FIRST MERCHANTS CORP
Form 10-K
March 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from __________to_________

Commission file number 0-17071

FIRST MERCHANTS CORPORATION

(Exact name of registrant as specified in its charter)

Indiana	35-1544218
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 East Jackson Muncie, Indiana	47305-2814
(Address of principal executive offices)	(Zip Code)

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

Securities registered pursuant to Section 12 (b) of the Act: None

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

Common Stock, $.125 stated value per share

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

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

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

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

The aggregate market value (not necessarily a reliable indication of the price at which more than a limited number of shares would trade) of the voting stock held by non-affiliates of the registrant was $430,736,000 as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2006).

As of March 8, 2007 there were 18,519,393 outstanding common shares, without par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Documents	Part of Form 10-K Into Which Incorporated
Portions of the Registrant's Annual Report to Shareholders for the year ended December 31, 2006	Part I (Item 1) Part II (Items 5, 6, 7, 7A, and 8)
Portions of the Registrant's Definitive Proxy Statement for Annual Meeting of Shareholders to be held April 24, 2007	Part III (Items 10 through 14)

FORM 10-K TABLE OF CONTENTS

STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

* statements of the Corporation's goals, intentions and expectations;

* statements regarding the Corporation's business plan and growth strategies;

* statements regarding the asset quality of the Corporation's loan and investment portfolios; and

* estimates of the Corporation's risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, 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 the Corporation's net interest margin, asset valuations and expense expectations;

* adverse changes in the economy, which might affect the Corporation's business prospects and could cause credit-related losses and expenses;

* adverse developments in the Corporation's loan and investment portfolios;

* competitive factors in the banking industry, such as the trend towards consolidation in the Corporation's market;

* changes in the banking legislation or the regulatory requirements of federal and state agencies applicable to bank holding companies and banks like the Corporation's affiliate banks;

* acquisitions of other businesses by the Corporation and integration of such acquired businesses;

* changes in market, economic, operational, liquidity, credit and interest rate risks associated with the Corporation's 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, the Corporation's actual future results may be materially different from the results indicated by these forward-looking statements. In addition, the Corporation's past results of operations do not necessarily indicate its future results.

PART I

Item 1. BUSINESS

GENERAL

First Merchants Corporation (the "Corporation") is a financial holding company headquartered in Muncie, Indiana. The Corporation's Common Stock is traded on NASDAQ's National Market System under the symbol FRME and was organized in September 1982. Since its organization, the Corporation has grown to include eight affiliate banks with over sixty-five locations in seventeen Indiana and three Ohio counties, a trust company, a multi-line insurance agency, a reinsurance agency, and a title agency.

The bank subsidiaries of the Corporation include the following:

* First Merchants Bank, National Association in Delaware and Hamilton counties;

* The Madison Community Bank, National Association in Madison County;

* United Communities National Bank with locations in Randolph, Union, Fayette, Wayne and Butler (OH) counties;

* The First National Bank of Portland in Jay County;

* Decatur Bank & Trust Company, National Association in Adams County;

* Frances Slocum Bank & Trust Company, National Association in Wabash, Howard, and Miami counties;

* Lafayette Bank and Trust Company, National Association in Tippecanoe, Carroll, Jasper, and White counties; and

* Commerce National Bank in Franklin and Hamilton counties in Ohio.

The Corporation approved on January 23, 2007, the combination of five of its bank charters into one. Subject to the approval of the Office of the Comptroller of the Currency (OCC), Frances Slocum Bank & Trust Company, N.A., Decatur Bank & Trust Company, N.A., First National Bank and United Communities National Bank will combine with First Merchants Bank, N.A. The anticipated effective date of the combinations is April 1, 2007. The Corporation also approved, subject to OCC approval, the purchase by The Madison Community Bank of five branches of First Merchants Bank located in Hamilton County, Indiana. The anticipated effective date of the branch purchases is June 1, 2007. In conjunction with the branch purchases, the name of The Madison Community Bank will be changed to First Merchants Bank of Central Indiana, National Association on April 1, 2007. As a result of these combinations, the Corporation will hold four bank charters: First Merchants Bank, N.A., First Merchants Bank of Central Indiana, N.A., Lafayette Bank and Trust Company, N.A. and Commerce National Bank.

The Corporation also operates First Merchants Insurance Services, Inc. a full- service property, casualty, personal lines, and health care insurance agency headquartered in Muncie, Indiana. On September 1, 2005, Trustcorp Financial Services of Greenville, Inc. merged with and into First Merchants Insurance Services, Inc. The Corporation is also the majority owner of the Indiana Title Insurance Company LLC, a full-service title insurance agency; operates First Merchants Reinsurance Co. Ltd., a reinsurance agency; and wholly-owns Merchants Trust Company, National Association, a trust and asset management services company.

As of December 31, 2006, the Corporation had consolidated assets of $3.6 billion, consolidated deposits of $2.8 billion and stockholders' equity of $327 million. The Corporation is presently engaged in conducting commercial banking business through the offices of its eight banking subsidiaries. As of December 31, 2006, the Corporation and its subsidiaries had 1,131 full-time equivalent employees.

Through its bank subsidiaries, 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; renting safe deposit facilities; providing personal and corporate trust services; providing full service brokerage; and providing other corporate services, letters of credit and repurchase agreements. Through various nonbank subsidiaries, the Corporation also offers personal and commercial lines of insurance and engages in the title agency business and the reinsurance of credit life, accident, and health insurance.

GENERAL continued

The Corporation makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, available on its website at www.firstmerchants.com without charge, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. These documents can also be read and copied at the Securities and Exchange Commission's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public at the Securities and Exchange Commission's web site at http://www.sec.gov. Additionally, the Corporation will also provide without charge, a copy of its Form 10-K to any shareholder by mail. Requests should be sent to Mr. Brian Edwards, Shareholder Relations Officer, First Merchants Corporation, P.O. Box 792, Muncie, IN 47308-0792.

