FIRST MID ILLINOIS BANCSHARES INC
Form 10-K
March 06, 2017

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, 2016
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 0-13368
FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware	37-1103704
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
1421 Charleston Avenue, Mattoon, Illinois	61938
(Address of principal executive offices)	(Zip code)

(217) 234-7454
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:
Common stock, par value $4.00 per share
(Title of class)

Securities registered pursuant to Section 12(g) of the Act:
NONE

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [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 amendments to this Form Yes [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [X]
Non-accelerated filer [ ] Smaller reporting company [ ]

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

The aggregate market value of the outstanding common stock, other than shares held by persons who may be deemed affiliates of the Registrant, as of the last business day of the Registrant’s most recently completed second fiscal quarter was approximately $199,086,958. Determination of stock ownership by non-affiliates was made solely for the purpose of responding to this requirement and the Registrant is not bound by this determination for any other purpose.

As of March 3, 2017, 12,479,559 shares of the Registrant’s common stock, $4.00 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Into Form 10-K Part:
Portions of the Proxy Statement for 2017 Annual Meeting of Shareholders to be held on April 26, 2017	III

First Mid-Illinois Bancshares, Inc.
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PART I

ITEM 1. BUSINESS

Company and Subsidiaries

First Mid-Illinois Bancshares, Inc. (the "Company") is a financial holding company. The Company is engaged in the business of banking through its wholly owned subsidiaries, First Mid-Illinois Bank & Trust, N.A. ("First Mid Bank") and First Clover Leaf Bank, N.A. ("First Clover Leaf Bank"). The Company provides data processing services to affiliates through another wholly owned subsidiary, Mid-Illinois Data Services, Inc. ("MIDS"). The Company offers insurance products and services to customers through its wholly owned subsidiary, The Checkley Agency, Inc. doing business as First Mid Insurance Group ("First Mid Insurance"). The Company also wholly owns three statutory business trusts, First Mid-Illinois Statutory Trust I ("First Mid Trust I"), and First Mid-Illinois Statutory Trust II ("First Mid Trust II"), and Clover Leaf Statutory Trust I ("CLST Trust"), all of which are unconsolidated subsidiaries of the Company.

The Company, a Delaware corporation, was incorporated on September 8, 1981, and pursuant to the approval of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") became the holding company owning all of the outstanding stock of First National Bank, Mattoon ("First National") on June 1, 1982. First National changed its name to First Mid-Illinois Bank & Trust, N.A. in 1992. The Company acquired all of the outstanding stock of a number of community banks or thrift institutions on the following dates, and subsequently combined their operations with those of the Company:

- Mattoon Bank, Mattoon on April 2, 1984
- State Bank of Sullivan on April 1, 1985
- Cumberland County National Bank in Neoga on December 31, 1985
- First National Bank and Trust Company of Douglas County on December 31, 1986
- Charleston Community Bank on December 30, 1987
- Heartland Federal Savings and Loan Association on July 1, 1992
- Downstate Bancshares, Inc. on October 4, 1994
- American Bank of Illinois on April 20, 2001
- Peoples State Bank of Mansfield on May 1, 2006
- First Clover Leaf Financial on September 8, 2016

In 1997, First Mid Bank acquired the Charleston, Illinois branch location and the customer base of First of America Bank and in 1999 acquired the Monticello, Taylorville and DeLand branch offices and deposit base of Bank One Illinois, N.A.

First Mid Bank also opened a de novo branch in Decatur, Illinois (2000); de novo branches in Champaign, Illinois and Maryville, Illinois (2002), a de novo branch in Highland, Illinois (2005) de novo branches in Decatur, Illinois and Champaign, Illinois (2009), and a de novo branch in Decatur, Illinois (2013).

In 2002, the Company acquired all of the outstanding stock of First Mid Insurance, an insurance agency located in Mattoon.

On September 10, 2010, First Mid Bank acquired 10 Illinois branches from First Bank, a Missouri state chartered bank, located in Bartonville, Bloomington, Galesburg, Knoxville, Peoria and Quincy, Illinois.

On August 14, 2015 First Mid Bank acquired 12 Illinois branch offices (the "ONB Branches") of Old National Bank in Southern Illinois, a national banking association having its principal office in Evansville, Indiana, located in Lawrenceville, Mt Carmel, Mt Vernon, Carmi, De Soto, Murphysboro, Marion, Harrisburg, Carterville and Carbondale, Illinois.

On December 1, 2015 FIrst Mid Insurance acquired Illiana Insurance Agency, LTD ("Illiana"), an insurance agency based in Philo, Illinois.

Employees

The Company, MIDS, First Mid Insurance, First Mid Bank and First Clover Leaf Bank, collectively, employed 598 people on a full-time equivalent basis as of December 31, 2016. The Company places a high priority on staff development, which involves extensive training, including customer service training. New employees are selected on the basis of experience, technical skills and customer service capabilities. None of the employees are covered by a collective bargaining agreement with the Company. The Company offers a variety of employee benefits.

Business Lines

The Company has chosen to operate in three primary lines of business—community banking and wealth management through First Mid Bank and First Clover Leaf Bank and insurance brokerage through First Mid Insurance. Of these, the community banking line contributes approximately 97% of the Company's total revenues and profits. Within the community banking line, the Company serves commercial, retail and agricultural customers with a broad array of deposit and loan related products. The wealth management line provides estate planning, investment and farm management services for individuals and employee benefit services for business enterprises. The insurance brokerage line provides commercial lines insurance to businesses as well as homeowner, automobile, health, life and other types of personal lines insurance to individuals. All three lines emphasize a "hands on" approach to service so that products and services can be tailored to fit the specific needs of existing and potential customers. Management believes that by emphasizing this personalized approach, the Company can, to a degree, diminish the trend towards homogeneous financial services, thereby differentiating the Company from competitors and allowing for slightly higher operating margins in each of the three lines.

Business Strategies

Mission Statement. The Company's mission statement is to fulfill the financial needs of our communities with exceptional personal service, professionalism and integrity, and deliver meaningful value and results for customers and shareholders.

Achieve 2020. Achieve 2020 is a strategic plan that was developed in 2015. This multi-year strategic plan has broad-based initiatives designed to ensure the Company performs at a level with the highest performing community banks in the Midwest and to increase value for its shareholders, customers and employees in the future. The strategic plan was developed by executive management of the Company, modified and adopted by the Board of Directors and communicated to employees. The plan is reviewed and updated, if needed, annually. The Achieve 2020 plan was not undertaken as a result of any weaknesses or deficiencies identified during the Company's control assessments but rather as part of the Company's effort to continually assess and improve. Achieve 2020 is comprised of broad strategies that impact growth, customers, employees, and operations and infrastructure, shareholders and risk management. Following is a description of these strategies.

Growth Strategy. The Company believes that growth of revenues and its customer base is vital to the goal of increasing the value of its shareholders' investment. The Company strives to create shareholder value by maintaining a strong balance sheet and increasing profits. Management attempts to grow in two primary ways:

· by organic growth through adding new customers and selling more products and services to existing customers; and
· by strategic acquisitions.

