



2015 FINANCIAL REPORTS

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

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2015

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: 000-10972



FIRST FARMERS AND MERCHANTS CORPORATION

(Exact name of registrant as specified in its charter)

Tennessee

62-1148660

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

816 South Garden Street
Columbia, Tennessee

38401

(Address of principal executive offices)

(Zip Code)

(931) 388-3145

(Registrant's telephone number, including area code)

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

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

Common Stock, \$10.00 par 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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

☒ Yes ☐ No

Indicate by check mark is 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, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

The aggregate market value of the registrant’s common stock held by non-affiliates as of June 30, 2015, was approximately \$113.1 million based on the reported price at which the common stock was last sold in a transaction known to the registrant.

As of February 29, 2016, the registrant had 4,739,502 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Annual Report to Shareholders for Fiscal Year Ended December 31, 2015 (included as Exhibit 13) -- Part I and II of this Report.

Proxy Statement for 2016 Annual Shareholders’ Meeting to be held on April 19, 2016 -- Part III of this Report.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
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PART I

Item 1. Business.

Description of Business

First Farmers and Merchants Corporation (the “Company”) was incorporated on March 31, 1982 as a Tennessee corporation. As of December 31, 2015, the only direct subsidiary of the Company was First Farmers and Merchants Bank, a Tennessee state-chartered bank (the “Bank”). Management evaluates the financial condition of the Company in terms of the Bank’s operations within its service area in Middle Tennessee.

The operations of the Bank are significantly affected by prevailing economic conditions, competition and the monetary, fiscal and regulatory policies of governmental agencies. Lending activities are influenced by the general credit needs of small businesses in the Bank’s service area, competition among lenders, the level of interest rates and the availability of funds. The Bank’s loan portfolio is comprised of commercial, commercial and residential real estate, and retail installment loans, which primarily originate within the Bank’s service area. Deposits are the primary source of funds for the Bank. Such deposits consist of checking accounts, regular savings deposits, negotiable order of withdrawal accounts, money market accounts and market rate certificates of deposit. Deposits are solicited from individuals and businesses in the Bank’s service area, state and local entities and, to a lesser extent, United States government entities and other depository institutions. Deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities and the levels of personal income and savings in the Bank’s service area. In addition to lending and deposit activities, the Bank maintains a trust department which provides fiduciary and investment management services for individual and commercial clients. Account types include personal trusts, endowments, individual retirement accounts, pensions and custody. All of the Company’s assets are located in the United States and all of its revenues generated from external customers originate within the United States.

The Bank’s net income is dependent primarily on its net interest income, which is the difference between the interest income earned on its loans, investment assets and other interest-earning assets and the interest paid on deposits and other interest-bearing liabilities. To a lesser extent, the Bank’s net income also is affected by its noninterest income derived principally from service fees as well as the level of noninterest expenses such as salaries and employee benefits.

For more information regarding the business of the Company and the Bank, please refer to Management’s Discussion and Analysis of Financial Condition and Results of Operations, which is included in the Company’s 2015 Annual Report to Shareholders (the “Annual Report to Shareholders”) attached as Exhibit 13 to this Annual Report on Form 10-K and incorporated herein by reference.

On November 20, 2015, the Company announced its Board of Directors approved a corporate reorganization plan (the “Plan”) providing for the termination of the Company’s reporting obligations under the Securities Exchange Act of 1934 (the “Exchange Act”). Under the Plan, holders of fewer than 400 shares of Company common stock will receive cash in exchange for their shares in an amount determined based on a valuation by an independent third party. Shareholders owning 400 or more shares will be unaffected by the Plan. The Plan will be considered and voted upon by its shareholders at the Company’s 2016 annual meeting.

Availability of SEC Reports

The Company’s website is www.myfirstfarmers.com. The Company makes available free of charge on its website under the “Our Story – Investor Services” link the Company’s annual reports 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 Exchange Act as soon as reasonably practicable after the Company electronically files such materials with, or furnishes them to, the Securities and Exchange Commission (the “SEC”). The SEC maintains a website at www.sec.gov that also contains reports, proxy and information statements and other information about the Company that are available free of charge. In addition, copies of our reports are available, without charge, by making a request through the “Contact Us” link on our website.

Regulation and Supervision

The following discussion sets forth certain material elements of the regulatory framework applicable to the Company and the Bank. This discussion is a brief summary of the regulatory environment in which the Company and its subsidiaries operate and is not designed to be a complete discussion of all statutes and regulations affecting such operations. Regulation of financial institutions is intended primarily for the protection of depositors, the deposit insurance fund and the banking system, and generally is not intended for the protection of shareholders. Changes in applicable laws, and their application by regulatory agencies, cannot necessarily be predicted, but could have a material effect on the business and results of the Company and its subsidiaries.

General

The Company and the Bank are subject to regulation and supervision by the Board of Governors of the Federal Reserve System. The Company and the Bank are required to file annual reports with the Federal Reserve and such other information as the Federal Reserve may require. The Federal Reserve also conducts examinations of the Company and the Bank.

The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve before:

- it may acquire direct or indirect ownership or control of any voting shares of any other bank holding company if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the other bank holding company;
- it may acquire direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the bank;
- it or any of its subsidiaries, other than a bank, may acquire all or substantially all of the assets of any bank; or
- it may merge or consolidate with any other bank holding company.

The Bank Holding Company Act further provides that the Federal Reserve may not approve any transaction that would result in a monopoly or that would substantially lessen competition in the banking business, unless the public interest in meeting the needs of the communities to be served outweighs the anticompetitive effects. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks involved and the convenience and needs of the communities to be served. Consideration of financial resources generally focuses on capital adequacy, and consideration of convenience and needs issues focuses, in part, on the performance under the Community Reinvestment Act of 1977, both of which are discussed below in more detail.

Subject to various exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring “control” of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control is also presumed to exist, although rebuttable, if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

- the bank holding company has registered securities under Section 12 of the Exchange Act of 1934, as amended (“Exchange Act”); or
- no other person owns a greater percentage of that class of voting securities immediately after the transaction.

The Company’s common stock is registered under Section 12 of the Exchange Act. The regulations provide a procedure for challenging rebuttable presumptions of control.

The Bank Holding Company Act generally prohibits a bank holding company from engaging in activities other than banking, managing or controlling banks or other permissible subsidiaries and acquiring or retaining direct or indirect control of any company engaged in any activities other than activities closely related to banking or managing or

controlling banks. In determining whether a particular activity is permissible, the Federal Reserve considers whether performing the activity can be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve has the power to order a bank holding company or its subsidiaries to terminate any activity or control of any subsidiary when the continuation of the activity or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company.

The Bank is incorporated under the laws of the State of Tennessee and is subject to the applicable provisions of Tennessee banking laws and the laws of the various states in which it operates, as well as federal law. The Bank is subject to the supervision of the Tennessee Department of Financial Institutions (“TDFI”) and to regular examinations by that department. Deposits in the Bank are insured by the Federal Deposit Insurance Corporation (the “FDIC”) and, therefore, the Bank is subject to the provisions of the Federal Deposit Insurance Act. As a member of the Federal Reserve System, the Bank is also subject to the supervision of the Federal Reserve.

Federal Reserve policy historically has required bank holding companies to act as a source of strength to their bank subsidiaries and to commit capital and financial resources to support those subsidiaries. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) codifies this policy as a statutory requirement. This support may be required by the Federal Reserve at times when the Company might otherwise determine not to provide it. In addition, if a bank holding company commits to a federal bank regulator that it will maintain the capital of its bank subsidiary, whether in response to the Federal Reserve’s invoking its source-of-strength authority or in response to other regulatory measures, that commitment will be assumed by the bankruptcy trustee and the bank will be entitled to priority payment in respect of that commitment, ahead of other creditors of the bank holding company.

In addition, the Company is required to file certain reports with, and otherwise comply with the rules and regulations of, the SEC under federal securities laws.

The Dodd-Frank Act

The Dodd-Frank Act, enacted in 2010, significantly restructured financial regulation in the United States, including through the creation of a new regulatory agency, mandating higher capital and liquidity requirements, requiring banks to pay increased fees to regulatory agencies, and through numerous other provisions intended to strengthen the financial services sector.

The Dodd-Frank Act established the Consumer Financial Protection Bureau (“CFPB”), which has extensive regulatory and enforcement powers over consumer financial products and services, and the Financial Stability Oversight Council, which has oversight authority for monitoring and regulating systemic risk. In addition, the Dodd-Frank Act altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies, including financial institutions, with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions, and restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates. The Dodd-Frank Act also required the issuance of numerous implementing regulations, many of which have not yet been issued.

In January 2013, the CFPB issued final regulations governing mainly consumer mortgage lending. One rule imposes additional requirements on lenders, including rules designed to require lenders to ensure borrowers’ ability to repay their mortgage. The CFPB also finalized a rule on escrow accounts for higher priced mortgage loans and a rule expanding the scope of the high-cost mortgage provision in the Truth in Lending Act. The CFPB also issued final rules implementing provisions of the Dodd-Frank Act that relate to mortgage servicing. In November 2013, the CFPB issued a final rule on integrated mortgage disclosures under the Truth in Lending Act and the Real Estate Settlement Procedures Act, compliance with which was required by October 3, 2015.

The Dodd-Frank Act authorizes national and state banks to establish de novo branches in other states to the same extent as a bank chartered by that state would be so permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks are now able to enter new markets more freely.

Recently, the CFPB and banking regulatory agencies have increasingly used a general consumer protection statute to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. Prior to the Dodd-Frank Act, there was little formal guidance to provide insight to the parameters for compliance with the “unfair or deceptive acts or practices” (“UDAP”) law. However, the UDAP provisions have been expanded under the Dodd-Frank Act to apply to “unfair, deceptive or abusive acts or practices,” which has been delegated to the CFPB for supervision.

Many aspects of the Dodd-Frank Act are subject to further rulemaking and will take effect over several years. The overall financial impact on the Company and its subsidiaries or the financial services industry generally cannot be anticipated at this time.

Dividends

The Company is a legal entity that is separate and distinct from its subsidiaries. The primary source of funds for dividends paid to the Company’s shareholders are dividends paid to the Company by the Bank. Various federal and state laws limit the amount of dividends that the Bank may pay to the Company without regulatory approval. The Bank is required by Tennessee law to obtain the prior approval of the Commissioner of the TDFI for payments of dividends if the total of all dividends declared by its board of directors in any calendar year will exceed (i) the total of the Bank’s retained net income for that year, plus (ii) the Bank’s retained net income for the preceding two years. The FDIC also has the authority to prohibit the Bank from engaging in business practices that the FDIC considers to be unsafe or unsound, which, depending on the financial condition of the Bank, could include the payment of dividends.