ACQUISITION POLICY

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

COMPETITION

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

REGULATION AND SUPERVISION

OF FIRST MERCHANTS CORPORATION AND SUBSIDIARIES

BANK HOLDING COMPANY REGULATION

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

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

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

2. Merging or consolidating with another bank holding company; or

3. Acquiring substantially all of the assets of any bank.

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

The BHC Act does not place territorial restrictions on such nonbanking-related activities.

CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES

The Corporation is required to comply with the Federal Reserve's risk-based capital guidelines. These guidelines require a minimum ratio of capital to risk-weighted assets of 8% (including certain off-balance sheet activities such as standby letters of credit). At least half of the total required capital must be "Tier 1 capital," consisting principally of stockholders' equity, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interest in the equity accounts of consolidated subsidiaries, less certain goodwill items. The remainder may consist of a limited amount of subordinate debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, cumulative perpetual preferred stock, and a limited amount of the general loan loss allowance.

In addition to the risk-based capital guidelines, the Federal Reserve has adopted a Tier 1 (leverage) capital ratio under which the Corporation must maintain a minimum level of Tier 1 capital to average total consolidated assets. The ratio is 3% in the case of bank holding companies which have the highest regulatory examination ratings and are not contemplating significant growth or expansion. All other bank holding companies are expected to maintain a ratio of at least 1% to 2% above the stated minimum.

The following are the Corporation's regulatory capital ratios as of December 31, 2006:

	Corporation	Regulatory Minimum Requirement
Tier 1 Capital: (to risk-weighted assets)	9.2%	4.0%
Total Capital:	11.1%	8.0%

BANK REGULATION

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

BANK CAPITAL REQUIREMENTS

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

Like the capital guidelines established by the Federal Reserve, these guidelines divide a bank's capital into tiers. Banks are required to maintain a total risk-based capital ratio of 8%. The OCC may, however, set higher capital requirements when a bank's particular circumstances warrant. Banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

In addition, the OCC established guidelines prescribing a minimum Tier 1 leverage ratio (Tier 1 capital to adjusted total assets as specified in the guidelines). These guidelines provide for a minimum Tier 1 leverage ratio of 3% for banks that meet specified criteria, including that they have the highest regulatory rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier 1 leverage ratio of 3% plus an additional 100 to 200 basis points.

All of the Corporation's affiliate banks exceed the risk-based capital guidelines of the OCC as of December 31, 2006.

The Federal Reserve and the OCC have adopted rules to incorporate market and interest rate risk components into their risk-based capital standards. Amendments to the risk-based capital requirements, incorporating market risk, became effective January 1, 1998. Under the new market risk requirements, capital will be allocated to support the amount of market risk related to a financial institution's ongoing trading activities.

FDIC IMPROVEMENT ACT OF 1991

The Federal Deposit Insurance Corporation Improvement Act of 1991

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

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

FDICIA continued

As of December 31, 2006, each bank subsidiary of First Merchants is "well capitalized" based on the "prompt corrective action" ratios and deadlines described above. It should be noted, however, that a bank's capital category is determined solely for the purpose of applying the OCC's "prompt corrective action" regulations and that the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects.

DEPOSIT INSURANCE

The Corporation's affiliated banks are insured up to regulatory limits by the FDIC and, accordingly, are subject to deposit insurance assessments to maintain the Bank Insurance Fund (the "BIF") and the Savings Association Insurance Fund ("SAIF") administered by the FDIC. The FDIC has adopted regulations establishing a permanent risk-related deposit insurance assessment system. Under this system, the FDIC places each insured bank in one of nine risk categories based on (i) the bank's capitalization, and (ii) supervisory evaluations provided to the FDIC by the institution's primary federal regulator. Each insured bank's insurance assessment rate is then determined by the risk category in which it is classified by the FDIC.

The Deposit Insurance Funds Act of 1996 provides for assessments to be imposed on insured depository institutions with respect to deposits insured by the BIF and the SAIF (in addition to assessments currently imposed on depository institutions with respect to BIF- and SAIF-insured deposits) to pay for the cost of Financing Corporation ("FICO") funding. The FICO assessments do not vary depending upon a depository institution's capitalization or supervisory evaluations.

DIVIDEND LIMITATIONS

National banking laws restrict the amount of dividends that an affiliate bank may declare in a year without obtaining prior regulatory approval. National banks are limited to the bank's retained net income (as defined) for the current year plus those for the previous two years. At December 31, 2006, the

Corporation's affiliate banks had a total of $34,149,000 retained net profits available for 2007 dividends to the Corporation without prior regulatory approval.

BROKERED DEPOSITS

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

INTERSTATE BANKING AND BRANCHING

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

FINANCIAL SERVICES MODERNIZATION ACT

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

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

USA PATRIOT ACT

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

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

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

THE SARBANES-OXLEY ACT

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

* a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);

* independence requirements for audit committee members;

* independence requirements for company auditors;

* certification of financial statements on Forms 10-K and 10-Q reports by the chief executive officer and the chief financial officer;

* the forfeiture by the chief executive officer and chief financial officer of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by such officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;

* disclosure of off-balance sheet transactions;

* two-business day filing requirements for insiders filing Form 4s;

* disclosure of a code of ethics for financial officers and filing a Form 8-K for a change in or waiver of such code;

* the reporting of securities violations "up the ladder" by both in-house and outside attorneys;

* restrictions on the use of non-GAAP financial measures in press releases and SEC filings;

* the formation of a public accounting oversight board; and

* various increased criminal penalties for violations of securities laws.

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

ADDITIONAL MATTERS

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

In addition to the matters discussed above, the Corporation's affiliate banks are subject to additional regulation of their activities, including a variety of consumer protection regulations affecting their lending, deposit and collection activities and regulations affecting secondary mortgage market activities.