Virtually all of the Company's customer-contact personnel, in each of its business lines, are engaged in organic growth efforts to one degree or another. These personnel attempt to match products and services with the particular financial needs of individual customers and prospective customers. Many senior officers of the organization are required to attend monthly meetings where they report on their business development efforts and results. Executive management uses these meetings as an educational and risk management opportunity as well. Cross-selling opportunities are encouraged and measured between the business lines and is facilitated by an on-line application.

Within the community banking line, the Company has focused on growing business operating and real estate loans. Total commercial real estate loans have increased from $316 million at December 31, 2012 to $630 million at December 31, 2016. Of this increase, approximately $20 million was the result of the acquisition of the ONB Branches in the third quarter of 2015 and $156 million was the result of the acquisition of First Clover Leaf in the third quarter of 2016. Approximately 62% of the Company's total revenues were derived from lending activities in the fiscal year ended December 31, 2016. The Company has also focused on growing its commercial and retail deposit base through growth in checking, money markets and customer repurchase agreement balances. The wealth management line has focused its growth efforts on estate planning, and investment services for individuals and employee benefit services for businesses. The insurance brokerage line has focused on increasing property and casualty, senior insurance products and group medical insurance for businesses and personal lines insurance to individuals.

Growth through acquisitions has been an integral part of the Company's strategy for an extended period of time. When reviewing acquisition possibilities, the Company focuses on those organizations where there is a cultural fit with its existing operations and where there is a strong likelihood of building shareholder value.

Customer Strategy. The Company uses its market and customer knowledge to build relationships that provide high-value customer experiences that continually improve customer satisfaction and loyalty.

Employee Strategy. The Company strives for employee engagement at all levels of the organization. The judgments, experiences and capabilities of these employees are used to create an environment where meeting the needs of our customer, communities and stockholders is always a priority.

Strategy for Operations & Infrastructure. Operationally, the Company centralizes most administrative and operational tasks within its home office in Mattoon, Illinois. This allows branches to maintain customer focus, helps assure compliance with banking regulations, keeps fixed administrative costs at as low a level as practicable, and allows for better management of risk inherent in the business. The Company also utilizes technology where practicable in daily banking activities to reduce the potential for human error. While the Company does not employ every new technology that is introduced, it attempts to be competitive with other banking organizations with respect to operational and customer technology.

Shareholder Strategy. The Company strives to provide a competitive dividend as well as the opportunity for stock price appreciation and is focused on improving the liquidity of the stock.

Risk Management Strategy. The Company maintains a comprehensive risk management framework. The Company has initiated an Enterprise Risk Management ("ERM") process whereby management assesses the relevant risks inherent in the business, determines internal controls and procedures are in place to address the various risks, develops a structure for monitoring and reporting risk indicators and trends over time, and incorporates action plans to manage risk positions. The ERM process was not undertaken as a result of any weaknesses or deficiencies identified during the Company's control assessments but rather is part of the Company's effort to continually assess and improve by taking a more holistic approach to risk management. The Company's Chief Risk Management Officer is responsible for facilitating the ERM process. The Company utilizes a comprehensive set of operational policies and procedures that have been developed over time. These policies are continually reviewed by management, the Chief Risk Management Officer, and the Board of Directors. The Company's internal audit function completes procedures to ensure compliance with these policies. While there are several risks that pertain to the business of banking, three risks that are inherent with most banking companies are credit risk, interest rate risk, and liquidity risk.

In the business of banking, credit risk is an important risk as losses from uncollectible loans can diminish capital, earnings and shareholder value. In order to address this risk, the lending function of First Mid Bank and First Clover Leaf Bank receives significant oversight from executive management and the Board of Directors. An important element of credit risk management is the quality, experience and training of the loan officers. The Company has invested, and will continue to invest, significant resources to ensure the quality, experience and training of our loan officers in order to keep credit losses at a minimum. In addition to the human element of credit risk management, the Company's loan policies address the additional aspects of credit risk. Most lending personnel have signature authority that allows them to lend up to a certain amount based on their own judgment as to the creditworthiness of a borrower. The amount of the signature authority is based on the lending officers' experience and training. The Senior Loan Committee, consisting of the most experienced lenders within the organization, must approve all underwriting decisions in excess of $4 million and up to $15 million. The full Board of Directors must approve all underwriting decisions in excess of $15 million. The legal lending limit for First Mid Bank was $29.6 million at December 31, 2016 and the legal lending limit for First Clover Leaf was $11.7 million at December 31, 2016. While the underlying nature of lending will result in some amount of loan losses, First Mid's loan loss experience has been good with average net charge offs amounting to $0.8 million (0.07% of total loans) over the past five years. Nonperforming loans were $18.2 million (1.00% of total loans) at December 31, 2016. These percentages have historically compared well with peer financial institutions and continue to do so today.

Interest rate and liquidity risk are two other forms of risk embedded in the banking business. The Company's Asset Liability Management Committee, consisting of experienced individuals, from various departments, who monitor all aspects of interest rates and maturities of interest earning assets and interest paying liabilities, manages these risks. The underlying objectives of interest rate and liquidity risk management are to shelter the Company's net interest margin from changes in interest rates while maintaining adequate liquidity reserves to meet unanticipated funding demands. The Company uses financial modeling technology as a tool for evaluating these risks. Despite the tools and methods used to monitor this risk, a sustained unfavorable interest rate environment will lead to some amount of compression in the net interest margin. During 2016, the Company's net interest margin increased to 3.28% from 3.27% in 2015 primarily due to the deployment of additional cash received from the ONB acquisition to higher yielding investments and loans.

Markets and Competition

The Company has active competition in all areas in which First Mid Bank and First Clover Leaf Bank do business. The Banks compete for commercial and individual deposits, loans, and trust business with many east central Illinois banks, savings and loan associations, and credit unions. The principal methods of competition in the banking and financial services industry are quality of services to customers, ease of access to facilities, on-line services and pricing of services, including interest rates paid on deposits, interest rates charged on loans, and fees charged for fiduciary and other banking services.

During 2016, First Mid Bank and First Clover Leaf Bank operated branches in the Illinois counties of Adams, Champaign, Christian, Coles, Cumberland, Dewitt, Douglas, Effingham, Jackson, Jefferson, Knox, Lawrence, Macon, Madison, Moultrie, McClean, Peoria, Piatt, Saline, St Clair, Wabash, White and Williamson and in Missouri, St. Louis county. Each branch primarily serves the community in which it is located. First Mid Bank served thirty-three different communities with forty-six separate locations in Illinois. First Clover Leaf Bank was acquired in September 2016 and has 7 banking centers in 4 Illinois and 1 Missouri communities. Within the areas of service, there are numerous competing financial institutions and financial services companies.