In addition, the Federal Reserve has the authority to prohibit the payment of dividends by a bank holding company if its actions constitute unsafe or unsound practices. The Federal Reserve has issued a policy statement, Supervisory Release 09-4, on the payment of cash dividends by bank holding companies, which outlines the Federal Reserve’s view that a bank holding company that is experiencing earnings weakness or other financial pressures should not pay cash dividends that exceed its net income, that are inconsistent with its capital position, or that could only be funded in ways that weaken its financial health, such as by borrowing or selling assets. The Federal Reserve has indicated that, in some instances, it may be appropriate for a bank holding company to eliminate its dividends.

Capital

The Federal Reserve has issued risk-based capital ratio and leverage ratio guidelines for bank holding companies. The risk-based capital ratio guidelines establish a systematic analytical framework that:

- makes regulatory capital requirements sensitive to differences in risk profiles among banking organizations;
- takes off-balance sheet exposures into explicit account in assessing capital adequacy; and
- minimizes disincentives to holding liquid, low-risk assets.

Under the guidelines and related policies, banks and bank holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and a leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance sheet commitments into four weighted categories, with higher weighting assigned to categories perceived as representing greater risk. The risk-based ratio represents capital divided by total risk-weighted assets. The leverage ratio is core capital divided by total assets adjusted as specified in the guidelines.

Generally, under the applicable guidelines, a financial institution’s capital is divided into two tiers. “Total capital” is Tier 1 plus Tier 2 capital. These two tiers are:

- “Tier 1,” or core capital, that includes total equity plus qualifying capital securities and minority interests, excluding unrealized gains and losses accumulated in other comprehensive income, and non-qualifying intangible and servicing assets; and
- “Tier 2,” or supplementary capital, includes, among other things, cumulative and limited-life preferred stock, mandatory convertible securities, qualifying subordinated debt, and the allowance for credit losses, up to 1.25% of risk-weighted assets.

The Federal Reserve and the other federal banking regulators require that all intangible assets (net of deferred tax), except originated or purchased mortgage-servicing rights, non-mortgage servicing assets, and purchased credit card relationships, be deducted from Tier 1 capital. However, the total amount of these items included in Total capital cannot exceed 100% of an institution's Tier 1 capital.

Under the risk-based capital guidelines existing prior to January 1, 2015, financial institutions were required to maintain a risk-based ratio of 8%, with 4% consisting of Tier 1 capital. The appropriate regulatory authority may set higher capital requirements when it believes an institution's circumstances warrant.

Under the leverage guidelines existing prior to January 1, 2015, financial institutions are required to maintain a leverage ratio of at least 3%. The minimum ratio is applicable only to financial institutions that meet certain specified criteria, including excellent asset quality, high liquidity, low interest rate risk exposure, and the highest regulatory rating. Financial institutions not meeting these criteria are required to maintain a minimum Tier 1 leverage ratio of 4%.

The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve has indicated that it will consider a "tangible Tier 1 capital leverage ratio" (deducting all intangibles) and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet applicable capital guidelines could subject the financial institution to a variety of enforcement remedies available to the federal regulatory authorities. These include limitations on the ability to pay dividends, the issuance of a capital directive to increase capital, and the termination of deposit insurance by the FDIC. In addition, the financial institution could be subject to the measures described below under "Prompt Corrective Action" as applicable to "under-capitalized" institutions.

New Capital Rules

On July 2, 2013, the Federal Reserve approved the final rule for BASEL III capital requirements for all bank holding companies chartered in the United States and banks that are members of the Federal Reserve System. The rule implements in the United States certain of the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. The major provisions of the new rule applicable to the Company and the Bank are:

- The new rule implements higher minimum capital requirements, includes a new common equity Tier 1 capital requirement, and establishes criteria that instruments must meet in order to be considered common equity Tier 1 capital, additional Tier 1 capital, or Tier 2 capital. These enhancements both improve the quality and increase the quantity of capital required to be held by banking organizations, better equipping the United States banking system to deal with adverse economic conditions.
- The new minimum capital to risk-weighted assets requirements are a common equity Tier 1 capital ratio of 4.5% and a Tier 1 capital ratio of 6.0% which is an increase from 4.0%, and a total capital ratio that remains at 8.0%. The minimum leverage ratio (Tier 1 capital to total assets) is 4.0%.
- The new rule improves the quality of capital by implementing changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of instruments such as trust preferred securities in Tier 1 capital going forward, and new constraints on the inclusion of minority interests, mortgage-servicing assets, deferred tax assets, and certain investments in the capital of unconsolidated financial institutions. In addition, the new rule requires that most regulatory capital deductions be made from common equity Tier 1 capital.
- Under the new rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity Tier 1 capital above its minimum risk-based capital requirements. This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk weighted assets. Phase-in of

the capital conservation buffer requirements began on January 1, 2016. A banking organization with a buffer greater than 2.5% would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The new rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the prompt corrective action well-capitalized thresholds.

- The new rule also increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

The transition period for implementation of Basel III is January 1, 2015, through December 31, 2018.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act of 1991, known as FDICIA, requires federal banking regulatory authorities to take “prompt corrective action” with respect to depository institutions that do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: “well-capitalized,” “adequately-capitalized,” “under-capitalized,” “significantly under-capitalized,” and “critically under-capitalized.”

An institution is deemed to be:

- “well-capitalized” if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater, a Tier 1 leverage ratio of 5% or greater, and, after January 1, 2015, a common equity Tier 1 capital ratio of 6.5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure;
- “adequately-capitalized” if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater, generally, a Tier 1 leverage ratio of 4% or greater, and, after January 1, 2015, a common equity Tier 1 capital ratio of 4.5% or greater, and the institution does not meet the definition of a “well-capitalized” institution;
- “under-capitalized” if it does not meet one or more of the “adequately-capitalized” tests;
- “significantly under-capitalized” if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 4%, a Tier 1 leverage ratio that is less than 3%, and, after January 1, 2015, a common equity Tier 1 capital ratio that is less than 3%; and
- “critically under-capitalized” if it has a ratio of tangible equity, as defined in the regulations, to total assets that is equal to or less than 2%.

Throughout 2015, the Bank’s regulatory capital ratios were in excess of the levels established for “well-capitalized” institutions.

FDICIA generally prohibits a depository institution from making any capital distribution, including payment of a cash dividend or paying any management fee to its holding company, if the depository institution would be “under-capitalized” after such payment. “Under-capitalized” institutions are subject to growth limitations and are required by the appropriate federal banking agency to submit a capital restoration plan. If any depository institution subsidiary of a holding company is required to submit a capital restoration plan, the holding company would be required to provide a limited guarantee regarding compliance with the plan as a condition of approval of such plan.

If an “under-capitalized” institution fails to submit an acceptable plan, it is treated as if it is “significantly under-capitalized.” “Significantly under-capitalized” institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become “adequately-capitalized,” requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks.

“Critically under-capitalized” institutions may not, beginning 60 days after becoming “critically under-capitalized,” make any payment of principal or interest on their subordinated debt. In addition, “critically under-capitalized” institutions are subject to appointment of a receiver or conservator within 90 days of becoming so classified.

Under FDICIA, a depository institution that is not “well-capitalized” is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. As previously stated, the Bank is “well-capitalized” and the FDICIA brokered deposit rule did not adversely affect its ability to accept brokered deposits. The Bank had \$0 of such brokered deposits at December 31, 2015.

Interstate Banking and Branching Legislation

Federal law allows banks to establish and operate a de novo branch in a state other than the bank’s home state if the law of the state where the branch is to be located would permit establishment of the branch if the bank were chartered by that state, subject to standard regulatory review and approval requirements. Federal law also allows the Bank to acquire an existing branch in a state in which the bank is not headquartered and does not maintain a branch if the FDIC and the TDFI approve the branch or acquisition, and if the law of the state in which the branch is located or to be located would permit the establishment of the branch if the bank were chartered by that state.

Once a bank has established branches in a state through an interstate merger transaction or through de novo branching, the bank may then establish and acquire additional branches within that state to the same extent that a state chartered bank is allowed to establish or acquire branches within the state.

Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation, subject to the prior approval of the applicable regulatory agency. Furthermore, a bank headquartered in one state is authorized to merge with a bank headquartered in another state, as long as neither of the states have opted out of such interstate merger authority prior to such date, and subject to any state requirement that the target bank shall have been in existence and operating for a minimum period of time, not to exceed five years, and subject to certain deposit market-share limitations.

FDIC Insurance

The deposits of the Bank are insured by the Deposit Insurance Fund (the “DIF”), which the FDIC administers. The Dodd-Frank Act permanently increased deposit insurance on accounts to \$250,000. To fund the DIF, FDIC-insured banks are required to pay deposit insurance assessments to the FDIC. For institutions like the Bank with less than \$10 billion in assets, the amount of the assessment is based on its risk classification. The higher an institution’s risk classification, the higher its rate of assessments (on the assumption that such institutions pose a greater risk of loss to the DIF). An institution’s risk classification is assigned based on its capital levels and the level of supervisory concern that the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances.

In addition, all institutions with deposits insured by the FDIC must pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established as a financing vehicle for the Federal Savings & Loan Insurance Corporation.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. If the FDIC terminates an institution’s deposit insurance, accounts insured at the time of the termination, less withdrawals, will continue to be insured for a period of six months to two years, as determined by the FDIC.

Affiliate Transactions

The Bank is subject to Regulation W, which comprehensively implements statutory restrictions on transactions between a bank and its affiliates. Regulation W combines the Federal Reserve's interpretations and exemptions relating to Sections 23A and 23B of the Federal Reserve Act. Regulation W and Section 23A place limits on the amount of loans or extensions of credit to, investments in, or certain other transactions with affiliates, and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. In general, the Bank's "affiliates" are the Company and its non-bank subsidiaries.

Regulation W and Section 23B prohibit, among other things, a bank from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with non-affiliated companies.

The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders and their related interests. Such extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and must not involve more than the normal risk of repayment or present other unfavorable features.

The Community Reinvestment Act

The Community Reinvestment Act of 1977 ("CRA") and its implementing regulations provide an incentive for regulated financial institutions to meet the credit needs of their local community or communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of such financial institutions. The regulations provide that the appropriate regulatory authority will assess reports under CRA in connection with applications for establishment of domestic branches, acquisitions of banks or mergers involving bank holding companies. An unsatisfactory rating under CRA may serve as a basis to deny an application to acquire or establish a new bank, to establish a new branch or to expand banking services. As of December 31, 2015, the Bank had an "outstanding" rating under the CRA.

Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, as extended and revised by the PATRIOT Improvement and Reauthorization Act of 2005 (the "Patriot Act"), requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign financial institutions; and (iii) avoid establishing, maintaining, administering or managing correspondent accounts in the United States for, or on behalf of, foreign financial institutions that do not have a physical presence in any country. The Patriot Act also requires that financial institutions follow certain minimum standards to verify the identity of customers, both foreign and domestic, when a customer opens an account. In addition, the Patriot Act contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. Federal banking regulators are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants.

Consumer Privacy and Other Consumer Protection Laws

The Bank, like all other financial institutions, is required to maintain the privacy of its customers' non-public, personal information. Such privacy requirements direct financial institutions to:

- provide notice to customers regarding privacy policies and practices;
- inform customers regarding the conditions under which their non-public personal information may be disclosed to non-affiliated third parties; and
- give customers an option to prevent disclosure of such information to non-affiliated third parties.