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

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

STATISTICAL DATA

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

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL
The daily average balance sheet amounts, the related interest income or expense, and average rates earned or paid are presented in the following table.
(Dollars in Thousands)

	2006			2005		
	Average Balance	Interest Income/ Balance	Average Rate	Average Balance	Interest Income/ Balance	Average Rate
Assets:						
Federal funds sold	$ 6,983	$ 373	5.3%	$ 8,385	$ 264	3.1%
Interest-bearing deposits......	7,831	500	6.4	16,683	695	4.2
Federal Reserve and Federal Home Loan Bank stock.	23,473	1,256	5.4	23,019	1,185	5.1
Securities: (1)						
Taxable	289,692	12,316	4.3	263,435	9,612	3.6
Tax-exempt (3).................	175,072	10,100	5.8	162,965	9,807	6.0
Total Securities.............	464,764	22,416	4.8	426,400	19,419	4.6
Mortgage loans held for sale.....	4,620	176	3.8	2,746	113	4.1
Loans: (2)						
Commercial	1,704,026	128,888	7.6	1,569,270	105,740	6.7
Bankers' acceptance and Commercial paper purchased...						
Real estate mortgage...........	441,407	27,813	6.3	464,426	27,334	5.9
Installment	405,006	29,891	7.4	385,097	25,248	6.6
Tax-exempt (3).................	14,788	1,274	8.6	12,595	989	7.9
Total loans	2,569,847	188,042	7.3	2,434,134	159,424	6.5
Total earning assets.........	3,072,898	212,587	6.9	2,908,621	180,987	6.3
Net unrealized gain (loss) on securities available for sale...........	(7,353)			(1,217)		
Allowance for loan losses........	(26,443)			(24,889)		
Cash and due from banks..........	58,305			53,037		
Premises and equipment	40,227			38,284		
Other assets	233,752			205,628		
Total assets	$3,371,386			$3,179,464		
Liabilities:						
Interest-bearing deposits:						
NOW accounts	$ 396,477	6,065	1.5%	$ 395,356	2,058	0.5%
Money market deposit accounts	251,746	7,551	3.0	280,508	4,899	1.7
Savings deposits	259,052	3,927	1.5	319,552	2,583	0.8
Certificates and other time deposits	1,333,408	56,771	4.3	1,149,679	36,581	3.2
Total interest-bearing						

deposits....................	2,240,683	74,314	3.3	2,145,095	46,121	2.2
Borrowings	445,806	24,197	5.4	412,091	19,959	4.8
Total interest-bearing liabilities................	2,686,489	98,511	3.7	2,557,186	66,080	2.6
Noninterest-bearing deposits.....	327,387			273,657		
Other liabilities	37,991			33,096		
Total liabilities............	3,051,867			2,863,939		
Stockholders' equity	319,519			315,525		
Total liabilities and stockholders' equity........	$3,371,386	98,511	3.2	$3,179,464	66,080	2.3
Net interest income		$114,076			$114,907	
Net interest margin..........			3.7			4.0

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

(2) Nonaccruing loans have been included in the average balances.

(3) Tax exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35% for 2006, 2005, and 2004......................... $3,981 $3,778

STATISTICAL DATA (continued)

ANALYSIS OF CHANGES IN NET INTEREST INCOME

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

	2006 Compared to 2005 Increase (Decrease) Due To			
	Volume	Rate	Total	Volu
	(Dollars in Thousands on Fully Taxable Eq			
Interest income:				
Federal funds sold	$ (50)	$ 159	$ 109	$
Interest-bearing deposits	(467)	272	(195)	(
Federal Reserve and Federal Home Loan Bank stock	24	47	71	

Securities	1,809	1,188	2,997	1,6
Mortgage loans held for sale	72	(9)	63	(
Loans	9,098	19,457	28,555	4,0
Totals	10,486	21,114	31,600	5,6
Interest expense:				
NOW accounts	6	4,001	4,007	2
Money market deposit accounts.......................	(547)	3,199	2,652	(8
Savings deposits.................	(565)	1,909	1,344	
Certificates and other time deposits..................	6,480	13,710	20,190	2,7
Borrowings.......................	1,713	2,525	4,238	4
Totals.........................	7,087	25,344	32,431	2,6
Change in net interest income (fully taxable equivalent basis)...............	$ 3,399	$ (4,230)	(831)	$ 2,9
Tax equivalent adjustment using marginal rate of 35% for 2006, 2005, and 2004.........................			(203)	
Change in net interest income..........................			$ (1,034)	

STATISTICAL DATA (continued)

INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealize Losses
		(Dollars in Thousands)	
Available for sale at December 31, 2006			
U.S. Treasury	$ 1,502	$ 1	
U.S. Government-sponsored agency securities..	87,193	69	$ 1,284
State and municipal	168,262	2,251	892
Mortgage-backed securities	195,228	600	3,983
Marketable equity securities	7,296		310

Total available for sale	459,481	2,921	6,469
Held to maturity at December 31, 2006			
State and municipal	9,266	432	200
Mortgage-backed securities	18		
Total held to maturity	9,284	432	200
Total investment securities	$468,765	$ 3,353	$ 6,669

	Amortized Cost	Gross Unrealized Gains	Gross Unrealize Losses
		(Dollars in Thousands)	
Available for sale at December 31, 2005			
U.S. Treasury	$ 1,586		$ 1
U.S. Government-sponsored agency securities..	83,026	$ 1	1,836
State and municipal	167,095	2,159	1,131
Mortgage-backed securities	168,019	139	5,656
Other asset-backed securities	1		
Marketable equity securities	9,660		435
Total available for sale	429,387	2,299	9,059
Held to maturity at December 31, 2005			
State and municipal	11,609	283	412
Mortgage-backed securities	30		
Total held to maturity	11,639	283	412
Total investment securities	$441,026	$ 2,582	$ 9,471

Page 13

STATISTICAL DATA (continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealize Losses
		(Dollars in Thousands)	
Available for sale at December 31, 2004			
U.S. Treasury	$ 1,745		$ 1
U.S. Government-sponsored agency securities..	65,325	$ 73	332
State and municipal	150,284	5,243	82
Mortgage-backed securities	183,200	485	1,980
Other asset-backed securities	18		
Marketable equity securities	12,191	8	
Total available for sale	412,763	5,809	2,395

Held to maturity at December 31, 2004			
State and municipal	5,306	162	
Mortgage-backed securities	52		
Total held to maturity	5,358	162	
Total investment securities	$418,121	$ 5,971	$ 2,395

	Cost	
	2006	2005
	(Dollars in Thousands)	
Federal Reserve and Federal Home Loan Bank stock at December 31:		
Federal Reserve Bank stock	$ 9,091	$ 8,913
Federal Home Loan Bank stock	14,600	14,287
Total	$23,691	$23,200

The fair value of Federal Reserve and Federal Home Loan Bank stock approximates cost.