Website

The Company maintains a website at www.firstmid.com. All periodic and current reports of the Company and amendments to these reports filed with the Securities and Exchange Commission (“SEC”) can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

Branch Purchase and Assumption

On January 30, 2015, First Mid Bank, a wholly-owned subsidiary of the Company, entered into a Purchase and Assumption Agreement (the “Purchase Agreement”) with Old National Bank, a national banking association having its principal office in Evansville, Indiana, pursuant to which First Mid Bank purchased certain assets and assumed certain liabilities of 12 branch offices of Old National Bank in Southern Illinois. Pursuant to the terms of the Purchase Agreement, First Mid Bank agreed to assume certain deposit liabilities and to acquire certain loans, as well as cash, real property, furniture, and other fixed operating assets associated with the ONB Branches. The book value of loan and deposit balances assumed was approximately $156 million and $453 million, respectively. First Mid Bank also agreed to assume certain leases, and entered into certain subleases, relating to the ONB Branches. The completion of the purchase was subject to regulatory approval required by the Office of the Comptroller of the Currency and normal customary closing conditions, including First Mid Bank, in conjunction with the Company, obtaining financing in connection with the acquisition. Following satisfaction of these conditions, First Mid Bank and Old National Bank closed the acquisition on August 14, 2015.

Capital Raise

On June 18, 2015, the Company entered into a securities purchase agreement with a limited number of institutional investors to sell, and accepted from certain other accredited investors, including certain directors of the Company, subscriptions for, an aggregate total of 1,392,859 newly issued shares of the Company's common stock at a purchase price of $21.00 per share, for an aggregate gross purchase price of approximately $29,250,039 (the "Offering"). The Offering closed on June 19, 2015. The Company used the net proceeds of the Offering to provide capital support for the purchase of the ONB Branches and for general corporate purposes.

Acquisition of Illiana

On December 1, 2015, First Mid Insurance Group, a wholly-owned subsidiary of the Company, acquired substantially all of the assets of Illiana, Insurance Limited, LTD, a senior health plan and life insurance and annuities business.

Agreement and Plan of Merger

On April 26, 2016, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with First Clover Leaf Financial Corp., a Maryland corporation ("First Clover Leaf"), pursuant to which, amongst other things, the Company agreed to acquire 100% of the issued and outstanding shares of First Clover Leaf pursuant to a business combination whereby First Clover Leaf would merge with and into the Company, with the Company as the surviving entity (the "Merger").

On September 8, 2016, the effective time of the Merger, 25% of the shares of First Clover Leaf common stock issued and outstanding immediately prior to the effective time of the Merger converted into the right to receive $12.87 per share, for an approximate aggregate total of $22,545,000, and 75% of the shares of First Clover Leaf common stock issued and outstanding immediately prior to the effective time of the Merger converted into the right to receive 0.495 shares of the Company’s common stock, par value $4.00 per share, for an approximate aggregate total of 2,600,616 shares of the Company’s common stock. Cash in lieu of fractional shares of Company common stock were issued in connection with the Merger.

The Company expects to merge First Clover Leaf Bank into FIrst Mid-Illinois Bank in the first quarter of 2017.

Supervision and Regulation

General

Financial institutions, financial services companies, and their holding companies are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes and regulations and the policies of various governmental regulatory authorities including, but not limited to, the Office of the Comptroller of the Currency (the “OCC”), the Federal Reserve Board, the Federal Deposit Insurance Corporation (the “FDIC”), the Internal Revenue Service and state taxing authorities. Any change in applicable laws, regulations or regulatory policies may have material effects on the business, operations and prospects of the Company, First Mid Bank and First Clover Leaf Bank. The Company is unable to predict the nature or extent of the effects that fiscal or monetary policies, economic controls or new federal or state legislation may have on its business and earnings in the future.

Federal and state laws and regulations generally applicable to financial institutions and financial services companies, such as the Company and its subsidiaries, regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to the Company and its subsidiaries establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC’s deposit insurance fund and the depositors, rather than the stockholders, of financial institutions.

The following references to material statutes and regulations affecting the Company and its subsidiaries are brief summaries thereof and do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations. Any change in applicable law or regulations may have a material effect on the business of the Company and its subsidiaries.

Financial Modernization Legislation

The 1999 Gramm-Leach-Bliley Act (the “GLB Act”) significantly changed financial services regulation by expanding permissible non-banking activities of bank holding companies and removing certain barriers to affiliations among banks, insurance companies, securities firms and other financial services entities. These activities and affiliations can be structured through a holding company structure or, in the case of many of the activities, through a financial subsidiary of a bank. The GLB Act also established a system of federal and state regulation based on functional regulation, meaning that primary regulatory oversight for a particular activity generally resides with the federal or state regulator having the greatest expertise in the area. Banking is supervised by banking regulators, insurance by state insurance regulators and securities activities by the SEC and state securities regulators. The GLB Act also requires the disclosure of agreements reached with community groups that relate to the Community Reinvestment Act, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

The GLB Act repealed the anti-affiliation provisions of the Glass-Steagall Act and revised the Bank Holding Company Act of 1956 (the "BHCA") to permit qualifying holding companies, called "financial holding companies," to engage in, or to affiliate with companies engaged in, a full range of financial activities, including banking, insurance activities (including insurance portfolio investing), securities activities, merchant banking and additional activities that are "financial in nature," incidental to financial activities or, in certain circumstances, complementary to financial activities. A bank holding company's subsidiary banks must be "well-capitalized" and "well-managed" and have at least a "satisfactory" Community Reinvestment Act rating for the bank holding company to elect and maintain its status as a financial holding company.

A significant component of the GLB Act's focus on functional regulation relates to the application of federal securities laws and SEC oversight of some bank securities activities previously exempt from broker-dealer registration. Among other things, the GLB Act amended the definitions of "broker" and "dealer" under the Securities Exchange Act of 1934, as amended, to remove the blanket exemption for banks. Under the GLB Act, banks may conduct securities activities without broker-dealer registration only if the activities fall within a set of activity-based exemptions designed to allow banks to conduct only those activities traditionally considered to be primarily banking or trust activities.

Securities activities outside these exemptions, as a practical matter, need to be conducted by a registered broker-dealer affiliate. The GLB Act also amended the Investment Advisers Act of 1940 to require the registration of banks that act as investment advisers for mutual funds. The Company believes that it has taken the necessary actions to comply with these requirements of the GLB Act and the regulations adopted under them.

Anti-Terrorism Legislation

The USA PATRIOT Act of 2001 included the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (the "IMLAFA"). The IMLAFA contains anti-money laundering measures affecting insured depository institutions, broker-dealers, and certain other financial institutions. The IMLAFA requires U.S. financial institutions to adopt policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on financial institutions' operations. The Company has established policies and procedures for compliance with the IMLAFA and the related regulations. The Company has designated an officer solely responsible for ensuring compliance with existing regulations and monitoring changes to the regulations as they occur.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law. The Company will continue to evaluate the affects of these changes. Uncertainty remains as to the ultimate impact of the Act, which could have a material adverse impact either on the financial services industry as a whole, or on the Company's business, results of operations and financial condition. The Act, among other things:

- Resulted in the Federal Reserve issuing rules limiting debit-card interchange fees.

