered loans on the risk-based capital ratios, as well as PPP covered loans pledged under the PPPL Facility on the leverage capital ratios. At September 30, 2020, the Corporation did not have an outstanding balance with the PPPL Facility; therefore there were no adjustments to the leverage ratio for PPP loans.

RESULTS OF OPERATIONS

Executive Summary

The Corporation reported third quarter 2020 net income of $36.2 million, compared to $36.8 million during the third quarter of 2019. Diluted earnings per share for the third quarter totaled $0.67 per share, compared to $0.71 per diluted share during the same period in 2019. Year-to-date net income totaled $103.5 million, compared to $116.6 million during the same period of 2019. Diluted earnings per share for the nine months ended September 30, 2020 was $1.91 per share, compared to $2.32 per share during the same period in 2019.

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

As of September 30, 2020, total assets equaled $13.7 billion, an increase of $1.3 billion, or 10.3 percent, from December 31, 2019. The Corporation's total loan portfolio increased $778.7 million, or 9.2 percent from December 31, 2019. At September 30, 2020, the Corporation's PPP loans totaled $901.4 million, net of deferred processing fees and costs of $21.5 million, 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 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 "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Interest-bearing deposits increased $155.7 million from December 31, 2019 due to excess liquidity from deposit growth and an increase in wholesale funding. Additionally, total investment securities increased $337.2 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 $48.4 million increase in net unrealized gains on the available for sale portfolio. The net increase in unrealized gains from December 31, 2019 to September 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. Additional details of the changes in the Corporation's investment securities portfolio are discussed within NOTE 3. INVESTMENT SECURITIES of the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

The Corporation’s allowance for loan losses totaled $126.7 million as of September 30, 2020 and equaled 1.37 percent of total loans. The Corporation's provision expense and net charge-offs for the three months ended September 30, 2020 were $12.5 million and $6.9 million, respectively, compared to provision expense and net charge-offs of $600,000 and $1.3 million, respectively, during the same period of 2019. For the three months ended September 30, 2020, there was one individual charge-off greater than $500,000 that totaled $6,665,000 and for the same period in 2019, there was one individual charge-off greater than $500,000 that totaled $1,318,000.

For the nine months ended September 30, 2020, the Corporation's provision expense and net charge-offs were $54.2 million and $7.7 million, respectively, compared to provision expense and net charge-offs of $2.3 million and $2.3 million during the same period in 2019. For the nine months ended September 30, 2020, there were two charge-offs greater than $500,000 for a total of $6,930,000 and for the same period in 2019, there were two individual charge-offs greater than $500,000 that totaled $3,273,000. 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 $56.7 million, an increase of $40.8 million from December 31, 2019. An increase of $36.0 million was attributed to the commercial and farmland segment, specifically non-owner occupied commercial real estate, as three relationships, primarily in the senior living and self storage sector, were moved to non-accrual during the second and third quarters of 2020. Additional 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 $55.7 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 $54.2 million and $55.0 million, respectively, from December 31, 2019. The increases are primarily due to a $176.4 million increase in the related outstanding notional balance. Additionally, yield curve rates used for valuation purposes were lower at each term point as of September 30, 2020 compared to December 31, 2019. This was primarily the result of investors seeking the safety of U.S. Treasuries, coupled with Federal Reserve purchases of U.S. Treasuries, as containment efforts related to the COVID-19 outbreak began to significantly reduce economic activity.

As of September 30, 2020, total deposits equaled $10.9 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 $622.1 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 $468.1 million and $116.8 million, respectively, from December 31, 2019. The low interest rate environment has resulted in customers moving funds from maturing time deposit products into non-maturity products due to similar rates offered for both products.

Total borrowings increased $52.9 million as of September 30, 2020, compared to December 31, 2019. Federal Home Loan Bank advances increased $48.5 million compared to December 31, 2019. The Corporation took advantage of the low interest rate environment to lock in longer term FHLB advances at low rates. Additionally, the Corporation's Federal Funds purchased increased $25 million from 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 September 30, 2020 increased $115.5 million compared to December 31, 2019. The Corporation accrued $66.2 million of trade date accounting related to investment securities purchases as of September 30, 2020, of which, there was no accrual at December 31, 2019. Additionally, as noted above, the derivative hedge liability increased $55.0 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.