Under the Fair and Accurate Credit Transactions Act of 2003, the Bank's customers may also opt out of information sharing between and among the Bank and its affiliates.

The Bank is also subject, in connection with its deposit, lending and leasing activities, to numerous federal and state laws aimed at protecting consumers, including the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the Truth-in-Savings Act, the Fair Housing Act, the Fair Credit Reporting Act, the Electronic Funds Transfer Act, the Currency and Foreign Transactions Reporting Act, the National Flood Insurance Act, the Flood Protection Act, the Bank Secrecy Act, laws and regulations governing unfair, deceptive, and/or abusive acts and practices, the Service Members Civil Relief Act, the Housing and Economic Recovery Act, and the Credit Card Accountability Act, among others, as well as various state laws.

Incentive Compensation

In 2010, the Federal Reserve issued guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or perform other actions. The guidance also provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The federal banking agencies have proposed rule-making implementing provisions of the Dodd-Frank Act to prohibit incentive-based compensation plans that expose "covered financial institutions" to inappropriate risks. Covered financial institutions are institutions that have over \$1 billion in assets and offer incentive-based compensation programs. If adopted, the proposed rules would require incentive-based compensation plans:

- to provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks;
- be compatible with effective internal controls and risk management; and
- be supported by strong corporate governance, including active and effective oversight by the organization's board of directors and appropriate policies, procedures and monitoring.

The scope and content of banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the Company's ability to hire, retain and motivate its key employees.

Sarbanes-Oxley

The Sarbanes-Oxley Act of 2002 is applicable to all companies with equity or debt securities registered under the Exchange. In particular, the Sarbanes-Oxley Act established: (i) requirements for audit committees, including independence, expertise and responsibilities; (ii) certification and related responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting Company; (iii) standards for auditors and regulation of audits; (iv) disclosure and reporting obligations for the reporting Company and its directors and executive officers; and (v) civil and criminal penalties for violation of the securities laws.

Effect of Governmental Policies

The Company and the Bank are affected by the policies of regulatory authorities, including the Federal Reserve, the FDIC, and the TDFI. An important function of the Federal Reserve is to regulate the national money supply. Among the instruments of monetary policy used by the Federal Reserve are: (i) purchases and sales of U.S. government and other securities in the marketplace; (ii) changes in the discount rate, which is the rate any depository institution must pay to borrow from the Federal Reserve; (iii) changes in the reserve requirements of depository institutions; and (iv) indirectly, changes in the federal funds rate, which is the rate at which depository institutions lend money to each other overnight. These instruments are intended to influence economic and monetary growth, interest rate levels, and inflation.

The monetary policies of the Federal Reserve and other governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. Because of changing conditions in the national and international economy and in the money markets, as well as the result of actions by monetary and fiscal authorities, it is not possible to predict with certainty future changes in interest rates, deposit levels, loan demand, or the business and results of operations of the Company and the Bank, or whether changing economic conditions will have a positive or negative effect on operations and earnings.

Other Proposals

Bills occasionally are introduced in the United States Congress and the Tennessee State Legislature and other state legislatures, and regulations occasionally are proposed by our regulatory agencies, any of which could affect our businesses, financial results, and financial condition. Generally it cannot be predicted whether or in what form any particular proposals will be adopted or the extent to which the Company and the Bank may be affected.

Competition

The business of providing financial services is highly competitive. In addition to competing with other commercial banks in the Bank's service area, the Bank competes with savings and loan associations, insurance companies, savings banks, small loan companies, finance companies, mortgage companies, real estate investment trusts, certain governmental agencies, credit card organizations, credit unions and other enterprises. None of these competitors are dominant in the entire area served by the Bank.

In the Tennessee markets it serves, the Bank offers a typical mix of interest-bearing transaction, savings and time deposit products as well as traditional non-interest bearing deposit accounts. The Bank's primary market areas for these products are Davidson, Dickson, Giles, Hickman, Lawrence, Marshall, Maury and Williamson Counties in Tennessee.

Employees

The Company has no employees. The Bank had approximately 226 full-time employees and 17 part-time employees at December 31, 2015. Four of the Bank's officers are also officers of the Company. None of our employees were represented by any union or similar group. We have not experienced any labor disputes or strikes arising from any organized labor groups. We believe our employee relations are good.

Item 1A. Risk Factors.

The risks and uncertainties that management believes affect or could affect us and our business are described below. This listing should not be considered as all-inclusive. You should carefully read and consider these risks and uncertainties described below together with all of the other information included or incorporated by reference in this Annual Report on Form 10-K. References to "we," "us," and "our" in this section refer to the Company and the Bank, unless otherwise specified or unless the context otherwise requires.

Our business and credit quality may be adversely affected by conditions in the financial markets and economic markets.

In recent years, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. Furthermore, there are continuing concerns related to the level of U.S. government debt and fiscal actions that may be taken to address that debt. There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. In addition, declining oil prices, on-going federal budget negotiations, the implementation of the employer mandate under the Patient Protection and Affordable Care Act and the level of U.S. debt may have a destabilizing effect on financial markets.

The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services the Company offers, is highly dependent upon the business environment in the markets where the Company operates in the State of Tennessee and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth; business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; or a combination of these or other factors.

Overall, during recent years, the business environment has been steadily improving for many households and businesses in the United States and worldwide. While economic conditions in the State of Tennessee and the United States have shown signs of improvement, there can be no assurance that this improvement will continue. Should a deterioration within the business environment occur, such deterioration could have a material adverse effect on the credit quality of the Bank's loans and the Company's business, financial condition and results of operations.

A reduction of customer deposits or an inability of our borrowers to repay loans could have a material adverse effect on our liquidity.

We rely on dividends from the Bank as our primary source of funds. The primary sources of funds of the Bank are customer deposits and loan repayments. While scheduled loan repayments are a relatively stable source of funds, they are subject to the ability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors, including changes in economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, inclement weather, natural disasters and international instability. Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, returns available to customers on alternative investments and general economic conditions. Accordingly, we may be required from time to time to rely on secondary sources of liquidity, such as Federal Home Loan Bank advances, to meet withdrawal demands or otherwise fund operations. While management believes that these sources are currently adequate, there can be no assurance they will be sufficient to meet future liquidity demands.

Our allowance for loan and lease losses may be insufficient, which could result in a reduction of net income and capital.

We maintain an allowance for loan and lease losses, which is a reserve established through a provision for loan and lease losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans and leases. The allowance, in the judgment of management, is necessary to reserve for estimated loan and lease losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of:

- portfolio quality trends;
- changes in the nature and volume of the portfolio;
- present and prospective economic and business conditions, locally and nationally;
- management review systems and board oversight;
- changes in credit policy, credit administration, portfolio management and procedures;

- changes in personnel, management and staff; and
- the existence and effect of any concentrations of credit.

The determination of the appropriate level of the allowance for loan and lease losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks using existing qualitative and quantitative information, all of which may undergo material changes. An increase in the allowance for loan and lease losses results in a decrease in net income, and possibly capital, and may have a material adverse effect on our financial condition and results of operations. For further discussion related to our allowance for loan and lease losses, please refer to “Liquidity and Capital Resources – Loans and Loan Quality” and “Critical Accounting Policies – Allowance for Loan and Lease Losses” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

Our profitability depends significantly on economic conditions in the communities in the State of Tennessee where we do business.

Our success and profitability depend on the general economic conditions in the specific local markets in Middle Tennessee where we do business. Local economic conditions have a significant impact on the demand for our products and services as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposit funding sources. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity or investor or business confidence; limitations on the availability of or increases in the cost of credit and capital; increases in inflation or interest rates; natural disasters; or a combination of these or other factors. A significant decline in general economic conditions could impact local economic conditions and, in turn, have a material adverse effect on our financial condition and results of operations.

We are subject to extensive government regulation and supervision.

The Company, primarily through the Bank, is subject to extensive federal and state regulation and supervision, which vests a significant amount of discretion in the various regulatory authorities. Banking regulations are primarily intended to protect depositors’ funds, the Deposit Insurance Fund and the banking system as a whole, not security holders. These regulations and supervisory guidance affect the Company’s lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes. Other changes to statutes, regulations or regulatory policies or supervisory guidance, including changes in interpretation or implementation of statutes, regulations, policies or supervisory guidance, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by Federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties and/or reputational damage. In this regard, government authorities, including the bank regulatory agencies, are pursuing aggressive enforcement actions with respect to compliance and other legal matters involving financial activities, which heightens the risks associated with actual and perceived compliance failures. Any of the foregoing could have a material adverse effect on the Company’s business, financial condition and results of operations.

It is possible that there will be continued changes to the banking and financial institutions regulatory conditions in the future. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. We cannot predict the extent to which the

government and governmental organizations may change any of these laws or controls. We also cannot predict how such changes would adversely affect our business and prospects.

We are subject to interest rate risk.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of our securities portfolio and other interest-earning rates received on loans and other investments, our net interest income, and therefore, earnings could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on our results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. For further discussion related to our management of interest rate risk, please refer to “Liquidity and Capital Resources – Interest Rate Risk” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

We rely heavily on our management team and on our ability to attract and retain key personnel.

We are a customer-focused and relationship-driven organization. Future growth is expected to be driven in large part by the relationships we maintain with our customers. Additionally, it is important for us to continue to attract, hire, motivate and retain skilled personnel to develop new customer relationships as well as new financial products and services. The market for such people is competitive and there is no assurance that we will be successful in attracting, hiring, motivating or retaining them.

Competition from other financial services providers could adversely impact our results of operation.

The banking and financial services business is highly competitive. We face competition in making loans, attracting deposits and providing trust services. Increased competition in the banking and financial services business may reduce our market share, impair its growth or cause the prices we charge for our services to decline. For further discussion related to our competition in our market area, please refer to “Competition” in Item 1 of this Annual Report on Form 10-K.

We obtain a significant portion of our noninterest revenue through service fees on deposit accounts; therefore, legislation and regulations impacting service fees could reduce our fee income.

A significant portion of our noninterest revenue is derived from service fee income. One of the components of this service fee income is overdraft-related fees. Management anticipates that changes in banking regulations, and in particular the Federal Reserve’s rules pertaining to certain overdraft payments on consumer accounts and the FDIC’s Overdraft Payment Programs and Consumer Protection Final Overdraft Payment Supervisory Guidance, will continue to have a significant adverse impact on our service fee income and overall results. Additionally, management anticipates that changes in customer behavior as well as increased competition from other financial institutions may result in declines in deposit accounts or in overdraft frequency resulting in a decline in service fee income. A reduction in deposit account fee income could have a material adverse effect on our earnings.

Our ability to declare and pay dividends is limited by law.

We derive our income primarily from dividends received from owning the Bank’s common stock. Federal and state law limit the Bank’s ability to declare and pay dividends. In addition, the Federal Reserve may impose restrictions on

our ability to declare and pay dividends on our common stock. For further discussion related to restrictions on our ability to declare and pay dividends, please refer to “Regulation and Supervision” in Item 1 of this Annual Report on Form 10-K.