- After a three-year phase-in period which began January 1, 2013, existing trust preferred securities for holding companies with consolidated assets greater than $15 billion and all new issuances of trust preferred securities are removed as a permitted component of a holding company's Tier 1 capital. Trust preferred securities outstanding as of May 19, 2010 that were issued by bank holding companies with total consolidated assets of less than $15 billion, such as First Mid, will continue to count as Tier 1 capital.

- Provides for an increase in the FDIC assessment for depository institutions with assets of $10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% (however, the FDIC is to offset the effect of this increase for holding companies with total consolidated assets of less than $10 billion, such as First Mid) and changes in the basis for determining FDIC premiums from deposits to assets.

- Creates a new Consumer Financial Protection Bureau that will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and certain non-bank financial institutions and would have broad powers to supervise and enforce consumer protection laws.

- Provides for new disclosure and other requirements relating to executive compensation and corporate governance.

- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries.

- Provides mortgage reform provisions including (i) a customer's ability to repay, (ii) restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by requiring lenders to evaluate using the maximum rate that will apply during the first five years of a variable-rate loan term, and (iii) making more loans subject to provisions for higher cost loans and new disclosures.

- Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

- Permanently increases the deposit insurance coverage to $250 thousand and allows depository institutions to pay interest on checking accounts.

- Requires publicly-traded bank holding companies with assets of $10 billion or more to establish a risk committee responsible for enterprise-wide risk management practices.

- Limits and regulates, under the provisions of the Act know as the Volker Rule, a financial institution's ability to engage in proprietary trading or to own or invest in certain private equity and hedge funds.

Basel III

In September 2010, the Basel Committee on Banking Supervision proposed higher global minimum capital standards, including a minimum Tier 1 common capital ratio and additional capital and liquidity requirements. On July 2, 2013, the Federal Reserve Board approved a final rule to implement these reforms and changes required by the Dodd-Frank Act. This final rule was subsequently adopted by the OCC and the FDIC.

The final rule included new risk-based capital and leverage ratios, which are being phased in from 2015 to 2019, and refined the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Company and First Mid Bank beginning in 2015 were: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The rule also established a "capital conservation buffer" of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital level falls below the buffer amount.

The final rule also made three changes to the proposed rule of June 2012 that impacted the Company. First, the proposed rule required banking organizations to include accumulated other comprehensive income ("AOCI") in common equity tier 1 capital. AOCI includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income. Under existing general risk-based capital rules, most components of AOCI are not included in a banking organization's regulatory capital calculations. The final rule allowed community banking organizations to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The Company has made this election

Second, the proposed rule modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposure into two categories in order to determine the applicable risk weight. The final rule, however, retained the existing treatment for residential mortgage exposures under the general risk-based capital rules.

Third, the proposed rule required banking organizations with total consolidated assets of less than $15 billion as of December 31, 2009, such as the Company, to phase out over ten years any trust preferred securities and cumulative perpetual preferred securities from its Tier 1 capital regulatory capital. The final rule, however, permanently grandfathers into Tier 1 capital of depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009 any trust preferred securities or cumulative perpetual preferred stock issued before May 19, 2010.

The Company

General. As a registered bank holding company under the BHCA that has elected to become a financial holding company under the GLB Act, the Company is subject to regulation by the Federal Reserve Board. In accordance with Federal Reserve Board policy, the Company is expected to act as a source of financial strength to First Mid Bank and

First Clover Leaf Bank and to commit resources to support First Mid Bank in circumstances where the Company might not do so absent such policy. The Company is subject to inspection, examination, and supervision by the Federal Reserve Board.

Activities. As a financial holding company, the Company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. A bank holding company that is not also a financial holding company is limited to engaging in banking and such other activities as determined by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

No Federal Reserve Board approval is required for the Company to acquire a company (other than a bank holding company, 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. However, the Company generally must give the Federal Reserve Board after-the-fact notice of these activities. Prior Federal Reserve Board approval is required before the Company may acquire beneficial ownership or control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank, or savings association.

If any subsidiary bank of the Company ceases to be “well-capitalized” or “well-managed” under applicable regulatory standards, the Federal Reserve Board may, among other actions, order the Company to divest its depository institution. Alternatively, the Company may elect to conform its activities to those permissible for a bank holding company that is not also a financial holding company.

If any subsidiary bank of the Company receives a rating under the Community Reinvestment Act of less than “satisfactory”, the Company will be prohibited, until the rating is raised to “satisfactory” or better, from engaging in new activities or acquiring companies other than bank holding companies, banks, or savings associations.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve Board capital adequacy guidelines. The Federal Reserve Board's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: a risk-based requirement expressed as a percentage of total risk-weighted assets, and a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 4%. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders' equity, less intangible assets (other than certain mortgage servicing rights and purchased credit card relationships), and total capital means Tier 1 capital plus certain other debt and equity instruments which do not qualify as Tier 1 capital, limited amounts of unrealized gains on equity securities and a portion of the Company's allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve Board's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels.

As of December 31, 2016, the Company had regulatory capital, calculated on a consolidated basis, in excess of the Federal Reserve Board's minimum requirements, and its capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies with a total risk-based capital ratio of 12.79%, a Tier 1 risk-based ratio of 11.99% and a leverage ratio of 9.19%.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of person from acquiring "control" of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company. In addition, any company is required to obtain the approval of the Federal Reserve Board under the BHCA before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the outstanding common of the Company, or otherwise obtaining control of a "controlling influence" over the Company or First Mid Bank.

Interstate Banking and Branching. The Dodd-Frank Act expands the authority of banks to engage in interstate branching. The Dodd-Frank Act allows a state or national bank to open a de novo branch in another state if the law of the state where the branch is to be located would permit a state bank chartered by that state to open the branch.

Privacy and Security. The GLB Act establishes a minimum federal standard of financial privacy by, among other provisions, requiring banks to adopt and disclose privacy policies with respect to consumer information and setting forth certain rules with respect to the disclosure to third parties of consumer information. The Company has adopted and disseminated its privacy policies pursuant to the GLB Act. Regulations adopted under the GLB Act set standards for protecting the security, confidentiality and integrity of customer information, and require notice to regulators, and in some cases, to customers, in the event of security breaches. A number of states have adopted their own statutes requiring notification of security breaches. In addition, the GLB Act requires the disclosure of agreements reached with community groups that relate to the CRA, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

First Mid Bank and First Clover Leaf Bank

General. Each of the Banks is a national bank, chartered under the National Bank Act. The FDIC insures the deposit accounts of the Banks. As national banks, the Banks are members of the Federal Reserve System and are subject to the examination, supervision, reporting and enforcement requirements of the OCC, as the primary federal regulator of national banks, and the FDIC, as administrator of the deposit insurance fund.

Deposit Insurance. As FDIC-insured institutions, the Banks are required to pay deposit insurance premium assessments to the FDIC. On July 21, 2010, The Dodd-Frank Act permanently raised the standard maximum deposit insurance amount from $100,000 to $250,000.