There were no issuers included in our investment security portfolio at December 31, 2006, 2005 or 2004 where the aggregate carrying value of any one issuer exceeded 10 percent of the Corporation's stockholders' equity at those dates. The term "issuer" excludes the U.S. Government and its sponsored agencies and corporations.

The maturity distribution (Dollars in Thousands) and average yields for the securities portfolio at December 31, 2006 were:

Securities available for sale December 31, 2006:

	Within 1 Year		1-5 Years	
	Amount	Yield*	Amount	Yie
U.S. Treasury...............................			$ 1,503	4.
U.S. Government-sponsored agency securities..	$15,236	3.4%	69,864	4.
State and Municipal.........................	18,216	4.1	91,671	4.
Total..................................	$33,452	3.8%	$163,038	4.

STATISTICAL DATA (continued)

	Due After Ten Years		Marketable Equity and Mortgage - Backed Securities	
	Amount	Yield*	Amount	Yield*
U.S. Treasury.......................				
U.S. Government-sponsored agency securities................				
State and Municipal.................	$ 8,997	7.9%		
Marketable equity securities.........			$ 6,986	5.8%
Mortgage-backed securities..........			191,845	4.5
Total..........................	$ 8,997	7.9%	$ 198,831	4.6%

Securities held to maturity at December 31, 2006:

	Within 1 Year		1-5 Years	
	Amount	Yield*	Amount	Yield*
State and municipal.................	$ 125	7.2%	$ 830	7.6%

	Due After Ten Years		Mortgage-Backed Securities	
	Amount	Yield*	Amount	Yield*
State and municipal.................	$ 7,431	7.1%		
Other asset-backed securities........			$ 18	8.4%
Total..........................	$ 7,431	7.1%	$ 18	8.4%

*Interest yields on state and municipal securities are presented on a fully taxable equivalent basis using a 35% rate.

STATISTICAL DATA (continued)

Federal Reserve and Federal Home Loan Bank stock at December 31, 2006:

	(Dollars in Thousands) Amount	Yield
Federal Reserve Bank Stock...........	$ 9,091	6.0%
Federal Home Loan Bank stock.........	14,600	4.3
Total..........................	$23,691	4.9%

The following tables show the Corporation's gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2006 and 2005:

	Less than 12 Months		12 Months Longer	
	FAIR VALUE	GROSS UNREALIZED LOSSES	FAIR VALUE	UN
			(Dollars in Th	
Temporarily impaired investment securities at December 31, 2006:				
U.S. Government-sponsored agency securities...........	$ 1,576	$ (3)	$ 71,702	$
State and municipal	9,608	(35)	81,841	
Mortgage-backed securities	7,457	(20)	126,555	
Corporate obligatoins			28	
Marketable equity securities	1,215	(304)		
Total temporarily impaired investment securities ..	$ 19,856	$ (362)	$ 280,126	$

	Less than 12 Months		12 Months Longer	
	FAIR VALUE	GROSS UNREALIZED LOSSES	FAIR VALUE	UN
			(Dollars in Th	
Temporarily impaired investment securities at December 31, 2005:				
U.S. Treasury	$ 1,487	$ (1)		
U.S. Government-sponsored agency securities...........	31,692	(581)	$ 45,466	$
State and municipal	90,905	(1,501)	2,124	
Mortgage-backed securities	59,595	(1,511)	96,120	
Marketable equity securities.........................	27	(8)	1,072	
Total temporarily impaired investment securities ..	$ 183,706	$ (3,602)	$ 144,782	$

STATISTICAL DATA (continued)

LOAN PORTFOLIO

TYPES OF LOANS

The loan portfolio at the dates indicated is presented below:

	2006	2005	2004
Loans at December 31:			
Commercial and industrial loans..............	$ 537,305	$ 461,102	$ 451,227
Agricultural production financing and other loans to farmers.......	100,098	95,130	98,902
Real estate loans:			
Construction..............................	169,491	174,783	164,738
Commercial and farmland...................	861,429	734,865	709,163
Residential...............................	749,921	751,217	761,163
Individuals' loans for household and other personal expenditures..	223,504	200,139	198,532
Tax-exempt loans...........................	14,423	8,263	8,203
Lease financing receivibles, net of unearned income	8,010	8,713	11,311
Other loans.................................	28,420	23,215	24,812
Total loans.......................	$2,692,601	$2,457,427	$2,428,051

(

Residential Real Estate Loans Held for Sale at December 31, 2006, 2005, 2004, 2003 and 2002 were $5,413,000, $4,910,000, $3,367,000, $3,043,000, and $21,545,000.

MATURITIES AND SENSITIVITIES OF LOANS TO CHANGES IN INTEREST RATES

Presented in the table below are the maturities of loans (excluding residential real estate, individuals' loans for household and other personal expenditures and lease financing) outstanding as of December 31, 2006. Also presented are the amounts due after one year classified according to the sensitivity to changes in interest rates.