We may elect or be compelled to seek additional capital in the future, but that capital may not be available on favorable terms when it is needed.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. In addition, we may elect to raise additional capital to support our business or to finance any acquisitions or we may otherwise elect or be required to raise additional capital. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, and on our financial performance. Accordingly, we cannot provide assurance of our ability to raise additional capital if needed or to be able to do so on terms acceptable to us. If we cannot raise additional capital on favorable terms when needed, it may have a material adverse effect on our financial condition and results of operations.

Our common stock is not listed or traded on any established securities market and is normally less liquid than securities traded in those markets.

Our common stock is not listed or traded on any established securities market and there are no plans to seek to list our common stock on any recognized exchange. Accordingly, our common stock has substantially less daily trading volume than the average securities listed on any national securities exchange. Most transactions in our common stock are privately negotiated trades, and the shares are very thinly traded. There is no dealer for our stock and no “market maker.” These factors can reduce the marketability of our shares and the lack of a liquid market can produce downward pressure on our stock price.

Maintaining or increasing our market share may depend upon our ability to adapt our products and services to evolving industry standards and consumer preferences.

Our success depends, in part, on our ability to adapt our products and services as well as our distribution of them to evolving industry standards and consumer preferences. Payment methods have evolved with the advancement of technology, such as consumer use of smart phones and PayPal accounts to pay bills, thereby increasing competitive pressure in the delivery of financial products and services. The development and adoption by us of new technologies could require us to make substantial expenditures to modify our existing products and services. Further, we might not be successful in developing or introducing new products and services, adapting to changing consumer preferences and spending and saving habits, achieving market acceptance or regulatory approval, or sufficiently maintaining and growing a loyal customer base. Our inability to adapt to evolving industry standards and consumer preferences could have an adverse impact on our financial condition or results of operations.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

A failure of our operating systems or infrastructure, or those of our third-party vendors, could disrupt our business. Our business is dependent on our ability to process and monitor large numbers of daily transactions in compliance with legal and regulatory standards. As processing demands change and our loan portfolios grow in both volume and differing terms and conditions, developing and maintaining our operating systems and infrastructure becomes increasingly challenging and there is no assurance that we can adequately or efficiently develop and maintain such systems.

Our operations rely on the secure processing, storage and transmission of personal, confidential and other information in our computer systems and networks. Although we take protective measures, our computer systems, software and networks may be vulnerable to unauthorized access, computer viruses, malicious attacks and other events that could have a security impact beyond our control. If one or more of such events occur, personal, confidential and other

information processed and stored in, and transmitted through, our computer systems and networks could be jeopardized or could cause interruptions or malfunctions in our operations that could result in significant losses or reputational damage. We have put in place secure transmission capability, and work to ensure third parties follow similar procedures. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a customer or third party could result in legal liability, regulatory action and reputational harm. In the event personal, confidential or other information is jeopardized, intercepted, misused or mishandled, we may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to fines, penalties, litigation costs and settlements and financial losses that are either not insured against or not fully covered through any insurance maintained by us. Any of these events could have a material adverse effect on our business, financial condition or results of operations.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

At December 31, 2015, the Bank maintained 19 offices and 35 separate automatic teller or cash dispensing machine locations. Our corporate headquarters is located at 816 S. Garden Street, Columbia, Tennessee and three of our nineteen offices are leased. A complete list of all branch and ATM locations can be found on the Bank's website at www.myfirstfarmers.com.

For more information on the properties owned and leased by the Company and the Bank, please refer to Notes 6 and 8 to the Consolidated Financial Statements, which are included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

Item 3. Legal Proceedings.

The Company, the Bank and the subsidiaries of the Bank are, from time to time, subject to claims or suits arising in the ordinary course of business. The Company, the Bank and the subsidiaries of the Bank currently are not a party to any legal proceeding that, in management's opinion, would have a material adverse effect on the Company's financial condition or results of operations.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

A discussion of the Company's common stock and related shareholder matters is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes to the Consolidated Financial Statements, each of which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference. There were no sales of unregistered securities of the Company during the 12 months ended December 31, 2015. In January 2016, the Company announced that its Board of Directors extended the stock repurchase program for up to 200,000 shares through December 31, 2016.

The following table provides information regarding purchases of the Company's common stock made by the Company during the year ended December 31, 2015:

COMPANY'S PURCHASES OF EQUITY SECURITIES				
Period	Total Number of Shares Purchased *	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 31, 2015	-	\$ -	-	\$ -
November 30, 2015	-	\$ -	-	\$ -
December 31, 2015	40,195	\$29.00	-	\$ -
Total	40,195	\$29.00	-	\$ -

*Purchased through negotiated transactions with several third-party sellers.

Item 6. Selected Financial Data.

The selected financial data is included in the Annual Report to Shareholders under the caption "Selected Financial Information" attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Management's Discussion and Analysis of Financial Condition and Results of Operations is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

A discussion of the market risk of the Company and the Bank as of December 31, 2015 related to the investment debt and equity securities held by the Company and the Bank is set forth in Note 3 to the Consolidated Financial Statements, which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference. A discussion of the market risk in the loan portfolio of the Bank is set forth in Note 4 to the Consolidated Financial Statements and in the section entitled "Liquidity and Capital Resources" in Management's Discussion and Analysis of Financial Condition and Results of Operations, each of which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein

by reference. A discussion of the rate sensitivity of all earning assets and interest-bearing liabilities of the Company and the Bank is set forth in the section entitled “Liquidity and Capital Resources– Interest Rate Risk” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

Financial statements and supplementary data are set forth in the Consolidated Financial Statements and Notes to Consolidated Financial Statements, each of which is included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K and is incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

The Company with the participation of its management, including the Company’s Chief Executive Officer and Treasurer and Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this Report.

Based upon that evaluation and as of the end of the period covered by this report, the Company’s Chief Executive Officer and Chief Financial Officer (principal financial and accounting officer) concluded that the Company’s disclosure controls and procedures were effective in ensuring that information required to be disclosed in the reports that the Company files or submits to the SEC under the Exchange Act is recorded, processed, summarized and reported on a timely basis.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, the Company has included a report of management’s assessment of the design and operating effectiveness of its internal controls as part of this report. BKD, LLC, the independent registered public accounting firm that audited the Consolidated Financial Statements of the Company included in the Annual Report to Shareholders attached as Exhibit 13 to this Annual Report on Form 10-K, has issued an attestation report on the effectiveness of the Company’s internal control over financial reporting as of December 31, 2015. The report, which expresses an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting as of December 31, 2015, along with management’s report, are included with the Consolidated Financial Statements in the Annual Report to Shareholders under the captions “Management Report on Internal Control Over Financial Reporting” and “Report of Independent Registered Public Accounting Firm,” each of which is incorporated herein by reference to Exhibit 13 to this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There are no changes in internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Reference is made to information in the Company's Proxy Statement relating to the 2016 Annual Meeting of Shareholders (the "Proxy Statement") under the captions "Proposal 1: Election of Directors," "Executive Officers," "Corporate Governance – Committees of the Board of Directors," "Corporate Governance – Code of Ethics," and "General Information – Section 16 (a) Beneficial Ownership Reporting Compliance," which information is incorporated herein by reference.

Item 11. Executive Compensation.

Reference is made to information in the Proxy Statement under the captions "Compensation Discussion and Analysis," "Executive Compensation," "Compensation of Directors," "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report," which information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Reference is made to information in the Proxy Statement under the captions "Security Ownership of Certain Beneficial Owners and Management," which information is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Reference is made to information in the Proxy Statement under the captions "Corporate Governance – Director Independence" and "Related Person Transactions," which information is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

Reference is made to information in the Proxy Statement under the captions "Audit Committee Report" and "Independent Registered Public Accounting Firm," which information is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) (1) Financial statements are set forth in the Consolidated Financial Statements and Notes to Consolidated Financial Statements, which are incorporated herein by reference to Exhibit 13 to this Annual Report on Form 10-K.

(2) All financial statement schedules are omitted because they are not applicable or not required, or because the required information is included in the Consolidated Financial Statements or Notes to Consolidated Financial Statements referenced in Item 15(a) ⁽¹⁾.

(3) Exhibits:

- 3.1 Charter. ⁽¹⁾
- 3.2 Articles of Amendment to Charter. ⁽¹⁾
- 3.3 Third Amended and Restated Bylaws.
- 4 Specimen Stock Certificate. ⁽¹⁾
- 10.1 Profit Sharing Plan. ^{(2)*}
- 10.2 First Amendment to Profit Sharing Plan. ^{(2)*}
- 10.3 Second Amendment to Profit Sharing Plan. ^{(2)*}
- 10.4 Executive Salary Continuation Agreement by and between First Farmers and Merchants National Bank and Waymon L. Hickman, dated as of December 1, 1992. ^{(2)*}
- 10.5 Benefits Agreement by and between First Farmers and Merchants Bank and Thomas Randall Stevens, the Bank's and the Company's Chairman and Chief Executive Officer, dated as of January 26, 2007. ^{(3)*}
- 10.6 Benefits Agreement by and between John P. Tomlinson, III, the Bank's and Company's Chief Administrative Officer, dated as of January 29, 2007. ^{(3)*}
- 10.7 Form of First Farmers and Merchants Corporation Amended and Restated Director Deferred Compensation Agreement. ^{(4)*}
- 10.8 First Amendment to the First Farmers and Merchants Corporation Amended and Restated Director Deferred Compensation Agreement with John P. Tomlinson, III, dated as of December 18, 2007. ^{(4)*}
- 10.9 Form of First Farmers and Merchants Bank Amended and Restated Director Deferred Compensation Agreement. ^{(4)*}
- 10.10 First Amendment to the First Farmers and Merchants Bank Director Deferred Compensation Agreement with Thomas Randall Stevens, dated as of January 5, 2007. ^{(4)*}
- 10.11 First Amendment to the First Farmers and Merchants Bank Amended and Restated Director Deferred Compensation Agreement with John P. Tomlinson, III, dated as of December 18, 2007. ^{(4)*}
- 10.12 Form of First Farmers and Merchants National Bank Director Split Dollar Agreement. ^{(4)*}
- 10.13 Form of Amendment to the First Farmers and Merchants National Bank Director Split Dollar Agreement. ^{(5)*}
- 10.14 First Farmers & Merchants Bank Group Term Carve-Out Plan, dated as of March 27, 2007. ^{(4)*}
- 10.15 First Farmers and Merchants National Bank Group Term Carve-Out Plan, dated as of July 23, 2002. ^{(4)*}

- 10.16 Amendment to the First Farmers and Merchants National Bank Group Term Carve-Out Plan, dated as of July 23, 2002. ^{(4)*}
- 10.17 First Farmers & Merchants Bank Life Insurance Endorsement Method Split Dollar Plan Agreement, dated as of January 7, 2008. ^{(4)*}
- 10.18 Form of First Farmers and Merchants Corporation Director Deferred Compensation Agreement. ^{(4)*}
- 10.19 Form of First Farmers and Merchants Bank Director Deferred Compensation Agreement. ^{(4)*}
- 10.20 First Farmers and Merchants Bank Director Deferred Compensation Agreement with Tim E. Pettus, dated as of March 5, 2008. ^{(4)*}
- 10.21 First Farmers and Merchants Corporation Director Deferred Compensation Agreement with Tim E. Pettus, dated as of March 5, 2008. ^{(4)*}
- 10.22 First Farmers and Merchants Bank Change in Control Agreement with Robert E. Krimmel. ^{(5)*}
- 13 Annual Report to Shareholders.
- 21 List of Subsidiaries. ⁽⁶⁾
- 31.1 Certification of the Chief Executive Officer of First Farmers and Merchants Corporation pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Treasurer (principal financial officer) of First Farmers and Merchants Corporation pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of the Chief Executive Officer and Treasurer (principal financial officer) of First Farmers and Merchants Corporation pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Annual Report on Form 10-K for the year ended December 31, 2015, is formatted in XBRL (Extensible Business Reporting Language) interactive data files: (i) the Consolidated Balance Sheets as of December 31, 2015 and 2014; (ii) the Consolidated Statements of Income for each of the years ended December 31, 2015, 2014 and 2013; (iii) the Consolidated Statements of Changes in Shareholders' Equity for each of the years ended December 31, 2015, 2014 and 2013; (iv) the Consolidated Statements of Cash Flows for each of the years ended December 31, 2015, 2014 and 2013; and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text.