On February 27, 2009, the FDIC adopted a final rule setting initial base assessment rates beginning April 1, 2009, at 12 to 45 basis points and, due to extraordinary circumstances, extended the period of the restoration plan to increase the deposit insurance fund to seven years. Also on February 27, 2009, the FDIC issued final rules on changes to the risk-based assessment system which imposes rates based on an institution’s risk to the deposit insurance fund. The rates increased the range of annual risk based assessment rates from 5 to 7 basis points to 7 to 24 basis points. The final rules both increase base assessment rates and incorporate additional assessments for excess reliance on brokered deposits and FHLB advances. This new assessment took effect April 1, 2009. The Company expensed $851,000, $809,000 and $717,000 for this assessment during 2016, 2015 and 2014, respectively. The increase in this assessment was primarily due to an increase in quarterly average assets.

In addition to its insurance assessment, each insured bank was subject to quarterly debt service assessments in connection with bonds issued by a government corporation that financed the federal savings and loan bailout. The Company expensed $115,000, $95,000 and $87,000 during 2016, 2015 and 2014, respectively, for this assessment.

OCC Assessments. All national banks are required to pay supervisory fees to the OCC to fund the operations of the OCC. The amount of such supervisory fees is based upon each institution’s total assets, including consolidated subsidiaries, as reported to the OCC. During the year ended December 31, 2016, 2015, and 2014 the Company expensed supervisory fees totaling $453,000, $352,000, and $342,000, respectively. The increase in 2016 resulted from the acquisition of First Clover Leaf Bank.

Capital Requirements. The OCC has established the following minimum capital standards for national banks a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 4%, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. For purposes of these capital standards, Tier 1 capital and total capital consists of substantially the same components as Tier 1 capital and total capital under the Federal Reserve Board's capital guidelines for bank holding companies (See "The Company—Capital Requirements").

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, the regulations of the OCC provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

During the year ended December 31, 2016, First Mid Bank and First Clover Leaf Bank were not required by the OCC to increase capital to an amount in excess of the minimum regulatory requirements, and capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies. First Mid Bank's total risk-based capital ratio was 12.44%, Tier 1 risk-based ratio was 11.39% and leverage ratio was 8.62%. First Clover Leaf Bank's total risk-based capital ratio was 15.08%, Tier 1 risk-based ratio was 15.08% and leverage ratio was 12.04%.

Prompt Corrective Action. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well-capitalized," "adequately-capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and in the most severe cases, appointing a conservator or receiver for the institution.

Dividends. The National Bank Act imposes limitations on the amount of dividends that may be paid by a national bank. Generally, a national bank may pay dividends out of its undivided profits, in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year which, in the aggregate, exceed the bank's year-to-date net income plus the bank's adjusted retained net income for the two preceding years.

The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, First Mid Bank and First Clover Leaf Bank exceeded minimum capital requirements under applicable guidelines as of December 31, 2016. As of December 31, 2016, approximately $16.4 million and $664,000 was available to be paid as dividends to the Company by First Mid Bank and First Clover Leaf Bank, respectively. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of any dividends by if the OCC determines that such payment would constitute an unsafe or unsound practice.

Affiliate and Insider Transactions. First Mid Bank and First Clover Leaf Bank are subject to certain restrictions under federal law, including Regulation W of the Federal Reserve Board, on extensions of credit to the Company and its subsidiaries, on investments in the stock or other securities of the Company and its subsidiaries and the acceptance of the stock or other securities of the Company or its subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by First Mid Bank and First Clover Leaf Bank to their directors and officers, to directors and officers of the Company and its subsidiaries, to principal stockholders of the Company, and to “related interests” of such directors, officers and principal stockholders.

First Mid Bank and First Clover Leaf Bank are subject to restrictions under federal law that limits certain transactions with the Company, including loans, other extensions of credit, investments or asset purchases. Such transactions by a banking subsidiary with any one affiliate are limited in amount to 10% of the bank’s capital and surplus and, with all affiliates together, to an aggregate of 20% of the bank’s capital and surplus. Furthermore, such loans and extensions of credit, as well as certain other transactions, are required to be secured in specified amounts. These and certain other transactions, including any payment of money to the Company, must be on terms and conditions that are or in good faith would be offered to nonaffiliated companies.

In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of the Company or one of its subsidiaries or a principal stockholder of the Company may obtain credit from banks with which one of the Banks maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution’s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. The preamble to the guidelines states that the agencies expect to require a compliance plan from an institution whose failure to meet one or more of the guidelines are of such severity that it could threaten the safety and soundness of the institution. Failure to submit an acceptable plan, or failure to comply with a plan that has been accepted by the appropriate federal regulator, would constitute grounds for further enforcement action.

Community Reinvestment Act. First Mid Bank and First Clover Leaf Bank are subject to the Community Reinvestment Act (CRA). The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service areas, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of its bank subsidiaries is reviewed by federal banking agencies in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or thrift or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction. First Mid Bank and First Clover Leaf Bank received satisfactory CRA ratings from their regulator in their most recent CRA examination.

Consumer Laws and Regulations. In addition to the laws and regulations discussed above, First Mid Bank and First Clover Leaf Bank are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act and the Real Estate Settlement Procedures Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans to or marketing to or engaging in other types of transactions with such customers. Failure to comply with these laws and regulations could lead to substantial penalties, operating restrictions and reputational damage to the financial institution.

Supplemental Item – Executive Officers of the Registrant

The executive officers of the Company are elected annually by the Company's Board of Directors and are identified below.

Name (Age)	Position With Company
Joseph R. Dively (57)	Chairman of the Board of Directors, President and Chief Executive Officer
Michael L. Taylor (48)	Senior Executive Vice President and Chief Financial Officer
Laurel G. Allenbaugh (56)	Executive Vice President
Eric S. McRae (51)	Executive Vice President
Bradley L. Beesley (45)	Executive Vice President
Matthew K. Smith (42)	Executive Vice President
Christopher L. Slabach (54)	Senior Vice President
Clay M. Dean (42)	Senior Vice President
Amanda D. Lewis (37)	Senior Vice President
Rhonda Gatons (45)	Senior Vice President

Joseph R. Dively, age 57, is the Chairman of the Board of Directors, President and Chief Executive Officer of the Company since January 1, 2014 and the President of First Mid Bank since May 2011. Prior to assuming these positions in the Company, he was the Senior Executive Vice President of the Company beginning in May 2011. He was with Consolidated Communications Holdings, Inc. in Mattoon, Illinois from 2003 to May 2011.

Michael L. Taylor, age 48, has been Senior Executive Vice President since 2014 and Chief Financial Officer of the Company since 2000. He served as Executive Vice President from 2007 to 2014 and as Vice President from 2000 to 2007. He was with AMCORE Bank in Rockford, Illinois from 1996 to 2000.

Laurel G. Allenbaugh, age 56, has been Executive Vice President of the Company and Executive Vice President, Chief Operations Officer of First Mid Bank since April 2008. She served as Vice President of Operations from February 2000 to April 2008. She served as Controller of the Company and First Mid Bank from 1990 to February 2000 and has been President of MIDS since 1998.