		Maturing	
	Within 1 Year	1-5 Years	Over 5 Years
		(Dollars in Thousands)	
Commercial and industrial loans...............	$ 310,241	$ 147,678	$ 79,386
Agricultural production financing and other loans to farmers..................	79,024	16,442	4,632
Real estate - Construction.....................	132,547	31,940	5,004
Real estate - Commercial and farmland..........	231,602	446,476	183,351
Tax-exempt loans............................	5,442	3,695	5,286
Other loans..................................	8,250	14,449	5,721
Total..................................	$ 767,106	$ 660,680	$283,380

STATISTICAL DATA (continued)

	Maturing	
	1 - 5 Years	Over 5 Years
	(Dollars in Thousands)	
Loans maturing after one year with:		
Fixed rate	$ 184,861	$ 177,846
Variable rate	475,819	105,534
Total	$ 660,680	$ 283,380

NONACCRUING, CONTRACTUALLY PAST DUE 90 DAYS OR MORE
OTHER THAN NONACCRUING AND RESTRUCTURED LOANS

	December 31			
	2006	2005	2004	2003
			(Dollars in T	
Nonaccruing loans	$17,926	$10,030	$15,355	$19,4
Loans contractually past due 90 days or more other than nonaccruing	2,870	3,965	1,907	6,5
Restructured loans	84	310	2,019	6
	$20,880	$14,305	$19,281	$26,6

Nonaccruing loans are loans which are reclassified to a nonaccruing status when in management's judgment the collateral value and financial condition of the borrower do not justify accruing interest. Interest previously recorded, but not deemed collectible, is reversed and charged against current income. Interest income on these loans is then recognized when collected.

Restructured loans are loans for which the contractual interest rate has been reduced or other concessions are granted to the borrower, because of a deterioration in the financial condition of the borrower resulting in the inability of the borrower to meet the original contractual terms of the loans.

Interest income of $1,365,000 for the year ended December 31, 2006, was recognized on the nonaccruing and restructured loans listed in the table above, whereas interest income of $1,650,000 would have been recognized under their original loan terms.

Potential problem loans:

Management has identified certain other loans totaling $66,656,000 as of December 31, 2006, not included in the table above, or the impaired loan table in the footnotes to the consolidated financial statements, about which there are doubts as to the borrowers' ability to comply with present repayment terms.

The Corporation's affiliate banks generate commercial, mortgage and consumer loans from customers located primarily in north-central and east-central Indiana and Butler, Franklin and Hamilton counties in Ohio. The Banks' loans are generally secured by specific items of collateral, including real property, consumer assets, and business assets.

STATISTICAL DATA (continued)

SUMMARY OF LOAN LOSS EXPERIENCE

The following table summarizes the loan loss experience for the years indicated.

	2006	2005	2004
			(Dollars in Thousands
Allowance for loan losses:			
Balance at January 1....................	$ 25,188	$ 22,548	$ 25,493
Charge-offs:			
Commercial and industrial(1)...........	1,369	3,763	7,455
Real estate mortgage(3)................	3,613	2,117	1,588
Individuals' loans for household and other personal expenditures, including other loans................	1,528	1,864	1,858
Total charge-offs....................	6,510	7,744	10,901
Recoveries:			
Commercial and industrial(2)...........	291	1,283	1,629
Real estate mortgage(4)................	863	122	161
Individuals' loans for household and other personal expenditures, including other loans................	450	625	461
Total recoveries.....................	1,604	2,030	2,251
Net charge-offs..........................	4,906	5,714	8,650
Provisions for loan losses...............	6,258	8,354	5,705
Allowance acquired in purchase...........			
Balance at December 31...................	$26,540	$25,188	$22,548

(1) Category also includes the charge-offs for lease financing, loans to financial institutions, tax-exempt loans and agricultural production financing and other loans to farmers.
(2) Category also includes the recoveries for lease financing, loans to financial institutions, tax-exempt loans and agricultural production financing and other loans to farmers.
(3) Category includes the charge-offs for construction, commercial and farmland and residential real estate loans.

(4)Category includes the recoveries for construction, commercial and farmland and residential real estate loans.

Ratio of net charge-offs during the period to average loans outstanding during the period..........	.19%	.23%	.37%

STATISTICAL DATA (continued)

The information regarding the analysis of loan loss experience on pages 8, 9 and 10 of the First Merchants Corporation - Annual Report 2006 under the caption "ASSET QUALITY/PROVISION FOR LOAN LOSSES" is expressly incorporated herein by reference.

Allocation of the Allowance for Loan Losses at December 31:

Presented below is an analysis of the composition of the allowance for loan losses and percent of loans in each category to total loans:

	2006		
	Amount	Per Cent	Amount
		(Dollars in Thousands)	
Balance at December 31:			
Commercial and industrial(1)...............	$ 9,598	31.0%	$ 7,43
Real estate mortgage(2)....................	12,479	60.5	13,14
Individuals' loans for household and other personal expenditures, including other loans....................	4,363	8.5	4,50
Unallocated................................	100	N/A	10
Totals.....................................	$ 26,540	100.0%	$ 25,18

	2004		
	Amount	Per Cent	Amoun
		(Dollars in Thousands)	
Balance at December 31:			
Commercial and industrial(1)...............	$ 16,821	30.9%	$ 17,51
Real estate mortgage(2)....................	1,916	60.6	4,44
Individuals' loans for household and other personal expenditures, including other loans....................	3,711	8.5	3,43
Unallocated................................	100	N/A	10
Totals.....................................	$ 22,548	100.0%	$ 25,49

	2002	
	Amount	Per Cent
	(Dollars in Thousands)	
Balance at December 31:		
Commercial and industrial(1)................	$ 12,405	31.8%
Real estate mortgage(2)....................	2,875	57.3
Individuals' loans for household and other personal expenditures, including other loans....................	7,037	10.9
Unallocated.	100	N/A
Totals....................................	$ 22,417	100.0%

(1) Category also includes the allowance for loan losses and percent of loans for lease financing, loans to financial institutions, tax-exempt loans, agricultural production financing and other loans to farmers and construction real estate loans.
(2) Category includes the allowance for loan losses and percent of loans for commercial real estate, farmland and residential real estate loans.

At December 31, 2006, the Corporation had no concentration of loans exceeding 10 percent of total loans, which are not otherwise disclosed. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions.