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

NET INTEREST INCOME

Net interest income is the most significant component of our earnings, comprising 77 percent of revenues for the nine months ended September 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 nine months ended September 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 $901.4 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 third quarter of 2020, asset yields decreased 119 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. Moreover, the 2020 addition of $901.4 million of PPP loans negatively impacted margin by 7 basis points during the quarter. Interest costs decreased 87 basis points, contributing to a 32 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 1.33 percent and 2.59 percent, respectively, during the three months ended September 30, 2019, to 0.45 percent and 1.92 percent, respectively, during the same period in 2020. Net interest margin, on a tax equivalent basis, decreased to 3.15 percent for the third quarter of 2020 compared to 3.62 percent during the same period in 2019.

The Corporation recognized fair value accretion income on purchased loans, which is included in interest income, of $3.3 million, which accounted for 10 basis points of net interest margin in the third quarter of 2020. Comparatively, the Corporation recognized $2.5 million of accretion income for the third quarter of 2019, or 10 basis points of net interest margin.

In the nine months ended September 30, 2020, asset yields decreased 96 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 202 basis points as of September 30, 2019 to 15 basis points on September 30, 2020. Interest costs decreased 62 basis points, contributing to a 34 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 1.29 percent and 2.72 percent, respectively, during the nine months ended September 30, 2019 to 0.69 percent and 1.88 percent, respectively, during the same period in 2020. Net interest margin, on a tax equivalent basis, decreased to 3.26 percent for the nine months ended September 30, 2020 compared to 3.72 percent during the same period in 2019.

The Corporation recognized fair value accretion income on purchased loans, which is included in interest income, of $10.5 million, which accounted for 12 basis points of net interest margin for the nine months ended September 30, 2020. Comparatively, the Corporation recognized $7.0 million of accretion income for the nine months ended September 30, 2019, or 10 basis points of net interest margin.

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

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 September 30, 2020, and 2019.

(Dollars in Thousands)	Three Months Ended					
	September 30, 2020			September 30, 2019		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Interest-bearing deposits	$ 301,529	$ 90	0.12 %	$ 262,082	$ 1,363	2.06 %
Federal Home Loan Bank stock	28,736	248	3.45	24,633	355	5.76
Investment Securities: [1]						
Taxable	1,258,690	5,399	1.72	1,104,612	6,729	2.44
Tax-Exempt [2]	1,499,463	13,837	3.69	1,027,528	10,551	4.11
Total Investment Securities	2,758,153	19,236	2.79	2,132,140	17,280	3.24
Loans held for sale	24,705	257	4.16	21,913	274	5.00
Loans: [3]						
Commercial	6,965,837	66,826	3.84	5,674,956	77,370	5.45
Real Estate Mortgage	887,661	9,996	4.50	822,874	9,518	4.63
Installment	693,363	7,083	4.09	715,428	9,688	5.42
Tax-Exempt [2]	681,273	6,829	4.01	538,157	5,696	4.23
Total Loans	9,252,839	90,991	3.93	7,773,328	102,546	5.28
Total Earning Assets	12,341,257	110,565	3.58 %	10,192,183	121,544	4.77 %
Net unrealized gain (loss) on securities available for sale	70,277			30,353		
Allowance for loan losses	(125,150)			(80,918)		
Cash and cash equivalents	169,539			143,266		
Premises and equipment	113,216			99,021		
Other assets	1,091,679			893,837		
Total Assets	$ 13,660,818			$ 11,277,742		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing deposits	$ 4,098,017	$ 3,890	0.38 %	$ 3,134,675	$ 9,285	1.18 %
Money market deposits	1,813,392	1,167	0.26	1,307,647	3,766	1.14
Savings deposits	1,574,700	583	0.15	1,244,859	2,523	0.80
Certificates and other time deposits	1,267,152	4,136	1.31	1,736,759	9,256	2.11
Total Interest-bearing Deposits	8,753,261	9,776	0.45	7,423,940	24,830	1.33
Borrowings	733,757	3,528	1.92	660,107	4,370	2.59
Total Interest-bearing Liabilities	9,487,018	13,304	0.56	8,084,047	29,200	1.43
Noninterest-bearing deposits	2,191,460			1,498,282		
Other liabilities	151,040			98,818		
Total Liabilities	11,829,518			9,681,147		
Stockholders' Equity	1,831,300			1,596,595		
Total Liabilities and Stockholders' Equity	$ 13,660,818	13,304		$ 11,277,742	29,200	
Net Interest Income (FTE)		$ 97,261			$ 92,344	
Net Interest Spread (FTE) [4]			3.02 %			3.34 %
Net Interest Margin (FTE):						
Interest Income (FTE) / Average Earning Assets			3.58 %			4.77 %
Interest Expense / Average Earning Assets			0.43 %			1.15 %
Net Interest Margin (FTE) [5]			**3.15 %**			**3.62 %**

[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 $4,340 and $3,412 for the three months ended September 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.