* Indicates a compensatory plan or arrangement.

- (1) Incorporated by reference to the First Farmers and Merchants Corporation Amendment No. 1 to the Annual Report on Form 10-K/A for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on May 7, 2004 (File Number 000-10972).
- (2) Incorporated by reference to the First Farmers and Merchants Corporation Amendment No. 2 to the Annual Report on Form 10-K/A for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on July 19, 2004 (File Number 000-10972).
- (3) Incorporated by reference to the First Farmers and Merchants Corporation Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 30, 2007 (File Number 000-10972).

- (4) Incorporated by reference to the First Farmers and Merchants Corporation Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission on March 13, 2009 (File Number 000-10972).
- (5) Incorporated by reference to the First Farmers and Merchants Corporation Current Report on Form 8-K, as filed with the Securities and Exchange Commission on May 1, 2015 (File Number 000-10972).
- (6) Incorporated by reference to the First Farmers and Merchants Corporation Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission on March 5, 2014 (File No. 000-10972).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST FARMERS AND MERCHANTS CORPORATION

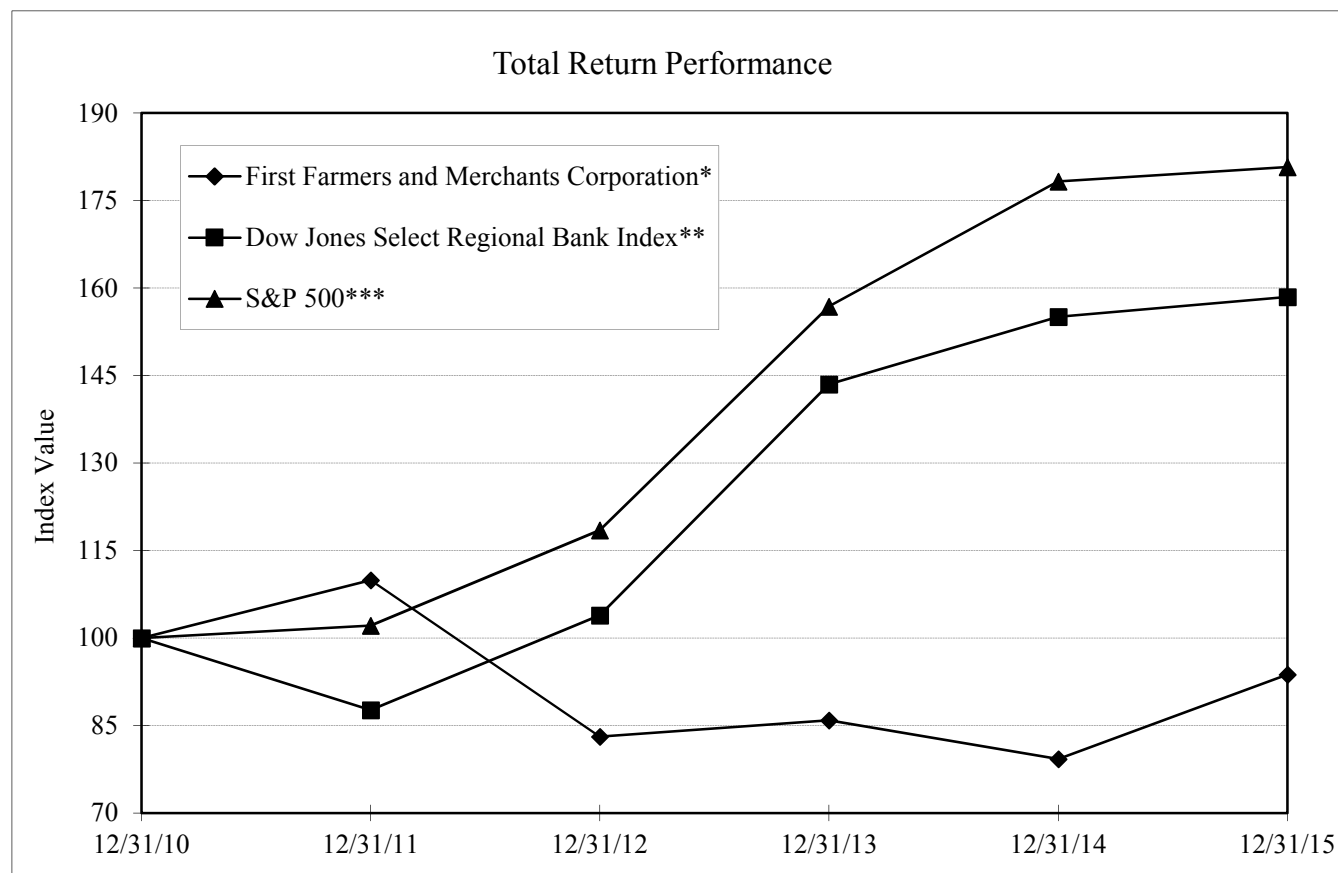
By /s/ T. Randy Stevens
T. Randy Stevens
Chairman and Chief Executive Officer
Date: March 1, 2016

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date:	<u>March 1, 2016</u>	<u>/s/ T. Randy Stevens</u> T. Randy Stevens, Director and Chairman <i>Principal Executive Officer</i>
Date:	<u>March 1, 2016</u>	<u>/s/ Timothy E. Pettus</u> Timothy E. Pettus, Director and Vice-Chairman
Date:	<u>March 1, 2016</u>	<u>/s/ M. Darlene Baxter</u> M. Darlene Baxter, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Jonathan M. Edwards</u> Jonathan M. Edwards, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Thomas Napier Gordon</u> Thomas Napier Gordon, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Dalton M. Mounger</u> Dalton M. Mounger, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Patrick J. Riley</u> Patrick J. Riley, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Matthew M. Scoggins, Jr.</u> Matthew M. Scoggins, Jr., Director
Date:	<u>March 1, 2016</u>	<u>/s/ W. Lacy Upchurch</u> W. Lacy Upchurch, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Dr. David S. Williams</u> Dr. David S. Williams, Director
Date:	<u>March 1, 2016</u>	<u>/s/ Robert E. Krimmel</u> Robert E. Krimmel, Chief Financial Officer <i>Principal Financial and Accounting Officer</i>

COMPARATIVE PERFORMANCE

Set forth below is a graph comparing the yearly change in the cumulative total shareholder return on the common stock of First Farmers and Merchants Corporation (FF&M in the graph) against the cumulative total return of the S&P 500 Index and the Dow Jones Select Regional Bank Index for the five-year period commencing December 31, 2010 and ending December 31, 2015.



<i>Index</i>	<i>Period Ending</i>					
	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15
First Farmers and Merchants Corporation ⁽¹⁾	100.00	109.90	83.07	85.89	79.27	93.72
Dow Jones Select Regional Bank Index ⁽²⁾	100.00	87.66	103.86	143.51	155.06	158.46
S&P 500 ⁽³⁾	100.00	102.11	118.45	156.82	178.28	180.75

- (1) Assumes that the value of the investment in FF&M was \$100 on December 31, 2010, with all dividends reinvested.
 (2) Assumes that the value of the investment in the index was \$100 on December 31, 2010, with all dividends reinvested.
 (3) Assumes that the value of the investment in the index was \$100 on December 31, 2010, with all dividends reinvested.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report to Shareholders may not be based on historical facts and are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may be identified by, among other things, the use of forward-looking terminology such as “believes,” “expects,” “hopes,” “may,” “plans,” “will,” or “anticipates,” or the negatives of such terms. We caution you not to place undue reliance on such forward-looking statements in this Annual Report to Shareholders because results could differ materially from those anticipated as a result of a variety of factors. These forward-looking statements include, without limitation, those relating to the quality of service provided to customers, reduction in net loans, the effect of fluctuating interest rates on net interest income, the stability of market rates, adequate access to capital to meet liquidity needs, capital expenditures, the completion of a new branch, cash dividends, cash flows on impaired loans, the present value of servicing income, deferred tax assets, potential issuance of shares, the fair value of bonds, impairment of securities, lease commitments, troubled debt restructurings, repayment of loans by borrowers, legal claims, capital adequacy requirements, fair value valuation methodologies, fair value of other assets, valuation of financial instruments, post-retirement benefit payments, interest rate sensitivity and risk, diversification of the loan portfolio, gross interest income, the adequacy of allowance for loan and lease losses, loan concentrations, expected maturity of investment securities, intent of management to hold certain loans until maturity or payoff, the value of underlying collateral and the impact of accounting standards on the financial statements. Factors that could affect our results include, but are not limited to, changes in economic conditions; fluctuations in prevailing interest rates and the effectiveness of our risk monitoring systems; our ability to maintain credit quality; our ability to provide market competitive products and services; laws and regulations affecting financial institutions in general; our ability to operate and integrate new technology; the effectiveness of our interest rate hedging strategies; government fiscal and monetary policies; changes in our operating or expansion strategy; changes in our assumptions or estimation methodologies; the availability of and costs associated with maintaining and/or obtaining adequate and timely sources of liquidity; limitations on our ability to pay dividends and to meet our cash obligations; assumptions and judgments about the collectability of our loan portfolio; and our ability to compete with other financial services companies and other factors generally understood to affect the financial results of financial services companies. Except as otherwise required by law, the Company undertakes no obligation to update its forward-looking statements to reflect events or circumstances that occur after the date of this annual report on Form 10-K.