STATISTICAL DATA (continued)

Loan Administration and Loan Loss Charge-off Procedures

Primary responsibility and accountability for day-to-day lending activities rests with the Corporation's affiliate banks. Loan personnel at each bank have the authority to extend credit under guidelines approved by the bank's board of directors. Executive and board loan committees active at each bank serve as vehicles for communication between the banks and for the pooling of knowledge, judgment and experience of the Corporation's affiliate banks. These committees provide valuable input to lending personnel, act as an approval body, and monitor the overall quality of the banks' loan portfolios. The Corporation also maintains a loan grading and review program for its affiliate banks, which includes quarterly reviews of problem loans, delinquencies and charge-offs. The purpose of this program is to evaluate loan administration, credit quality, loan documentation and the adequacy of the allowance for loan losses.

The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. The allowance is increased by the provision for loan losses and decreased by charge-offs less recoveries. All charge-offs are approved by the bank's senior loan officer and are reported to the Banks' Boards. The Banks charge off loans when a determination is made that all or a portion of a loan is uncollectible or as a result of examinations by regulators and the independent auditors.

Provision for Loan Losses

In banking, loan losses are one of the costs of doing business. Although the Banks' management emphasize the early detection and charge-off of loan losses, it is inevitable that at any time certain losses exist in the portfolio which have not been specifically identified. Accordingly, the provision for loan losses is charged to earnings on an anticipatory basis, and recognized loan losses are deducted from the allowance so established. Over time, all net loan losses must be charged to earnings. During the year, an estimate of the loss experience for the year serves as a starting point in determining the appropriate level for the provision. However, the amount actually provided in any period may be greater or less than net loan losses, based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio. The evaluation by management includes consideration of past loan loss experience, changes in the composition of the loan portfolio, and the current condition and amount of loans outstanding.

Impaired loans are measured by the present value of expected future cash flows, or the fair value of the collateral of the loans, if collateral dependent. Information on impaired loans is summarized below:

	2006	200
	(Dollars in T	
As of, and for the year ending December 31:		
Impaired loans with an allowance............................	$ 17,291	$ 7
Impaired loans for which the discounted cash flows or collateral value exceeds the carrying value of the loan...............................	43,029	44
Total impaired loans.................................	$ 60,320	$ 52
Total impaired loans as a percent of total loans.............	2.24%	2
Allowance for impaired loans (included in the Corporation's allowance for loan losses).................	$ 4,130	$ 2
Average balance of impaired loans...........................	66,139	44
Interest income recognized on impaired loans................	5,143	3
Cash basis interest included above..........................	1,364	

STATISTICAL DATA (continued)

DEPOSITS

The average balances, interest income and expense and average rates on deposits for the years ended December 2006, 2005 and 2004 are presented within the "Distribution of Assets, Liabilities and Stockholders' Equity, Interest Rates and Interest Differential" table on page 11 of this Form 10-K.

As of December 31, 2006, certificates of deposit and other time deposits of $100,000 or more mature as follows:

	Maturing			
	3 Months or less	3-6 Months	6-12 Months	Over 12 Months
	(Dollars in Thousands)			
Certificates of deposit and other time deposits..........	$201,073	$ 80,900	$ 94,968	$ 54,127
Per cent......................	46%	19%	22%	13

RETURN ON EQUITY AND ASSETS

The information regarding return on equity and assets presented on page 2 of the First Merchants Corporation - Annual Report 2006 under the caption "Five - Year Summary of Selected Financial Data" is expressly incorporated herein by reference.

SHORT-TERM BORROWINGS

	2006	2005
	(Dollars in Thousa	
Balance at December 31:		
Securities sold under repurchase agreements (short-term portion)........	$ 42,750	$ 106,415
Federal funds purchased.................	56,150	50,000
Total short-term borrowings......	$ 98,900	$ 156,415

Securities sold under repurchase agreements are borrowings maturing within one year and are secured by U.S. Treasury and U.S. Government-sponsored agency securities.

Pertinent information with respect to short-term borrowings is summarized below:

	2006	2005
	(Dollars in Th	
Weighted average interest rate on outstanding balance at December 31:		
Securities sold under repurchase agreements(short-term portion).............	4.4%	3.8%
Total short-term borrowings....................	4.9	4.3
Weighted average interest rate during the year:		
Securities sold under repurchase agreements (short-term portion)............	4.4%	2.1%
Total short-term borrowings....................	4.6	2.3
Highest amount outstanding at any month end during the year:		

Securities sold under repurchase agreements (short-term portion)............	$ 98,765	$ 68,198
Total short-term borrowings....................	219,337	144,898
Average amount outstanding during the year:		
Securities sold under repurchase agreements (short-term portion)............	$ 73,818	$ 77,969
Total short-term borrowings....................	109,577	95,447

ITEM 1A. RISK FACTORS

RISK FACTORS

There are a number of factors, including those specified below, that may adversely affect the Corporation's business, financial results or stock price. Additional risks that the Corporation currently does not know about or currently views as immaterial may also impair the Corporation's business or adversely impact its financial results or stock price.

INDUSTRY RISK FACTORS

* The Corporation's business and financial results are significantly affected by general business and economic conditions.

The Corporation's business activities and earnings are affected by general business conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the United States economy and the state and local economies in which the Corporation operates. For example, an economic downturn, an increase in unemployment, or other events that affect household and/or corporate incomes could result in a deterioration of credit quality, a change in the allowance for loan losses, or reduced demand for loan or fee-based products and services. Changes in the financial performance and condition of the Corporation's borrowers could negatively affect repayment of those borrowers' loans. In addition, changes in securities market conditions and monetary fluctuations could adversely affect the availability and terms of funding necessary to meet the Corporation's liquidity needs.

* Changes in the domestic interest rate environment could reduce the Corporation's net interest income.