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

(Dollars in Thousands)	Nine Months Ended					
	September 30, 2020			September 30, 2019		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Interest-bearing deposits	$ 280,038	$ 799	0.38 %	$ 184,640	$ 3,022	2.18 %
Federal Home Loan Bank stock	28,736	828	3.84	24,603	1,028	5.57
Investment Securities: [1]						
Taxable	1,302,943	19,177	1.96	1,021,102	19,822	2.59
Tax-Exempt [2]	1,342,477	38,335	3.81	923,030	28,684	4.14
Total Investment Securities	2,645,420	57,512	2.90	1,944,132	48,506	3.33
Loans held for sale	17,175	581	4.51	13,618	512	5.01
Loans: [3]						
Commercial	6,698,042	213,241	4.24	5,469,377	224,766	5.48
Real Estate Mortgage	882,911	30,520	4.61	778,778	26,526	4.54
Installment	725,596	23,784	4.37	686,055	28,351	5.51
Tax-Exempt [2]	663,921	20,341	4.09	517,082	16,325	4.21
Total Loans	8,987,645	288,467	4.28	7,464,910	296,480	5.30
Total Earning Assets	11,941,839	347,606	3.88 %	9,618,285	349,036	4.84 %
Net unrealized gain on securities available for sale	58,623			12,856		
Allowance for loan losses	(104,465)			(81,172)		
Cash and cash equivalents	210,778			130,587		
Premises and equipment	113,517			94,628		
Other assets	1,077,497			848,480		
Total Assets	$ 13,297,789			$ 10,623,664		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing deposits	$ 3,880,489	$ 16,351	0.56 %	$ 2,921,762	$ 24,844	1.13 %
Money market deposits	1,674,622	6,647	0.53	1,222,860	10,057	1.10
Savings deposits	1,507,269	3,007	0.27	1,187,173	7,315	0.82
Certificates and other time deposits	1,476,499	18,226	1.65	1,652,141	25,295	2.04
Total Interest-bearing Deposits	8,538,879	44,231	0.69	6,983,936	67,511	1.29
Borrowings	796,836	11,237	1.88	636,295	12,997	2.72
Total Interest-bearing Liabilities	9,335,715	55,468	0.79	7,620,231	80,508	1.41
Noninterest-bearing deposits	2,002,898			1,413,120		
Other liabilities	144,705			87,839		
Total Liabilities	11,483,318			9,121,190		
Stockholders' Equity	1,814,471			1,502,474		
Total Liabilities and Stockholders' Equity	$ 13,297,789	55,468		$ 10,623,664	80,508	
Net Interest Income (FTE)		$ 292,138			$ 268,528	
Net Interest Spread (FTE) [4]			3.09 %			3.43 %
Net Interest Margin (FTE):						
Interest Income (FTE) / Average Earning Assets			3.88 %			4.84 %
Interest Expense / Average Earning Assets			0.62 %			1.12 %
Net Interest Margin (FTE) [5]			**3.26 %**			**3.72 %**

[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 $12,322 and $9,452 for the nine months ended September 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.

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

NON-INTEREST INCOME

Non-interest income increased $4.0 million, or 18.3 percent, in the third quarter of 2020, compared to the third quarter of 2019. The continued low mortgage interest rate environment produced an increase of $3.6 million in net gains and fees on sales of loans when compared to the same period in 2019. Additionally, the larger customer base resulting from the MBT acquisition on September 1, 2019, in addition to organic growth, resulted in an increase in fiduciary and wealth management fees of $1.5 million. 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 $1.4 million in the third quarter of 2020 when compared to the same period in 2019. These increases were partially offset by a decrease in card payment fee income of $1.2 million in the third quarter of 2020 when compared to the third quarter of 2019. While the larger customer base resulting from the MBT acquisition and organic growth resulted in increased transaction volume, the cap placed on interchange fee income as a result of the Durbin Amendment to the Dodd-Frank Act became effective for the Bank July 1, 2020 and resulted in over $2 million less in interchange revenue. Additionally, service charges on deposit accounts decreased by $898,000 in the third 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 September 30, 2020.