Eric S. McRae, age 51, has been Executive Vice President of the Company and Executive Vice President, Chief Credit Officer of First Mid Bank since January 2017. He served as Senior Lender of First Mid Bank from December 2008 to December 2016 and he served as President of the Decatur region from 2001 to December 2008.

Bradley L. Beesley, age 45, has been Executive Vice President of the Company and Chief Trust & Wealth Management Officer of First Mid Bank since March 2015. He served as Senior Vice President from May 2007 to March 2015.

Matthew K. Smith, age 42, has been Executive Vice President of the Company and Director of Finance since November 2016. He was Treasurer and Vice President of Finance and Investor Relations with Consolidated Communications, Inc from 1997 to 2016.

Christopher L. Slabach, age 54, has been Senior Vice President of the Company since 2007 and Senior Vice President, Chief Risk Officer of First Mid Bank since 2008. He served as Vice President, Audit of the Company from 1998 to 2007.

Clay M. Dean, age 42, has been Senior Vice President of the Company since 2010 and Senior Vice President and Chief Insurance Services Officer of the First Mid Bank and Chief Executive Officer of First Mid Insurance since September 2014. He served as Senior Vice President, Chief Deposit Services Officer of First Mid Bank from

November 2012 to September 2014 and as Senior Vice President, Director of Treasury Management of First Mid Bank from 2010 to 2012.

Amanda D. Lewis, age 37, has been Senior Vice President of the Company and Senior Vice President, Retail Banking Officer of First Mid Bank since September 2014. She served as Vice President, Director of Marketing from 2001 until September 2014.

Rhonda Gatons, age 45, has been Senior Vice President of the Company and Director of Human Resources since March 2016. Prior to joining the Company, she was the Director of Human Resources at Midland States Bank.

ITEM 1A. RISK FACTORS

Various risks and uncertainties, some of which are difficult to predict and beyond the Company’s control, could negatively impact the Company. As a financial institution, the Company is exposed to interest rate risk, liquidity risk, credit risk, operational risk, risks from economic or market conditions, and general business risks among others. Adverse experience with these or other risks could have a material impact on the Company’s financial condition and results of operations, as well as the value of its common stock.

Difficult economic conditions and market disruption have adversely impacted the banking industry and financial markets generally and may again significantly affect the business, financial condition, or results of operations of the Company. The Company’s success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond the Company’s control may adversely affect its asset quality, deposit levels and loan demand and, therefore, its earnings.

The Company’s profitability depends significantly on economic conditions in the geographic region in which it operates. A large percentage of the Company’s loans are to individuals and businesses in Illinois, consequently, any decline in the economy of this market area could have a materially adverse effect on the Company’s financial condition and results of operations.

Decline in the strength and stability of other financial institutions may adversely affect the Company’s business. The actions and commercial soundness of other financial institutions could affect the Company’s ability to engage in routine funding transactions. Financial services institutions are interrelated as a result of clearing, counterparty or other relationships. The Company has exposure to different counterparties, and executes transactions with various counterparties in the financial industry. Recent defaults by financial services institutions, and even rumors or questions about one or more financial services institutions or the financial services industry in general, led to market-wide liquidity problems in recent years and could lead to losses or defaults by the Company or by other institutions. Many of these transactions expose the Company to credit risk in the event of default of its counterparty or client. Any such losses could materially and adversely affect the Company’s results of operations.

Changes in interest rates may negatively affect our earnings. Changes in market interest rates and prices may adversely affect the Company’s financial condition or results of operations. The Company’s net interest income, its largest source of revenue, is highly dependent on achieving a positive spread between the interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in interest rates could negatively impact the Company’s ability to attract deposits, make loans, and achieve a positive spread resulting in compression of the net interest margin.

A decrease to the corporate federal income tax rate may impair the Company's deferred tax assets ("DTA's"). At December 31, 2016, the Company's DTA's were approximately $9.5 million while a decline in the corporate tax rate may lower the Company's tax provision expense, it may also significantly impair the value of the Company's DTA's in the year the rate decrease is enacted. Such impairment could have a material adverse effect on the Company's financial condition and results of operations.

The Company may not have sufficient cash or access to cash to satisfy current and future financial obligations, including demands for loans and deposit withdrawals, funding operating costs and for other corporate purposes. This type of liquidity risk arises whenever the maturities of financial instruments included in assets and liabilities differ. The Company’s liquidity can be affected by a variety of factors, including general economic conditions, market disruption, operational problems affecting third parties or the Company, unfavorable pricing, competition, the

Company’s credit rating and regulatory restrictions. (See “Liquidity” herein for management’s actions to mitigate this risk.)

If the Company were unable to borrow funds through access to capital markets, it may not be able to meet the cash flow requirements of its depositors, creditors, and borrowers, or the operating cash needed to fund corporate expansion and other corporate activities. As seen starting in the middle of 2007, significant turmoil and volatility in worldwide financial markets can result in a disruption in the liquidity of financial markets, and could directly impact the Company to the extent it needs to access capital markets to raise funds to support its business and overall liquidity position. These types of situations could affect the cost of such funds or the Company’s ability to raise such funds. If the Company were unable to access any of these funding sources when needed, it might be unable to meet customers’ needs, which could adversely impact its financial condition, results of operations, cash flows, and level of regulatory-qualifying capital. For further discussion, see the “Liquidity” section.

Loan customers or other counter-parties may not be able to perform their contractual obligations resulting in a negative impact on the Company’s earnings. Overall economic conditions affecting businesses and consumers, including the current difficult economic conditions and market disruptions, could impact the Company’s credit losses. In addition, real estate valuations could also impact the Company’s credit losses as the Company maintains $1.2 million in loans secured by commercial, agricultural, and residential real estate. A significant decline in real estate values could have a negative effect on the Company’s financial condition and results of operations. In addition, the Company’s total loan balances by industry exceeded 25% of total risk-based capital for each of four industries as of December 31, 2016. A listing of these industries is contained in under “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations -- Loans” herein. A significant change in one of these industries such as a significant decline in agricultural crop prices, could adversely impact the Company’s credit losses.

Deterioration in the real estate market could lead to losses, which could have a material adverse effect on the business, financial condition and results of operations or the Company. Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. Increases in commercial and consumer delinquency levels or declines in real estate market values would require increased net charge-offs and increases in the allowance for loan and lease losses, which could have a material adverse effect on our business, financial condition and results of operations and prospects.

The allowance for loan losses may prove inadequate or be negatively affected by credit risk exposures. The Company's business depends on the creditworthiness of its customers. Management periodically reviews the allowance for loan and lease losses for adequacy considering economic conditions and trends, collateral values and credit quality indicators, including past charge-off experience and levels of past due loans and nonperforming assets. There is no certainty that the allowance for loan losses will be adequate over time to cover credit losses in the portfolio because of unanticipated adverse changes in the economy, market conditions or events adversely affecting specific customers, industries or markets. If the credit quality of the customer base materially decreases, if the risk profile of a market, industry or group of customers changes materially, or if the allowance for loan losses is not adequate, the Company's business, financial condition, liquidity, capital, and results of operations could be materially adversely affected.