EXECUTIVE OVERVIEW

General

First Farmers and Merchants Corporation (the “Company”) was incorporated on March 31, 1982 as a Tennessee corporation. As of December 31, 2015, the only direct subsidiary of the Company was First Farmers and Merchants Bank (the “Bank”), which conducts the principal business of the consolidated company. The Bank was organized as a national bank in 1954 as a successor to a state bank that was organized in 1909. The Bank remained a national bank until July 5, 2005, when it converted back to a state-chartered bank and changed its name from First Farmers and Merchants National Bank to First Farmers and Merchants Bank. The Bank has direct and indirect subsidiaries through which it holds F&M West, Inc., Maury Tenn, Inc. and Maury Tenn Properties, Inc. The principal executive offices of the Company are located at 816 South Garden Street, Columbia, Maury County, Tennessee. Management of the Company evaluates the financial condition of the Company in terms of the Bank’s operations within its service area.

Financial Condition

The Company’s assets consist primarily of its investment in the Bank and other smaller investments. Its primary activities are conducted through the Bank. The Bank is committed to providing quality services in diverse markets and a changing interest rate environment. Management hopes to provide Bank customers the quality service of a community bank and the safety and strength of a regional institution.

At December 31, 2015, the Company’s consolidated total assets were \$1.260 billion, its consolidated net loans were \$722.6 million, its total deposits were \$1.104 billion and its total shareholders’ equity was \$117.8 million. The economic climate in the Company’s market area of Middle Tennessee continued to be stable in 2015, as evidenced by

Financial Condition, (continued)

the Company's loan volume, an increase of 12.2% in net loans at December 31, 2015 compared to December 31, 2014. Total deposits increased by 8.2% and total shareholders' equity increased by 2.8% over the same period.

Results of Operations

Consolidated net income in 2015 totaled \$10.3 million, a 0.6% increase from \$10.2 million in 2014 and a 7.2% increase from \$9.6 million in 2013. Net interest income increased 6.1% from 2014 and 5.8% from 2013. Although short-term interest rates increased during December 2015, we continue to experience falling loan yields as new volume was added at lower rates. On a per common share basis, net income totaled \$2.13 for 2015 versus \$2.06 for 2014 and \$1.88 for 2013.

The accompanying tables and the discussion and financial information are presented to aid in understanding the Company's financial position and results of operations. The emphasis of this discussion is on the years ended December 31, 2015, 2014 and 2013; however, financial information for prior years will also be presented where appropriate or required. This discussion should be read in conjunction with the Consolidated Financial Statements and the Notes to Consolidated Financial Statements included elsewhere in this Annual Report to Shareholders.

CRITICAL ACCOUNTING ESTIMATES

The accounting and reporting policies followed by the Company conform, in all material respects, to GAAP and to general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. In connection with the application of those principles, the Company's management has made judgments and estimates that, in the case of determining the ALLL, the recognition of deferred income tax assets and the assessment of impairment of intangibles has been critical to the determination of the Company's financial position, results of operations and cash flows.

Allowance for Loan and Lease Losses

Our management assesses the adequacy of the allowance for loan and lease losses at the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolio, past loan loss experience, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay the loans (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations. The allowance maintained is believed by management to be adequate to absorb probable losses inherent in the loan portfolio at December 31, 2015. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectible.

In assessing the adequacy of the allowance, we also consider the results of our ongoing independent loan review process. We undertake this process both to ascertain those loans in the portfolio with elevated credit risk and to assist in our overall evaluation of the risk characteristics of the entire loan portfolio. Our loan review process includes the judgment of management, independent internal credit analysts, and reviews that may have been conducted by third-party reviewers including regulatory examiners. We incorporate relevant loan review results in the loan impairment determination and the adequacy of the allowance.

Allowance for Loan and Lease Losses. (continued)

Our allowance for loan and lease losses is composed of the result of two independent analyses pursuant to the provisions of Accounting Standards Codification (“ASC”) 450-20, *Loss Contingencies* and ASC 310-10-35, *Receivables*. The ASC 450-20 analysis is intended to quantify the inherent risk in our performing loan portfolio. The component of the allowance generated by ASC 310-10-35 is the result of an analysis of loans that have been specifically identified as impaired.

The ASC 450-20 component of the allowance for loan and lease losses begins with a process of estimating the probable losses based on our internal system of risk ratings and historical loss data for our risk rated portfolio. Loss estimates are derived from the Bank’s historical loss data by loan categories and compared to peer institutions. As of June 30, 2014 and prior, the look-back period for historical loss data was the prior eight quarters. Subsequently, we have increased our look-back period each quarter to include the most recent quarters’ loss history for a total of 10 quarters as of December 31, 2015.

The allowance allocation for non risk-rated portfolios is based on consideration of our actual historical loss rates and industry loss rates for those particular segments. Non risk-rated loans are evaluated as a group by category rather than on an individual loan basis because these loans are smaller and homogeneous. We weight the allocation methodologies for the non risk-rated loan portfolio and determine a weighted average allocation for these portfolios.

The estimated loan loss allocation for all loan segments is then adjusted for management’s estimate of probable losses for a number of environmental factors. The allocation for environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and is based upon quarterly trend assessments in delinquent and nonaccrual loans, unanticipated charge-offs, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These environmental factors are considered for each of the five loan segments, and the allowance allocation, as determined by the processes noted above for each segment, is increased or decreased based on the incremental assessment of these various environmental factors.

The second component of the allowance for loan and lease losses is determined pursuant to ASC 310-10-35. Loans are impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the interest and principal payments of a loan will be collected as scheduled in the loan agreement. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loan losses are charged off when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a “confirming event” has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net of deferred loan fees or costs and unamortized premium or discount). The impairment is recognized through the provision for loan and lease losses and is a component of the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, at the fair value of the collateral, less estimated disposal costs. If the loan is collateral dependent, the principal balance of the loan is charged-off in an amount equal to the impairment measurement. The fair value of collateral dependent loans is derived primarily from collateral appraisals performed by independent third-party appraisers. Management believes it follows appropriate accounting and regulatory guidance in determining impairment and accrual status of impaired loans.

Pursuant to the guidance set forth in Accounting Standards Update (“ASU”) No. 2011-02, *A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring*, the above impairment methodology is also applied to those loans identified as troubled debt restructurings.

Allowance for Loan and Lease Losses. (continued)

Management tests the resulting total allowance for loan and lease losses by comparing the balance in the allowance to historical trends and industry and peer information. Our management then evaluates the result of the procedures performed, including the results of our testing, and decides on the appropriateness of the balance of the allowance in its entirety. Our board of directors reviews and approves the assessment prior to the filing of quarterly and annual financial information.

While our policies and procedures used to estimate the allowance for loan and lease losses, as well as the resultant provision for loan and lease losses charged to operations, are considered adequate by management and are reviewed from time to time by our regulators, they are inherently imprecise. There are factors beyond our control, such as conditions in the local and national economy, a local real estate market or particular industry conditions which may negatively impact materially our asset quality and the adequacy of our allowance for loan and lease losses and thus the resulting provision for loan losses. See notes 1, 4 and 5 in the consolidated financial statements for more information on the allowance for loan and lease losses.

The following table sets forth the allocation of the allowance to types of loans and the percentage of loans in each category to total loans:

	December 31,			
	2015		2014	
	(dollars in thousands)			
	Amount	Percent	Amount	Percent
Balance at end of period applicable to:				
Commercial	\$ 7,402	58.5%	\$ 6,719	58.7%
Residential real estate	1,061	35.7%	1,053	35.2%
Consumer and other retail	171	5.8%	162	6.1%
Total loans	\$ 8,634	100.0%	\$ 7,934	100.0%

Deferred Income Tax Assets

Deferred income tax assets consist mainly of the tax effect of excess provisions for loan and lease losses over actual losses incurred, the unrealized loss on available-for-sale securities and deferred compensation. Management believes that it is more likely than not that these assets will be realized in future years.

Impairment of Intangible Assets

Long-lived assets, including purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. There were no such assets to be disposed of at December 31, 2015.

Goodwill is evaluated for impairment annually and more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. As of December 31, 2015, the fair value of our goodwill exceeded the carrying value.

FINANCIAL CONDITION

Net Interest Margin

Net interest margin is defined as the difference between the revenue from earning assets (primarily interest income) and interest expense related to interest bearing liabilities. Net interest margin is a function of the average balances of earning assets and interest bearing liabilities and the yields earned and rates paid on those balances. In order to succeed in the banking industry, it is critical to maintain the net interest margin at a level that, when coupled with non-interest revenues, exceeds additions to the allowance for loan and lease losses, non-interest expenses and income taxes and yields an acceptable profit.

The Company plans the Bank's operations with the goal of maintaining a satisfactory spread between the yields on earning assets and the related cost of interest bearing funds. The gross interest spread is determined by comparing the taxable equivalent gross interest margin to average earning assets before deducting the allowance for loan and lease losses. This spread reflects the overall profitability of earning assets, including both those funded by interest bearing sources and those that do not generate interest (primarily non-interest bearing demand deposits). This spread is most often used when analyzing a banking institution's overall gross margin profitability compared to that of other financial institutions. Management uses calculations and similar ratios to assist in pricing decisions for interest-related products. Table A on the following page presents the average daily balances, the components of the gross interest margin (on a taxable equivalent basis), the yield or rate, and the incremental and gross interest spread for each of the last three years by major categories of assets and liabilities.

Net Interest Margin, (continued)

TABLE A - Distribution of Assets, Liabilities, Shareholders' Equity, Interest Rates and Interest Differential

	Year ended December 31,								
	2015			2014			2013		
(Dollars in thousands)	Average balance ³	Rate/ yield	Interest	Average balance ³	Rate/ yield	Interest	Average balance ³	Rate/ yield	Interest
ASSETS									
Interest earning assets									
Loans, net ²	\$ 683,319	4.56%	\$ 31,139	\$ 607,957	4.72%	\$ 28,673	\$ 572,913	5.05%	\$ 28,949
Bank deposits	11,766	0.28%	33	23,423	0.27%	64	21,706	1.73%	375
Taxable securities ¹	340,630	1.73%	5,891	329,621	1.79%	5,911	311,796	1.82%	5,677
Tax-exempt securities ^{1,2}	75,220	4.47%	3,361	69,427	5.71%	3,963	78,138	5.97%	4,667
Federal funds sold	6,609	0.27%	18	7,598	0.25%	19	12,732	0.25%	32
TOTAL EARNING ASSETS	1,117,544	3.62%	\$ 40,442	1,038,026	3.72%	\$ 38,630	997,285	3.98%	\$ 39,700
Non-interest earning assets									
Cash and due from banks	19,292			18,715			16,775		
Bank premises and equipment	25,790			24,972			25,795		
Other assets	50,814			40,127			47,632		
TOTAL ASSETS	\$ 1,213,440			\$ 1,121,840			\$ 1,087,487		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest bearing liabilities									
Time and savings deposits:									
NOW and money market accounts	\$ 522,586	0.12%	\$ 624	\$ 457,027	0.13%	\$ 608	\$ 432,853	0.15%	\$ 630
Savings	89,925	0.04%	33	95,637	0.04%	42	89,453	0.05%	47
Time up to \$100	103,342	0.56%	576	111,931	0.65%	733	122,947	0.75%	916
Time over \$100	118,421	0.76%	898	122,557	0.80%	975	119,130	0.92%	1,101
TOTAL INTEREST BEARING DEPOSITS	834,274	0.26%	2,131	787,152	0.30%	2,358	764,383	0.35%	2,694
Federal funds purchased and securities sold under agreements to repurchase	25,992	0.34%	89	21,716	0.32%	70	19,855	0.31%	62
Other borrowings	1,880	0.27%	5	-	-	-	3,868	3.90%	151
TOTAL INTEREST BEARING LIABILITIES	862,146	0.26%	\$ 2,225	808,868	0.30%	\$ 2,428	788,106	0.37%	\$ 2,907
Non-interest bearing liabilities									
Demand deposits	219,732			187,053			173,648		
Other liabilities	13,080			16,083			14,800		
TOTAL LIABILITIES	1,094,958			1,012,004			976,554		
Shareholders' equity	118,482			109,836			110,933		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,213,440			\$ 1,121,840			\$ 1,087,487		
Spread between combined rate earned and combined rates paid*		3.36%			3.42%			3.61%	
Net yield on interest-earning assets*		3.43%			3.49%			3.69%	

* Taxable equivalent adjustments for the periods ending December 31, 2015, December 31, 2014 and December 31, 2013 were \$1.8 million, \$1.9 million and \$2.3 million, respectively.