During the first nine months of 2020, non-interest income increased $20.0 million, or 32.0 percent, compared to the same period in 2019. The larger customer base and the low mortgage interest rate environment combined to produce an increase of $7.6 million in net gains and fees on sales of loans. Additionally, the larger customer base from the MBT acquisition, in addition to organic growth, resulted in increases in fiduciary and wealth management fees, card payment fees, and derivative hedge fees of $5.3 million, $1.2 million and $744,000, respectively. Finally, net realized gains on the sales of available for sale securities increased by $6.1 million in the first nine months of 2020 when compared to the same period in 2019.

The increases noted above were partially offset by a decrease in service charges on deposit accounts of $1.1 million 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 first nine months of 2020 when compared to the same period in 2019.

NON-INTEREST EXPENSE

Non-interest expense decreased $2.6 million, or 3.9 percent, in the third quarter of 2020, compared to the third quarter of 2019. The acquisition of MBT on September 1, 2019 was the largest contributing factor to the decrease. In the third quarter of 2019, the Corporation recorded acquisition related expenses of $11.2 million primarily consisting of $5.2 million of contract terminations and core conversion expenses, $4.5 million of employee severance and retention expenses and $1.3 million of professional and other outside services expense.

While the third quarter of 2020 did not have the acquisition related expenses noted above, the larger franchise and growth in our customer base from the acquisition and organic growth resulted in increases in most non-interest expense categories with the largest being in salaries and employee benefits, net occupancy, and equipment which accounted for a $6.7 million increase in the third quarter of 2020 compared to the third quarter of 2019. Additionally, FDIC assessment expense increased $1.9 million in the third quarter of 2020, when compared to the same period in 2019, due to a combination of 2019 reflecting assessment credits issued as a result of the FDIC insurance fund reaching the FDIC's target minimum reserve ratio and increased expense in the current year resulting from the Corporation's FDIC assessment changing to the calculation applicable to banks over $10 billion in total assets. Finally, the Corporation incurred $618,000 of additional expense in the third quarter of 2020, compared to the same period of 2019, mainly in net occupancy and equipment costs, in response to social distancing and cleaning protocols related to actions taken in response to the COVID-19 pandemic.

Non-interest expense increased $9.3 million, or 5.1 percent, in the first nine 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 due to the larger franchise and growth in our customer base with the largest increases in salaries and employee benefits, net occupancy, and equipment accounting for an increase of $14.3 million. Additionally, FDIC assessment expense increased $3.5 million in the first nine months of 2020, when compared to the same period in 2019, due to a combination of 2019 reflecting assessment credits issued as a result of the FDIC insurance fund reaching the FDIC's target minimum reserve ratio and increased expense in the current year resulting from the Corporation's FDIC assessment changing to the calculation applicable to banks over $10 billion in total assets. The Corporation also incurred $2.0 million of additional expense in the first nine 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 $1.0 million in net occupancy and equipment costs in response to social distancing and cleaning protocols.

The increases noted above, for the nine-month period, were partially offset by the acquisition of MBT on September 1, 2019, as the Corporation recorded $11.9 million of acquisition-related expenses, primarily consisting of $5.2 million of contract termination and core system conversion expenses, $4.5 million of employee severance and retention expenses and $1.5 million of professional and other outside services expense. Additionally, the decrease in outside data processing fees of $1.5 million, when comparing the first nine months of 2020 to the first nine months of 2019, is mainly related to the sunsetting of a debit rewards program. Finally, 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.

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

INCOME TAXES

Income tax expense for the third quarter of 2020 was $5,621,000 on pre-tax net income of $41,831,000. For the same period in 2019, income tax expense was $6,337,000 on pre-tax net income of $43,094,000. The effective income tax rates for the third quarter of 2020 and 2019 were 13.4 percent and 14.7 percent, respectively.

Income tax expense for the nine months ended September 30, 2020 was $13,734,000 on pre-tax net income of $117,199,000. For the same period in 2019, income tax expense was $21,027,000 on pre-tax net income of $137,657,000. The effective income tax rates for the nine months ended September 30, 2020 and 2019 were 11.7 percent and 15.3 percent, respectively.

The lower effective income tax rates during the three and nine months ended September 30, 2020 when compared to the same periods 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 was 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.