The operations of financial institutions such as the Corporation are dependent to a large degree on net interest income, which is the difference between interest income from loans and investments and interest expense on deposits and borrowings. An institution's net interest income is significantly affected by market rates of interest, which in turn are affected by prevailing economic conditions, by the fiscal and monetary policies of the federal government and by the policies of various regulatory agencies. Like all financial institutions, the Corporation's balance sheet is affected by fluctuations in interest rates. Volatility in interest rates can also result in the flow of funds away from financial institutions into direct investments. Direct investments, such as U.S. Government and corporate securities and other investment vehicles (including mutual funds) generally pay higher rates of return than financial institutions, because of the absence of federal insurance premiums and reserve requirements.

* Changes in the laws, regulations and policies governing banks and financial services companies could alter the Corporation's business environment and adversely affect operations.

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its fiscal and monetary policies determine in a large part the Corporation's cost of funds for lending and investing and the return that can be earned on those loans and investments, both of which affect the Corporation's net interest margin. Federal Reserve Board policies can also materially affect the value of financial instruments that the Corporation holds, such as debt securities. The Corporation and its bank subsidiaries are heavily regulated at the federal and state levels. This regulation is to protect depositors, federal deposit insurance funds and the banking system as a whole. Congress and state legislatures and federal and state agencies continually review banking laws, regulations and policies for possible changes. Changes in statutes, regulations or policies could affect the Corporation in substantial and unpredictable ways, including limiting the types of financial services and products that the Corporation offers and/or increasing the ability of non-banks to offer competing financial services and products. The Corporation cannot predict whether any of this potential legislation will be enacted, and if enacted, the effect that it or any regulations would have on the Corporation's financial condition or results of operations.

* The banking and financial services industry is highly competitive, and competitive pressures could intensify and adversely affect the Corporation's financial results.

The Corporation operates in a highly competitive industry that could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. The Corporation competes with other banks, savings and loan associations, mutual savings banks, finance companies, mortgage banking companies, credit unions and investment companies. In addition, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks. Many of the Corporation's competitors have fewer regulatory constraints and some have lower cost structures. Also, the potential need to adapt to industry changes in information technology systems, on which the Corporation and financial services industry are highly dependent, could present operational issues and require capital spending.

* Acts or threats of terrorism and political or military actions taken by the United States or other governments could adversely affect general economic or industry conditions.

Geopolitical conditions may also affect the Corporation's earnings. Acts or threats or terrorism and political or military actions taken by the United States or other governments in response to terrorism, or similar activity, could adversely affect general economic or industry conditions.

CORPORATION RISK FACTORS

* The Corporation's allowance for loan losses may not be adequate to cover actual losses.

The Corporation maintains an allowance for loan losses to provide for loan defaults and non-performance. The allowance for loan losses represents management's estimate of probable losses inherent in the Corporation's loan portfolio. The Corporation's allowance consists of three components: probable losses estimated from individual reviews of specific loans, probable losses estimated from historical loss rates, and probable losses resulting from economic, environmental, qualitative or other deterioration above and beyond what is reflected in the first two components of the allowance. The process for determining the adequacy of the allowance for loan losses is critical to our financial results. It requires management to make difficult, subjective and complex judgments, as a result of the need to make estimates about the effect of matters that are uncertain. Therefore, the allowance for loan losses, considering current factors at the time, including economic conditions and ongoing internal and external examination processes, will increase or decrease as deemed necessary to ensure the allowance for loan losses remains adequate. In addition, the allowance as a percentage of charge-offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

* The Corporation may suffer losses in its loan portfolio despite its underwriting practices.

The Corporation seeks to mitigate the risks inherent in its loan portfolio by adhering to specific underwriting practices. The Corporation's strategy for credit risk management includes conservative credit policies and underwriting criteria for all loans, as well as an overall credit limit for each customer significantly below legal lending limits. The strategy also emphasizes diversification on a geographic, industry and customer level, regular credit quality reviews and management reviews of large credit exposures and loans experiencing deterioration of credit quality. There is a continuous review of the loan portfolio, including an internally administered loan "watch" list and an independent loan review. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that are not specifically identified. Although the Corporation believes that its underwriting criteria are appropriate for the various kinds of loans it makes, the Corporation may incur losses on loans due to the factors previously discussed.

* Because the nature of the financial services business involves a high volume of transactions, the Corporation faces significant operational risks.

The Corporation operates in diverse markets and relies on the ability of its employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from the Corporation's operations, including, but not limited to, the risk of fraud by employees or persons outside of the Corporation, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements and business continuation and disaster recovery. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, the Corporation could suffer financial loss, face regulatory action and suffer damage to its reputation.

* A natural disaster could harm the Corporation's business.

Natural disasters could harm the Corporation's operations directly through interference with communications, as well as through the destruction of facilities and operational, financial and management information systems. These events could prevent the Corporation from gathering deposits, originating loans and processing and controlling its flow of business.

* The Corporation faces systems failure risks as well as security risks, including "hacking" and "identity theft."

The computer systems and network infrastructure the Corporation uses could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect computer equipment against damage from fire, power loss or telecommunication failure. Any damage or failure that causes an interruption in our operations could adversely affect our business and financial results. In addition, our computer systems and network infrastructure present security risks, and could be susceptible to hacking or identity theft.

* The Corporation relies on dividends from its subsidiaries for its liquidity needs.

The Corporation is a separate and distinct legal entity from its bank and non-bank subsidiaries. The Corporation receives substantially all of its cash from dividends paid by its subsidiaries. These dividends are the principal source of funds to pay dividends on the Corporation's stock and interest and principal on its debt. Various federal and state laws and regulations limit the amount of dividends that our bank subsidiaries may pay to the Corporation.

* The Corporation's reported financial results depend on management's selection of accounting methods and certain assumptions and estimates.