Notes:

1. U.S. government (agency, state and political subdivision), and corporate debt securities plus equity securities in the available-for-sale and held-to-maturity categories are taxable securities. Most municipal debt securities are nontaxable.
2. The taxable equivalent adjustment has been computed based on a 34% federal income tax rate and has given effect to the disallowance of interest expense, for federal income tax purposes, related to certain tax-free assets. Loans include nonaccrual loans for all years presented.
3. The average balances of the amortized cost of available-for-sale securities were used in the calculations in this table.

Net Interest Margin, (continued)

Table B below sets forth, for the periods indicated, a summary of consolidated changes in interest earned and interest paid, reflected by the interest generated by volume changes and the interest generated by changes in the yield or rate. On a tax equivalent basis, net interest income increased \$2.4 million for the year ended December 31, 2015 compared to the year ended December 31, 2014 primarily because of increased loan volume. Interest paid on interest bearing deposits was down in 2015 compared to 2014 primarily because of lower average interest rates.

TABLE B - Volume and Yield/Rate Variances

(Taxable Equivalent Basis)

(Dollars in thousands)	2015 compared to 2014			2014 compared to 2013		
	Volume	Yield /rate	Net increase (decrease) ¹	Volume	Yield /rate	Net increase (decrease) ¹
Revenue earned on						
Loans, net ²	\$ 3,434	\$ (968)	\$ 2,466	\$ 1,770	\$ (2,046)	\$ (276)
Bank deposits	(32)	1	(31)	30	(341)	(311)
Investment securities:						
Taxable securities ³	190	(211)	(21)	324	(90)	234
Tax-free securities ²	259	(860)	(601)	(520)	(184)	(704)
Federal funds sold	(3)	2	(1)	(13)	-	(13)
Total interest earning assets	3,848	(2,036)	1,812	1,591	(2,661)	(1,070)
Interest paid on						
NOW and money market accounts	79	(63)	16	39	(61)	(22)
Savings deposits	(2)	(7)	(9)	3	(8)	(5)
Time deposits up to \$100	(48)	(109)	(157)	(83)	(100)	(183)
Time deposits over \$100	(31)	(46)	(77)	32	(158)	(126)
Federal funds purchased and securities sold under agreements to repurchase	15	4	19	6	2	8
Other borrowings	5	-	5	(151)	-	(151)
Total interest-bearing funds	18	(221)	(203)	(154)	(325)	(479)
Net interest earnings	\$ 3,830	\$ (1,815)	\$ 2,015	\$ 1,745	\$ (2,336)	\$ (591)

Notes:

1. The change in interest earned or paid resulting from both volume and rate or yield has been allocated accordingly in proportion to the relationship of the absolute amounts of the change in each. Loans include nonaccrual loans for all years presented.

2. The computation of the taxable equivalent adjustment has given effect to the disallowance of interest expense, for federal income tax purposes, related to certain tax-exempt assets.

3. U.S. government (agency, state and political subdivision), and corporate debt securities plus equity securities in the available-for-sale and held-to-maturity categories are taxable securities.

Overview of Assets and Liabilities

Average earning assets increased 7.7% in 2015 compared to 2014 and increased 4.1% in 2014 compared to 2013. As a financial institution, the Company's primary earning assets are loans made by the Bank. In 2015, average net loans represented 61.1% of average earning assets compared to 58.6% of average earnings assets in 2014. Average net loans increased 12.4% in 2015 compared to 2014 and increased 6.1% in 2014 compared to 2013. We anticipate average net loans will increase throughout 2016 because of the strong loan demand momentum experienced in 2015.

Overview of Assets and Liabilities, (continued)

Average investment securities, which comprised 37.2% of average earning assets in 2015, increased 4.2% from 2014 compared to a 2.3% increase in 2014 from 2013. We anticipate average investment securities to decline as a percentage of average earnings assets in 2016. Average total assets increased 8.2% in 2015 compared to a 3.2% increase in 2014 from 2013.

The Bank's average interest-bearing deposits increased 6.0% in 2015 compared to 2014. Most of the increase is attributable to money market accounts, in which the average balance increased 14.3% from 2015 compared to 2014. Time deposits up to \$100,000 decreased 7.7% as of December 31, 2015 compared to December 31, 2014 and time deposits over \$100,000 decreased 3.4% over the same period. Average savings deposits decreased 6.0% in 2015 compared to 2014. Savings deposits have historically been steady providers of a core, low cost source of funding.

Customer relationship development helped maintain a relatively stable base in non-interest bearing deposits during 2015. The Bank's non-interest bearing deposits have remained strong and were 20.9% of average total deposits in 2015, 19.2% of average total deposits in 2014 and 18.5% of average total deposits in 2013. Average non-interest bearing deposits increased 17.5% for 2015 and 7.7% for 2014.

The Bank has a Blanket Agreement for Advances and Security Agreement with the Federal Home Loan Bank ("FHLB") for term debt or other obligations. For more information, see Note 10 of the Notes to Consolidated Financial Statements included elsewhere in this Annual Report to Shareholders.

Loans and Loan Quality

The Bank's loan portfolio is the largest component of earning assets and, therefore, provides the highest amount of revenue. The loan portfolio also contains the highest exposure to risk, as a result of credit quality. When analyzing potential loans, management assesses both interest rate objectives and credit quality objectives in determining whether to authorize a given loan and the appropriate pricing for that loan. The Bank maintains a diversified portfolio in order to spread its risk and reduce its exposure to economic downturns that may occur in different segments of the economy or in particular industries. The composition of the loan portfolio is disclosed in detail in Note 4 in the Notes to Consolidated Financial Statements included elsewhere in this Annual Report to Shareholders.

The following table presents the maturities of the Bank's loans by category as of December 31, 2015:

	<u>Within one year</u>	<u>One to five years</u>	<u>After five years</u>	<u>Total</u>
	(dollars in thousands)			
Commercial:				
Commercial and industrial	\$ 32,100	\$ 62,863	\$ 32,936	\$ 127,899
Non-farm, nonresidential real estate	7,462	73,939	79,608	161,009
Construction and development	31,015	15,301	5,014	51,330
Commercial loans secured by real estate	5,141	14,338	8,612	28,091
Other commercial	721	4,228	55,376	60,325
Total commercial	<u>76,439</u>	<u>170,669</u>	<u>181,546</u>	<u>428,654</u>
Retail:				
Consumer	3,175	6,117	622	9,914
Single family residential	2,673	23,527	234,054	260,254
Other retail	1,475	7,741	23,228	32,444
Total retail	<u>7,323</u>	<u>37,385</u>	<u>257,904</u>	<u>302,612</u>
Total loans	<u>\$ 83,762</u>	<u>\$ 208,054</u>	<u>\$ 439,450</u>	<u>\$ 731,266</u>

Loan and Loan Quality, (continued)

The lending activities of the Bank are subject to written underwriting standards and policies established by the Bank's Board of Directors and management that include loan review procedures and approvals. Depending primarily on the dollar amount of the loan, there are various approval levels required, including that of the Executive Committee of the Bank's Board of Directors.

The composition of the Bank's loan and lease portfolio for the years presented were as follows:

	2015	Percentage of total	2014	2013	2012	2011
	(dollars in thousands)					
Commercial:						
Commercial and industrial	\$ 127,899	17.5%	\$ 99,788	\$ 94,702	\$ 83,631	\$ 60,448
Non-farm, non-residential real estate	161,009	22.0%	163,461	176,213	167,565	140,147
Construction and development	51,330	7.0%	50,424	29,938	36,323	29,042
Commercial loans secured by real estate	28,091	3.8%	27,937	26,940	23,983	4,095
Other commercial	60,325	8.2%	41,185	26,582	24,423	47,696
Total commercial	428,654	58.5%	382,795	354,375	335,925	281,428
Retail:						
Consumer	9,914	1.4%	9,536	10,957	11,621	14,297
Single family residential	260,254	35.7%	229,559	213,763	196,349	196,913
Other retail	32,444	4.4%	30,162	27,671	23,264	25,700
Total retail	302,612	41.5%	269,257	252,391	231,234	236,910
Total loans	\$ 731,266	100.0%	\$ 652,052	\$ 606,766	\$ 567,159	\$ 518,338

The composition of the Bank's outstanding loans by Tennessee County for the quarters presented were as follows:

Loan Balances by County:	2015	2014	2013	2012	2011
	(dollars in thousands)				
Davidson	\$ 63,958	\$ 16,131	\$ -	\$ -	\$ -
Dickson	4,514	4,463	5,095	5,730	7,253
Giles	55,554	48,458	38,848	42,209	31,313
Hickman	28,912	29,109	28,756	23,563	23,097
Lawrence	114,980	111,202	114,386	101,103	101,319
Marshall	23,679	22,017	21,256	24,130	25,948
Maury	320,734	308,987	291,156	284,844	266,999
Williamson	118,935	111,685	107,269	85,580	61,873
	<u>\$ 731,266</u>	<u>\$ 652,052</u>	<u>\$ 606,766</u>	<u>\$ 567,159</u>	<u>\$ 517,802</u>

Loan and Loan Quality, (continued)

Loan demand showed solid momentum in 2015, mainly due to commercial and residential mortgage lending. Commercial loans grew 12.0% from the previous year. Residential mortgage loans grew 13.4% from the previous year. Portfolio growth and asset quality remain strong. The bank will continue to diligently review its pricing structure and to seek out new lending opportunities and bank relationships within our market footprint.