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

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 September 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 September 30, 2020 and December 31, 2019 were as follows:

			Prompt Corrective Action Thresholds			
	Actual		Basel III Minimum Capital Required		Well Capitalized	
September 30, 2020	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total risk-based capital to risk-weighted assets						
First Merchants Corporation	$ 1,438,331	14.38 %	$ 1,050,092	10.50 %	N/A	N/A
First Merchants Bank	1,400,114	13.96	1,053,455	10.50	$ 1,003,291	10.00 %
Tier 1 capital to risk-weighted assets						
First Merchants Corporation	$ 1,248,299	12.48 %	$ 850,075	8.50 %	N/A	N/A
First Merchants Bank	1,274,686	12.71	852,797	8.50	$ 802,633	8.00 %
CET1 capital to risk-weighted assets						
First Merchants Corporation	$ 1,201,991	12.02 %	$ 700,061	7.00 %	N/A	N/A
First Merchants Bank	1,274,686	12.71	702,304	7.00	$ 652,139	6.50 %
Tier 1 capital to average assets						
First Merchants Corporation	$ 1,248,299	9.53 %	$ 523,790	4.00 %	N/A	N/A
First Merchants Bank	1,274,686	9.75	522,926	4.00	$ 653,657	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 September 30, 2020, risk-weighted assets included $901.4 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 allowed to neutralize the regulatory effects of PPP covered loans on the risk-based capital ratios, as well as PPP covered loans pledged under the PPPL Facility on the leverage capital ratios. At September 30, 2020, the Corporation did not have an outstanding balance with the PPPL Facility; therefore there were no adjustments to the leverage ratio for PPP loans.

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

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.

	September 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)	$ 1,833,656	$ 1,908,858	$ 1,786,437	$ 1,787,006
Adjust for Accumulated Other Comprehensive (Income) Loss [1]	(65,468)	(68,423)	(27,874)	(30,495)
Less: Preferred Stock	(125)	(125)	(125)	(125)
Add: Qualifying Capital Securities	46,308	—	66,363	—
Less: Disallowed Goodwill and Intangible Assets	(566,072)	(565,624)	(569,468)	(569,021)
Total Tier 1 Capital (Regulatory)	1,248,299	1,274,686	1,255,333	1,187,365
Qualifying Subordinated Debentures	65,000	—	65,000	—
Allowance for Loan Losses Includible in Tier 2 Capital	125,032	125,428	80,284	80,284
Total Risk-Based Capital (Regulatory)	$ 1,438,331	$ 1,400,114	$ 1,400,617	$ 1,267,649
Net Risk-Weighted Assets (Regulatory)	$ 10,000,878	$ 10,032,908	$ 9,799,329	$ 9,849,913
Average Assets (Regulatory)	$ 13,094,746	$ 13,073,145	$ 11,909,571	$ 11,889,092
Total Risk-Based Capital Ratio (Regulatory)	14.38 %	13.96 %	14.29 %	12.87 %
Tier 1 Capital to Risk-Weighted Assets	12.48 %	12.71 %	12.81 %	12.05 %
Tier 1 Capital to Average Assets	9.53 %	9.75 %	10.54 %	9.99 %
CET1 Capital Ratio				
Total Tier 1 Capital (Regulatory)	$ 1,248,299	$ 1,274,686	$ 1,255,333	$ 1,187,365
Less: Qualified Capital Securities	(46,308)	—	(66,363)	—
CET1 Capital (Regulatory)	$ 1,201,991	$ 1,274,686	$ 1,188,970	$ 1,187,365
Net Risk-Weighted Assets (Regulatory)	$ 10,000,878	$ 10,032,908	$ 9,799,329	$ 9,849,913
CET1 Capital Ratio (Regulatory)	12.02 %	12.71 %	12.13 %	12.05 %

[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.

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

The Corporation had a strong capital position as evidenced by the tangible common equity to tangible assets ratio of 9.57 percent at September 30, 2020, and 10.16 percent at December 31, 2019.

(Dollars in thousands, except per share amounts)	Tangible Common Equity to Tangible Assets (non-GAAP) September 30, 2020	December 31, 2019
Total Stockholders' Equity (GAAP)	$ 1,833,656	$ 1,786,437
Less: Cumulative preferred stock (GAAP)	(125)	(125)
Less: Intangible assets (GAAP)	(574,369)	(578,881)
Tangible common equity (non-GAAP)	$ 1,259,162	$ 1,207,431
Total assets (GAAP)	$ 13,737,350	$ 12,457,254
Less: Intangible assets (GAAP)	(574,369)	(578,881)
Tangible assets (non-GAAP)	$ 13,162,981	$ 11,878,373
Stockholders' Equity to Assets (GAAP)	13.35 %	14.34 %
Tangible common equity to tangible assets (non-GAAP)	9.57 %	10.16 %
Tangible common equity (non-GAAP)	$ 1,259,162	$ 1,207,431
Plus: Tax Benefit of intangibles (non-GAAP)	6,292	7,257
Tangible common equity, net of tax (non-GAAP)	$ 1,265,454	$ 1,214,688
Common Stock outstanding	53,892	55,368
Book Value (GAAP)	$ 34.02	$ 32.26
Tangible book value - common (non-GAAP)	$ 23.48	$ 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 nine months ended September 30, 2020 and 2019.