Declines in the value of securities held in the investment portfolio may negatively affect the Company's earnings and capital. The value of an investment in the portfolio could decrease due to changes in market factors. The market value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect the Company's future earnings and capital. Continued volatility in the market value of certain of the investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on the Company's accumulated other comprehensive loss and shareholders' equity depending upon the direction of the fluctuations.

Furthermore, future downgrades or defaults in these securities could result in future classifications as other-than-temporarily impaired. The Company has invested in trust preferred securities issued by financial institutions and insurance companies, corporate securities of financial institutions, and stock in the Federal Home Loan Bank of Chicago and Federal Reserve Bank of Chicago. Deterioration of the financial stability of the underlying financial institutions for these investments could result in other-than-temporary impairment charges to the Company and could have a material impact on future earnings. For further discussion of the Company's investments, see Note 4 – "Investment Securities."

A failure in or breach of the company's operational or security systems, or those of it's third party service providers, including as a result of cyber-attacks, could disrupt the company's business, result in unintentional disclosure or misuse of confidential or proprietary information, damage the company's reputation, increase our costs and cause losses. As a financial institution, the company's operations rely heavily on the secure processing, storage and transmission of confidential and other information on it's computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in the company's online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of these systems could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber-attacks, electronic fraudulent activity or attempted theft of financial assets. Management cannot assert that any such failures, interruption or security breaches will not occur, or if they do occur that they will be adequately addressed. While certain protective policies and procedures are in place, the nature and sophistication of the threats continue to evolve. The Company may be required to expend significant additional resources in the future to modify and enhance these protective measures.

Additionally, the company faces the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate its business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, its operational systems. Any failures, interruptions or security breaches in the company's information systems could damage its reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance.

If the Company’s stock price declines from levels at December 31, 2016, management will evaluate the goodwill balances for impairment, and if the values of the businesses have declined, the Company could recognize an impairment charge for its goodwill. Management performed an annual goodwill impairment assessment as of September 30, 2016. Based on these analyses, management concluded that the fair value of the Company’s reporting units exceeded the fair value of its assets and liabilities and, therefore, goodwill was not considered impaired. It is possible that management’s assumptions and conclusions regarding the valuation of the Company’s lines of business could change adversely, which could result in the recognition of impairment for goodwill, which could have a material effect on the Company’s financial position and future results of operations.

The Company may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing stockholders. In order to maintain capital at desired or regulatory-required levels, to replace existing capital, or to complete acquisitions the Company may be required to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. The Company may sell these shares at prices below the current market price of shares, and the sale of these shares may significantly dilute stockholder ownership. The Company could also issue additional shares in connection with acquisitions of other financial institutions.

Human error, inadequate or failed internal processes and systems, and external events may have adverse effects on the Company. Operational risk includes compliance or legal risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards. Operational risk also encompasses transaction risk, which includes losses from fraud, error, the inability to deliver products or services, and loss or theft of information. Losses resulting from operational risk could take the form of explicit charges, increased operational costs, harm to the Company’s reputation or forgone opportunities. Any of these could potentially have a material adverse effect on the Company’s reputation, financial condition and results of operations.

The Company is exposed to various business risks that could have a negative effect on the financial performance of the Company. These risks include: changes in customer behavior, changes in competition, new litigation or changes to existing litigation, claims and assessments, environmental liabilities, real or threatened acts of war or terrorist activity, adverse weather, changes in accounting standards, legislative or regulatory changes, taxing authority interpretations, and an inability on the Company's part to retain and attract skilled employees.

In addition to these risks identified by the Company, investments in the Company's common stock involve risk. The market price of the Company's common stock may fluctuate significantly in response to a number of factors including: volatility of stock market prices and volumes, rumors or erroneous information, changes in market valuations of similar companies, changes in securities analysts' estimates of financial performance, and variations in quarterly or annual operating results.

If the Company is unable to make favorable acquisitions or successfully integrate our acquisitions, the Company's growth could be impacted. In the past several years, the Company has completed acquisitions of banks, bank branches and other businesses. We may continue to make such acquisitions in the future. When the Company evaluates acquisition opportunities, the Company evaluates whether the target institution has a culture similar to the Company, experienced management and the potential to improve the financial performance of the Company. If the Company fails to successfully identify, complete and integrate favorable acquisitions, the Company could experience slower growth. Acquiring other banks, bank branches or businesses involves various risks commonly associated with acquisitions, including, among other things: potential exposure to unknown or contingent liabilities or asset quality issues of the target institution, difficulty and expense of integrating the operations and personnel of the target institution, potential disruption to the Company (including diversion of management's time and attention), difficulty in estimating the value of the target institution, and potential changes in banking or tax laws or regulations that may affect the target institution.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's headquarters is located at 1421 Charleston Avenue, Mattoon Illinois . This location is also used by the loan and deposit operations departments of First Mid Bank. In addition, the Company owns a facility located at 1500 Wabash Avenue, Mattoon, Illinois, which it is currently leasing to a non-affiliated third party.

The main office of First Mid Bank is located at 1515 Charleston Avenue, Mattoon, Illinois and is owned by First Mid Bank. First Mid Bank also owns a building located at 1520 Charleston Avenue, which is used by First Mid Insurance, MIDS or its data processing and by First Mid Bank for back room operations. First Mid Bank also conducts business through numerous facilities, owned and leased, located in twenty-three counties throughout Illinois. Of the forty-five other banking offices operated by First Mid Bank, twenty-four are owned and twenty-one are leased from non-affiliated third parties.

The main office of First Clover Leaf Bank is located at 6814 Goshen Road, Edwardsville, Illinois and is owned by First Clover Leaf Bank. Of the six other banking offices operated by First Clover Leaf Bank, four are owned and two are leased. Six of these locations are located in one Illinois county and one is located in a Missouri county.

None of the properties owned by the Corporation are subject to any major encumbrances. The Company believes these facilities are suitable and adequate to operate its banking and related business. The net investment of the Company and subsidiaries in real estate and equipment at December 31, 2016 was $40.3 million.

ITEM 3. LEGAL PROCEEDINGS

The Company as successor to First Clover Leaf, certain former executive officers of First Clover Leaf, and certain former members of First Clover Leaf’s board of directors, and the Company are named as defendants in one purported class action lawsuit brought by an alleged individual First Clover Leaf stockholder challenging the merger of First Clover Leaf into the Company (the “Lawsuit”). The Lawsuit is captioned Raul v. Highlander, et al , Case No. 16-L-703, and was filed on May 20, 2016, in the Circuit Court of Madison County, Illinois, Third Judicial District. The Lawsuit alleges breaches of fiduciary duty by the individual officers and directors of First Clover Leaf relating to the process leading to the merger of First Clover Leaf and the Company. The Lawsuit alleges that the merger consideration was inadequate and that the joint proxy statement/prospectus did not contain sufficient disclosures and detail. The Lawsuit also alleges that First Clover Leaf and the Company aided and abetted the alleged breaches of fiduciary duty by the individual defendants. The relief sought includes class certification, rescission of the merger and damages and costs, including attorneys’ fees. The Company and the individual defendants believe that the factual allegations in the Lawsuit are without merit and legally unfounded. They have moved to dismiss the complaint and intend to vigorously defend against these allegations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER OF PURCHASES OF EQUITY SECURITIES

The Company’s common stock was held by approximately 861 shareholders of record as of December 31, 2016 and is included for quotation on the NASDAQ Stock Market, LLC.