The Corporation's accounting policies and methods are fundamental to how it records and reports its financial condition and results of operations. The Corporation's management must exercise judgment in selecting and applying many of these accounting policies and methods, so they comply with Generally Accepted Accounting Principles and reflect management's judgment of the most appropriate manner to report the Corporation's financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which might be reasonable under the circumstances yet might result in the Corporation's reporting materially different results than would have been reported under a different alternative. Certain accounting policies are critical to presenting the Corporation's financial condition and results, and require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include: the allowance for loan losses; the valuation of investment securities; the valuation of goodwill and intangible assets; and pension accounting. Because of the uncertainty of estimates involved in these matters, the Corporation may be required to do one or more of the following: significantly increase the allowance for loan losses and/or sustain loan losses that are significantly higher than the reserve provided; recognize significant provision for impairment of its investment securities; recognize significant impairment on its goodwill and intangible assets; or significantly increase its pension liability. For more information, refer to pages 4 through 6 of the First Merchants Corporation - Annual Report 2006 under the caption "Critical Accounting Policies."

* Changes in accounting standards could materially impact the Corporation's financial statements.

From time to time, the Financial Accounting Standards Board changes the financial accounting and reporting standards that govern the preparation of the Corporation's financial statements. These changes can be hard to predict and can materially impact how the Corporation records and reports its financial condition and results of operations. In some cases, the Corporation could be required to apply a new or revised standard retroactively, resulting in the Corporation's restating prior period financial statements.

* Significant legal actions could subject the Corporation to substantial

uninsured liabilities.

The Corporation is from time to time subject to claims related to its operations. These claims and legal actions, including supervisory actions by the Corporation's regulators, could involve large monetary claims and significant defense costs. To protect itself from the cost of these claims, the Corporation maintains insurance coverage in amounts and with deductibles that it believes are appropriate for its operations. However, the Corporation's insurance coverage may not cover all claims against the Corporation or continue to be available to the Corporation at a reasonable cost. As a result, the Corporation may be exposed to substantial uninsured liabilities, which could adversely affect the Corporation's results of operations and financial condition.

* Negative publicity could damage the Corporation's reputation and adversely impact its business and financial results.

Reputation risk, or the risk to the Corporation's earnings and capital from negative publicity, is inherent in the Corporation's business. Negative publicity can result from the Corporation's actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and actions taken by government regulators and community organizations in response to those activities. Negative publicity can adversely affect the Corporation's ability to keep and attract customers and can expose the Corporation to litigation and regulatory action. Although the Corporation takes steps to minimize reputation risk in dealing with customers and other constituencies, the Corporation is inherently exposed to this risk.

* Acquisitions may not produce revenue enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties.

The Corporation regularly explores opportunities to acquire banks, financial institutions, or other financial services businesses or assets. The Corporation cannot predict the number, size or timing of acquisitions. Difficulty in integrating an acquired business or company may cause the Corporation not to realize expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from the acquisition. The integration could result in higher than expected deposit attrition (run-off), loss of key employees, disruption of the Corporation's business or the business of the acquired company, or otherwise adversely affect the Corporation's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the acquisition. Also, the negative effect of any divestitures required by regulatory authorities in acquisitions or business combinations may be greater than expected.

* The Corporation's stock price can be volatile.

The Corporation's stock price can fluctuate widely in response to a variety of factors, including: actual or anticipated variations in the Corporation's quarterly operating results; recommendations by securities analysts; significant acquisitions or business combinations; strategic partnerships, joint ventures or capital commitments; operating and stock price performance of other companies that investors deem comparable to the Corporation; new technology used or services offered by the Corporation's competitors; news reports relating to trends, concerns and other issues in the banking and financial services industry, and changes in government regulations. General market fluctuations, industry factors and general economic and political conditions and events, including terrorist attacks, economic slowdowns or recessions, interest rate changes, credit loss trends or currency fluctuations, could also cause the Corporation's stock price to decrease, regardless of the Corporation's operating results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES.

The headquarters of the Corporation and First Merchants are located in a five-story building at 200 East Jackson Street, Muncie, Indiana. The building is owned by First Merchants.

The Corporation's affiliate banks conduct business through numerous facilities owned and leased by the respective affiliate banks. Of the 65 banking offices operated by the Corporation's affiliate banks, 49 are owned by the respective banks and 16 are leased from non-affiliated third parties.

None of the properties owned by the Corporation's affiliate banks are subject to any major encumbrances. The net investment of the Corporation and subsidiaries in real estate and equipment at December 31, 2006 was $42,393,000.

ITEM 3. LEGAL PROCEEDINGS.

There is no pending legal proceeding, other than ordinary routine litigation incidental to the 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 is no material legal proceeding 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted during the fourth quarter of 2006 to a vote of security holders, through the solicitation of proxies or otherwise.

SUPPLEMENTAL INFORMATION - EXECUTIVE OFFICERS OF THE REGISTRANT.

The names, ages, and positions with the Corporation and subsidiary banks of all executive officers of the Corporation and all persons chosen to become executive officers are listed below. The officers are elected by the Board of Directors of the Corporation for a term of one (1) year or until the election of their successors. There are no arrangements between any officer and any other person pursuant to which he was selected as an officer.

Offices with the Corporation Pri

Name and Age	And Subsidiary Banks	Duri
Michael L. Cox 62	President, Chief Executive Officer, Corporation	Chief Execut since April from April 1 and Chief Op August 1998 respectively Officer, Fir April 1999; Merchants si
Michael C. Rechin 48	Executive Vice President and Chief Operating Officer, Corporation	Executive Vi Officer, Cor Executive Vi National Cit 2005.(1)
Mark K. Hardwick 36	Executive Vice President and Chief Financial Officer, Corporation	Executive Vi Officer of t Senior Vice Officer from Corporate Co 1997 to Apri
Robert R. Connors 57	Senior Vice President, Chief Information Officer, Corporation and First Merchants	Senior Vice Officer of t since Januar Operations a First Mercha 2006; Senior Compliance O Indiana from
Shawn R. Blackburn 53	Senior Vice President of Administrative Services, Corporation	Senior Vice Services, Co National Ban of the Curre
Kimberly J. Ellington 47	Senior Vice President and Director of Human Resources, Corporation	Senior Vice Resources si Director of 1999 to 2004
David W. Spade 54	Senior Vice President and Chief Credit Officer, Corporation	Senior Vice of First Mer 2007; Vice P of First Mer 2006 to Febr and Chief Le Bank from No Executive Vi