(Dollars in thousands, except per share amounts)	Three Months Ended September 30, 2020	2019	Nine Months Ended September 30, 2020	2019
Average goodwill (GAAP)	$ 543,919	$ 477,260	$ 543,919	$ 456,107
Average core deposit intangible (GAAP)	31,357	26,193	32,851	24,088
Average deferred tax on CDI (GAAP)	(6,478)	(5,405)	(6,806)	(4,956)
Intangible adjustment (non-GAAP)	$ 568,798	$ 498,048	$ 569,964	$ 475,239
Average stockholders' equity (GAAP)	$ 1,831,300	$ 1,596,595	$ 1,814,471	$ 1,502,474
Average cumulative preferred stock (GAAP)	(125)	(125)	(125)	(125)
Intangible adjustment (non-GAAP)	(568,798)	(498,048)	(569,964)	(475,239)
Average tangible capital (non-GAAP)	$ 1,262,377	$ 1,098,422	$ 1,244,382	$ 1,027,110
Average assets (GAAP)	$ 13,660,818	$ 11,277,742	$ 13,297,789	$ 10,623,664
Intangible adjustment (non-GAAP)	(568,798)	(498,048)	(569,964)	(475,239)
Average tangible assets (non-GAAP)	$ 13,092,020	$ 10,779,694	$ 12,727,825	$ 10,148,425
Net income available to common stockholders (GAAP)	$ 36,210	$ 36,757	$ 103,465	$ 116,630
CDI amortization, net of tax (GAAP)	1,174	1,071	3,564	3,480
Tangible net income available to common stockholders (non-GAAP)	$ 37,384	$ 37,828	$ 107,029	$ 120,110
Per Share Data:				
Diluted net income available to common stockholders (GAAP)	$ 0.67	$ 0.71	$ 1.91	$ 2.32
Diluted tangible net income available to common stockholders (non-GAAP)	$ 0.69	$ 0.73	$ 1.97	$ 2.39
Ratios:				
Return on average GAAP capital (ROE)	7.91 %	9.21 %	7.60 %	10.35 %
Return on average tangible capital	11.85 %	13.78 %	11.47 %	15.59 %
Return on average assets (ROA)	1.06 %	1.30 %	1.04 %	1.46 %
Return on average tangible assets	1.14 %	1.40 %	1.12 %	1.58 %

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.

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

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 September 30, 2020, non-performing loans totaled $59.4 million, an increase of $42.6 million from December 31, 2019. Loans not accruing interest income totaled $56.7 million at September 30, 2020, an increase of $40.8 million from December 31, 2019. An increase of $36.0 million was attributed to the commercial and farmland segment, specifically non-owner occupied commercial real estate, as three relationships were moved to non-accrual during the second and third quarters of 2020. These three relationships involve four properties, three of which total $31.2 million in the senior living sector and the fourth totals $3.4 million in the self-storage sector. Additionally, $4.7 million of the increase in non-accrual loans was in the commercial and industrial loans segment. This largest portion of this increase was due to the addition of a $2.8 million loan in the university logo apparel sports industry. This loan was added to the non-accrual list in the second quarter at a balance of $14.4 million, but was restructured in the third quarter resulting in a $6.7 million charge-off.