The following table shows the high and low bid prices per share of the Company’s common stock for the indicated periods. These quotations represent inter-dealer prices without retail mark-ups, mark-downs or commissions and may not necessarily represent actual transactions.

Quarter	High	Low
2016		
4th	$36.80	$25.80
3rd	27.69	22.95
2nd	26.00	23.02
1st	26.40	23.32
2015		
4th	$26.50	$21.05
3rd	22.50	21.00
2nd	21.97	19.35
1st	21.10	17.51

The Board of Directors of the Company declared cash dividends semi-annually during the two years ended December 31, 2016 and 2015. A special dividend was declared in 2016 immediately preceding the acquisition of First Clover Leaf. The following table sets forth the cash dividends per share on the Company’s common stock for the last two years.

Date Declared	Date Paid	Dividend Per Share
10/25/2016	12/08/2016	$0.16
08/23/2016	09/07/2016	0.16
04/27/2016	06/08/2016	0.30
10/27/2015	12/07/2015	0.29
04/29/2015	06/08/2015	0.30

The Company’s shareholders are entitled to receive such dividends as are declared by the Board of Directors, which considers payment of dividends semi-annually. The ability of the Company to pay dividends, as well as fund its operations, is dependent upon receipt of dividends from First Mid Bank and First Clover Leaf Bank. Regulatory authorities limit the amount of dividends that can be paid by First Mid Bank and First Clover Leaf Bank without prior approval from such authorities. For further discussion of the Bank’s dividend restrictions, see Item1 – “Business” – “First Mid Bank and First Clover Leaf Bank” – “Dividends” and Note 16 – “Dividend Restrictions” herein.

The following table summarizes share repurchase activity for the fourth quarter of 2016:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs at End of Period
October 1, 2016 – October 31, 2016	—	—	—	$7,173,000
November 1, 2016 – November 30, 2016	—	—	—	7,173,000
December 1, 2016 – December 31, 2016	—	—	—	7,173,000
Total	—	$0.00	—	$7,173,000

Since August 5, 1998, the Board of Directors has approved repurchase programs pursuant to which the Company may repurchase a total of approximately $76.7 million of the Company’s common stock. The repurchase programs approved by the Board of Directors are as follows:

- On August 5, 1998, repurchases of up to 3%, or $2 million, of the Company’s common stock.
- In March 2000, repurchases up to an additional 5%, or $4.2 million of the Company’s common stock.
- In September 2001, repurchases of $3 million of additional shares of the Company’s common stock.
- In August 2002, repurchases of $5 million of additional shares of the Company’s common stock.
- In September 2003, repurchases of $10 million of additional shares of the Company’s common stock.
- On April 27, 2004, repurchases of $5 million of additional shares of the Company’s common stock.
- On August 23, 2005, repurchases of $5 million of additional shares of the Company’s common stock.
- On August 22, 2006, repurchases of $5 million of additional shares of the Company’s common stock.
- On February 27, 2007, repurchases of $5 million of additional shares of the Company’s common stock.
- On November 13, 2007, repurchases of $5 million of additional shares of the Company’s common stock.
- On December 16, 2008, repurchases of $2.5 million of additional shares of the Company’s common stock.
- On May 26, 2009, repurchases of $5 million of additional shares of the Company’s common stock.
- On February 22, 2011, repurchases of $5 million of additional shares of the Company’s common stock.
- On November 13, 2012 repurchases of $5 million of additional shares of the Company’s common stock.
- On November 19, 2013, repurchases of $5 million additional shares of the Company's common stock.
- On October 28, 2014, repurchases of $5 million additional shares of the Company's common stock.

ITEM 6. SELECTED FINANCIAL DATA

The following sets forth a five-year comparison of selected financial data (dollars in thousands, except per share data).

	2016	2015	2014	2013	2012
Summary of Operations					
Interest income	$75,496	$59,251	$54,734	$53,459	$55,767
Interest expense	4,292	3,499	3,252	3,535	6,157
Net interest income	71,204	55,752	51,482	49,924	49,610
Provision for loan losses	2,826	1,318	629	2,193	2,647
Other income	26,912	20,544	18,369	19,341	18,310
Other expense	61,510	49,248	44,507	43,504	42,838
Income before income taxes	33,780	25,730	24,715	23,568	22,435
Income tax expense	11,940	9,218	9,254	8,846	8,410
Net income	21,840	16,512	15,461	14,722	14,025
Dividends on preferred shares	825	2,200	4,152	4,417	4,252
Net income available to common stockholders	$21,015	$14,312	$11,309	$10,305	$9,773
Per Common Share Data					
Basic earnings per share	$2.07	$1.84	$1.88	$1.74	$1.62
Diluted earnings per share	2.05	1.81	1.85	1.73	1.62
Dividends declared per share	0.62	0.59	0.55	0.46	0.42
Book value per common share	22.51	21.01	19.55	16.54	17.53
Tangible Book Value per common share	16.84	15.09	15.63	11.75	12.68
Capital Ratios					
Total capital to risk-weighted assets	12.79 %	14.25 %	15.60 %	15.58 %	15.65 %
Tier 1 capital to risk-weighted assets	11.99 %	13.23 %	14.42 %	14.37 %	14.51 %
Common equity tier 1 ratio	10.86 %	9.92 %	10.32 %	7.78 %	7.54 %
Tier 1 capital to average assets	9.19 %	9.20 %	10.52 %	10.12 %	9.66 %
Financial Ratios					
Net interest margin	3.28 %	3.27 %	3.43 %	3.38 %	3.44 %
Return on average assets	0.94 %	0.91 %	0.97 %	0.94 %	0.91 %
Return on average common equity	9.30 %	8.97 %	10.34 %	10.11 %	9.53 %
Dividend on common shares payout ratio	29.95 %	32.07 %	29.26 %	26.44 %	25.93 %
Average equity to average assets	10.12 %	10.34 %	9.94 %	9.81 %	9.76 %
Allowance for loan losses as a percent of total loans	0.92 %	1.14 %	1.29 %	1.35 %	1.29 %
Year End Balances					
Total assets	$2,884,535	$2,114,499	$1,607,103	$1,605,498	$1,578,032
Net loans, including loans held for sale	1,809,239	1,267,313	1,048,724	969,555	899,289
Total deposits	2,329,887	1,732,568	1,272,077	1,287,616	1,274,065
Total equity	280,673	205,009	164,916	149,381	156,687
Average Balances					