Other real estate owned and repossessions, totaling $6.9 million at September 30, 2020, decreased $543,000 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 September 30, 2020, impaired loans totaled $52.5 million, an increase of $40.8 million from the December 31, 2019 balance of $11.7 million. Also at September 30, 2020, a specific allowance for losses was not deemed necessary for impaired loans totaling $14.7 million as there were no identified losses on these credits. An allowance of $9.1 million was recorded for the remaining balance of these impaired loans totaling $37.8 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)	September 30, 2020	December 31, 2019
Non-Performing Assets:		
Non-accrual loans	$ 56,739	$ 15,949
Renegotiated loans	2,677	841
Non-performing loans (NPL)	59,416	16,790
OREO and Repossessions	6,984	7,527
Non-performing assets (NPA)	66,400	24,317
Loans 90-days or more delinquent and still accruing	1,330	69
NPAs and loans 90-days or more delinquent	$ 67,730	$ 24,386
Impaired Loans	$ 52,484	$ 11,709

The non-accrual balances in the table above include troubled debt loan restructures totaling $1.7 million and $709,000 as of September 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)	September 30, 2020	December 31, 2019
Non-performing assets and loans 90-days or more delinquent:		
Commercial and industrial loans	$ 5,950	$ 1,259
Agricultural production financing and other loans to farmers	1,100	183
Real estate loans:		
Construction	6,340	7,191
Commercial and farmland	43,740	7,103
Residential	7,581	6,810
Home equity	2,912	1,795
Individuals' loans for household and other personal expenditures	65	45
Public finance and other commercial loans	42	—
Non-performing assets and loans 90-days or more delinquent:	$ 67,730	$ 24,386

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

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 troubled debt restructure 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 has offered short-term modifications in response to COVID-19 borrowers who were current and otherwise not past due. These included 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 remained in deferment as of the period indicated:

	September 30, 2020	
	Recorded Balance	Number of Loans
Commercial and industrial loans	$ 29,735	33
Agriculture production financing and other loans to farmers	265	2
Real estate loans:		
Construction	3,093	1
Commercial and farmland	134,435	62
Residential	6,815	50
Home equity	1,286	11
Individuals' loans for household and other personal expenditures	305	20
Total	$ 175,934	179

During the third quarter of 2020, a second COVID-19 related modification was processed on approximately $116 million of loan balances. Of the loans still in deferment at September 30, 2020, $92 million, or 52 percent of the balance, were in the hotel industry.

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 $778.7 million from December 31, 2019 to $9.2 billion at September 30, 2020. PPP loans accounted for $901.4 million of the total loan balance at September 30, 2020. At September 30, 2020, the allowance for loan and lease losses totaled $126.7 million, which represents an increase of $46.4 million from December 31, 2019. As a percent of loans, the allowance for loan losses was 1.37 percent at September 30, 2020 compared to 0.95 percent at December 31, 2019. When excluding PPP loans of $901.4 million, the allowance for loan losses as a percentage of total loans was 1.52 percent as of September 30, 2020. Under the terms of the PPP, the loans are fully guaranteed by the SBA.

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 higher level of unemployment which has negatively impacted consumer and business spending. Due to this uncertainty, the national and local economic conditions qualitative factor has increased $35.1 million during 2020. In addition, impairment increased $8.5 million from December 31, 2019 due primarily to the addition of specific reserves, of $7.9 million, related to commercial senior living 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 nine months ended September 30, 2020 was $12.5 million and $54.2 million, respectively. Comparatively, the provision for loan losses for the three months and nine months ended September 30, 2019 was $600,000 and $2.3 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.

Net charge-offs totaling $6.9 million and $7.7 million, respectively, were recognized for the three and nine months ended September 30, 2020. Comparatively, net charge-offs totaled $1.3 million and $2.3 million, respectively, for the same periods in 2019. For the three months ended September 30, 2020, there was one individual charge-off greater than $500,000 that totaled $6,665,000 and for the nine months ended September 30, 2020 there were two charge-offs greater than $500,000 for a total of $6,930,000. There have been no recoveries greater than these amounts in 2020. For the three months ended September 30, 2019, there was one individual charge-off greater than $500,000 that totaled $1,318,000. For the nine months ended September 30, 2019, there were two individual charge-offs greater than $500,000 that totaled $3,273,000. For the three months ended September 30, 2019, there were no individual recoveries greater than $500,000. For the nine months ended September 30, 2019, there was one individual recovery greater than $500,000, which totaled $738,000. The distribution of the net charge-offs (recoveries) for the three and nine months ended September 30, 2020 and 2019 are reflected in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in Thousands)	2020	2019	2020	2019
Net charge-offs (Recoveries):				
Commercial and industrial loans	$ 6,702	$ 23	$ 6,862	$ (130)
Agricultural production financing and other loans to farmers	(72)	(3)	(67)	13
Real estate loans:				
Construction	—	1,007	(37)	1,226
Commercial and farmland	(46)	(72)	(10)	876
Residential	19	8	50	62
Home equity	296	25	616	(44)
Individuals' loans for household and other personal expenditures	38	4	335	39
Public finance and other commercial loans	—	311	—	239
Total net charge-offs	$ 6,937	$ 1,303	$ 7,749	$ 2,281

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 $1.8 billion at September 30, 2020, an increase of $34.1 million, or 1.9 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 $9.7 million at September 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 September 30, 2020, total borrowings from the FHLB were $399.5 million The Bank has pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at September 30, 2020 was $690.3 million.

The required payments related to operating leases and borrowings at September 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	$ 913	$ 3,458	$ 3,331	$ 2,937	$ 2,867	$ 10,277	$ —	$ 23,783
Federal funds purchased	80,000	—	—	—	—	—	—	80,000
Securities sold under repurchase agreements	187,732	—	—	—	—	—	—	187,732
Federal Home Loan Bank advances	20,024	55,097	75,097	115,097	97	134,110	—	399,522
Subordinated debentures and other borrowings	—	—	—	—	—	122,012	(3,692)	118,320
Total	$ 288,669	$ 58,555	$ 78,428	$ 118,034	$ 2,964	$ 266,399	$ (3,692)	$ 809,357

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.

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 September 30, 2020 are as follows:

(Dollars in Thousands)	September 30, 2020
Amounts of commitments:	
Loan commitments to extend credit	$ 3,462,258
Standby and commercial letters of credit	31,908
	$ 3,494,166

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 September 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.

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

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 September 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:

	September 30, 2020	
	RISING	FALLING
Driver Rates	(200 Basis Points)	(100 Basis Points)
Prime	200	—
Federal funds	200	—
One-year CMT	200	(4)
Three-year CMT	200	(4)
Five-year CMT	200	(5)
CD's	200	(16)
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 September 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.

	September 30, 2020		
		RISING	FALLING
(Dollars in Thousands)	Base	(200 Basis Points)	(100 Basis Points)
Net interest income	$ 348,659	$ 367,460	$ 352,237
Variance from base		$ 18,800	$ 3,577
Percent of change from base		5.4 %	1.0 %

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 September 30, 2020 and December 31, 2019. Earning assets increased by $1.3 billion during the nine months ended September 30, 2020.

Interest-bearing deposits increased $155.7 million from December 31, 2019 due to excess liquidity from deposit growth and an increase in wholesale funding. Additionally, total investment securities increased $337.2 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 $48.4 million increase in net unrealized gains on the available for sale portfolio. The net increase in unrealized gains from December 31, 2019 to September 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 $778.7 million from December 31, 2019. As of September 30, 2020, the Corporation had $901.4 million of PPP loans, which were primarily included in the commercial and industrial loan class. The largest loan segments that experienced a decrease from December 31, 2019 were real estate construction 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)	September 30, 2020	December 31, 2019
Interest-bearing deposits	$ 273,936	$ 118,263
Investment securities available for sale	1,824,160	1,790,025
Investment securities held to maturity	1,109,126	806,038
Loans held for sale	3,183	9,037
Loans	9,243,833	8,459,310
Federal Home Loan Bank stock	28,736	28,736
Total	$ 12,482,974	$ 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 continued 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 September 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
July, 2020	35,668	$ 24.43	—	—
August, 2020	275	$ 26.36	—	—
September, 2020	422	$ 24.40	—	—

(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

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.
10.1	Consulting Agreement between Michael C. Rechin and First Merchants Corporation, effective January 1, 2021 (Incorporated by reference to registrant's Form 8-K filed on September 29, 2020) (SEC No. 000-17071) (1)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (2)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (2)
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (3)
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 (2)
101.SCH	Inline XBRL Taxonomy Extension Schema Document (2)
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document (2)
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document (2)
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document (2)
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document (2)
104	Cover Page Interactive Data File (formatted as Inline XBRL and included in Exhibit 101)

(1) Management contract or compensatory plan.
(2) Filed herewith.
(3) 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)
November 9, 2020	By: /s/ Michael C. Rechin Michael C. Rechin President and Chief Executive Officer (Principal Executive Officer)
November 9, 2020	By: /s/ Mark K. Hardwick Mark K. Hardwick Executive Vice President, Chief Financial Officer and Chief Operating Officer (Principal Financial and Accounting Officer)

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.

November 9, 2020

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

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.

November 9, 2020

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

EXHIBIT-32

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

In connection with the Quarterly Report of First Merchants Corporation (the “Corporation”) on Form 10-Q for the period ending September 30, 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.

November 9, 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 September 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.

November 9, 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.