The Bank has a credit administration function that is responsible for assisting loan officers in underwriting new loans, reviewing problem loans, monitoring the status of problem loans from period to period, and assisting in their resolution. This review process also includes semi-annual reviews by an outside party to assess the quality of the loan portfolio independently. Management has concluded that this independent review has served to strengthen underwriting practices. The analysis and review by the Bank's credit administration department also includes a formal review that is prepared quarterly to assess the risk in the loan portfolio and to determine the adequacy of the allowance for loan and lease losses ("ALLL"). Loan reviews of all relationships aggregating \$750,000 and greater are completed on an annual schedule.

Loans that are impaired and not accruing interest were actively monitored in 2015 to determine those for which more aggressive action plans should be taken. The Bank ended 2015 with \$670,000, or 0.10% in net recoveries.

Loan and Loan Quality, (continued)

Table D below summarizes average loan balances and reconciles the ALLL for each of the last five years. Additions or reductions to the allowance, which are included in operating expenses, are also included.

TABLE D - Loan Portfolio

(Dollars in thousands)	December 31,				
	2015	2014	2013	2012	2011
Average amount of gross loans outstanding	\$ 691,697	\$ 616,467	\$ 581,596	\$ 526,973	\$ 543,203
Balance of allowance for possible loan and lease losses at beginning of year	7,934	8,595	8,809	9,200	9,420
Loans charged off					
Commercial loans	-	739	222	1,690	3,353
Residential real estate loans	34	41	27	176	52
Loans to individuals	13	11	49	19	147
TOTAL CHARGE-OFFS	47	791	298	1,885	3,552
Recoveries of loans previously charged off					
Commercial loans	683	99	53	364	103
Residential real estate loans	12	10	2	2	-
Loans to individuals	22	21	29	8	104
TOTAL RECOVERIES	717	130	84	374	207
NET CHARGE-OFFS (RECOVERIES)	(670)	661	214	1,511	3,345
Provision charged					
to operating expenses	30	-	-	1,120	3,125
BALANCE AT END OF YEAR	\$ 8,634	\$ 7,934	\$ 8,595	\$ 8,809	\$ 9,200
Ratio of net charge-offs (recoveries) to average gross loans outstanding	(0.10%)	0.11 %	0.04 %	0.29 %	0.62 %

In reviewing the Bank's loan portfolio, management categorizes certain loans as "classified assets," which consist of substandard, doubtful and loss categories of loans, and "special mention," which is a less severe category of loans that do not warrant an adverse classification. The Bank closed 2015 with \$3.0 million in classified assets compared to \$10.8 million in 2014; of these amounts, none of the loans were classified as doubtful at December 31, 2015 and December 31, 2014, there were \$3.0 million and \$10.8 million in loans classified as substandard at December 31, 2015 and 2014, respectively, and \$62,000 and \$5,000 were classified as OREO at December 31, 2015 and 2014, respectively. At December 31, 2015, loans totaling \$269,000, or 0.04% of the portfolio, were classified as "special mention" loans. This compares to loans totaling \$1.1 million so classified at December 31, 2014, representing a decrease of \$859,000.

Loans having recorded investments of \$2.3 million and \$9.4 million at December 31, 2015 and 2014, respectively, have been identified as impaired. Loans amounting to \$2.2 million and \$5.4 million at December 31, 2015 and 2014, respectively, were not accruing interest. These loans are considered nonaccrual loans and represented 0.3% and 0.8% of gross loans as of December 31, 2015 and 2014, respectively. Interest received on nonaccrual loans during 2015, 2014 and 2013 were \$242,000, \$319,000 and \$326,000, respectively. The Bank had no loans that were 90 days or more past due that were not included in nonaccrual loans as of December 31, 2015. The Bank had three loans amounting to \$97,000 that were 90 days or more past due that were not included in nonaccrual loans as of December 31, 2014.

Loan and Loan Quality, (continued)

The Bank had \$1.1 million and \$3.5 million that qualified as “troubled debt restructurings” as defined in ASC Topic 310-40 as of December 31, 2015 and 2014, respectively. Troubled debt restructurings are loans for which the Bank, for economic or legal reasons related to a borrower’s financial difficulties, grants a concession to the borrower which would otherwise not be considered. For a loan to be classified as a troubled debt restructuring, the borrower must be experiencing financial difficulties (even if the borrower is not currently in default on any of its indebtedness), and because of those difficulties the Bank must have made a concession that would otherwise not be granted. These concessions can take many forms, including but not limited to granting temporary payment relief, restructuring a loan to extend the amortization or lower the required payment amount, and forgiveness of principal. Likewise, the financial difficulty being experienced by a borrower can take many forms, including but not limited to:

- Being in default on any existing indebtedness;
- Declaring, or being in the process of declaring, bankruptcy;
- Significant doubt as to whether an existing business can continue to operate as a going concern;
- Historically demonstrating, or forecasting, insufficient cash flows with which to service all debt in a timely manner; or
- Absent the modification, the borrower cannot continue to keep all payments on indebtedness current.

Once loans are identified as a troubled debt restructuring, the Bank will track these loans and periodically report to the Board of Directors the aggregate balances thereof. Please refer to Note 1 and Note 4 in the Notes to Consolidated Financial Statements that are included elsewhere in this Annual Report to Shareholders for more information on the Bank’s policy regarding loan impairment and troubled debt restructuring.

The provision for loan and lease losses represents a charge to earnings necessary to establish an allowance for loan and lease losses that management believes to be adequate to provide coverage for the inherent losses on outstanding loans. The provision for loan and lease losses amounted to approximately \$30,000, \$0, and \$0 for the years ended December 31, 2015, 2014, and 2013, respectively.

Several factors including the change in outstanding loan balances, the level of charge-offs and recoveries, the changes in the amount of impaired loans, changes in the risk ratings assigned to our loans, results of regulatory examinations, credit quality comparison to peer banks, the industry at large, and, ultimately, the results of our quarterly assessment of the inherent risks of our loan portfolio including past loan loss experience impact the ALLL.

Based upon management's assessment of the loan portfolio, we adjust our allowance for loan and lease losses to an amount deemed appropriate to adequately cover probable losses in the loan portfolio. Improving net-recoveries, particularly in our commercial real estate loan portfolio, and decreased non-performing assets positively affected our provision for loan and lease losses in 2015 and 2014. Our allowance for loan and lease losses as a percentage of loans decreased to 1.18% at December 31, 2015 from 1.22% at December 31, 2014. Based upon our evaluation of the loan portfolio, we believe the ALLL to be adequate to absorb our estimate of probable losses existing in the loan portfolio at December 31, 2015. While our policies and procedures used to estimate the ALLL, as well as the resultant provision for loan losses charged to operations, are considered adequate by management, they are inherently imprecise. There are factors beyond our control, such as conditions in the local and national economy, local real estate market or a particular industry or borrower which may negatively impact, materially, our asset quality and the adequacy of our allowance for loan and lease losses and, thus, the resulting provision for loan and lease losses.

RESULTS OF OPERATIONS

Interest Income and Expense

Total interest income increased 5.2% during 2015 as a result of increased loan volume. Interest and fees earned on loans totaled 78.9% of gross interest income during 2015 and increased 7.9% from 2014 as a result of increased loan volume. Interest earned on securities and other investments totaled 21.1% of total interest income during 2015 and decreased 3.8% from 2014 primarily due to the repricing of higher yielding tax-exempt municipal securities at lower yielding rates.

Total interest expense decreased 8.4% in 2015 compared to a 16.5% decrease in 2014 and a 24.3% decrease in 2013. Decreases in the average interest rate paid on interest bearing liabilities contributed to the lower interest expense. The cost of interest bearing deposits is monitored monthly by the Bank's Asset Liability Management Committee ("ALCO"). The net interest margin (tax equivalent net interest income divided by average earning assets) was 3.43%, 3.49% and 3.69% for years ended December 31, 2015, 2014 and 2013, respectively.

Net interest income on a fully taxable equivalent basis is influenced primarily by changes in the volume and mix of earning assets and sources of funding and market rates of interest. The impact of some of these factors can be controlled by management policies and actions. External factors can also have a significant impact on changes in net interest income from one period to another. Some examples of such factors include the strength of credit demands by customers, Federal Reserve Board monetary policy, and fiscal and debt management policies of the federal government, including changes in tax laws. For the twelve months ended December 31, 2015, net interest income was \$36.5 million compared to \$34.4 million and \$34.5 million for the twelve months ended December 31, 2014 and 2013, respectively.

Non-interest Income and Expenses

The components of non-interest income were as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
		(dollars in thousands)	
Trust department income	\$ 2,530	\$ 2,491	\$ 2,298
Service fees on deposit accounts	6,616	6,470	6,479
Mortgage banking income (gains of loans sold)	270	294	437
Earnings on bank owned life insurance	376	398	497
Gain on sale of available-for-sale securities	534	652	829
Gain (loss) on foreclosed property	33	516	(308)
Other	1,084	906	884
	<u>\$ 11,443</u>	<u>\$ 11,727</u>	<u>\$ 11,116</u>

Non-interest income decreased 2.4% in 2015 compared to 2014 and increased 5.5% in 2014 compared to 2013. There was a \$534,000 gain on sale of available-for-sale securities in 2015 compared to a \$652,000 gain in 2014. Income from service charges on accounts increased 2.3% in 2015 compared to 2014 representing 57.8% of total non-interest income. Income from fiduciary services offered in the Bank's Trust department increased 1.6% in 2015 compared to 2014 representing 22.1% of total non-interest income. Stability in the equity and bond markets impacted the market value of the assets managed by the Trust Department and the related investment fees earned by the Bank.

The components of non-interest expense were as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
		(dollars in thousands)	
Salaries and employee benefits	\$ 18,897	\$ 17,557	\$ 18,331
Occupancy	2,192	2,032	2,581
Depreciation	1,489	1,441	1,397
Other	11,621	11,235	10,934
	<u>\$ 34,199</u>	<u>\$ 32,265</u>	<u>\$ 33,243</u>

Non-interest Income and Expense, (continued)

Non-interest expense increased 6.0% in 2015 compared to 2014. A 7.6% increase in salaries and employee benefits was a contributor to this increase, due mainly to increased employee health insurance expenses for the year. Additionally, increased legal and professional fees of \$441,000 in 2015 compared to 2014 also contributed to the increase in non-interest expense. Non-interest expense decreased 2.9% in 2014 compared to 2013.

Income Tax Expense

Applicable income taxes on 2015 earnings amounted to \$3.3 million, resulting in an effective tax rate of 24.4% compared to \$3.6 million, or 25.8%, in 2014. The effective tax rate for 2015 and 2014 is a function of the net income earned, the effect of having a real estate investment trust structure, which results in having limited Tennessee excise tax expense and the effects of interest earned on tax-exempt loans and securities.

Net Income

Net income was 0.6% higher in 2015 than in 2014. Higher levels of non-interest income and reductions in non-interest expense were the primary reasons for the increase in net income. The Bank's annualized net recoveries ended the year at 0.10%, an increase from net charge-offs of 0.11% in 2014. Total non-performing assets, including other real estate owned, experienced a cumulative decrease of \$3.2 million, or 58.8% from 2015 to 2014. Net income was 6.6% higher in 2014 than in 2013.

LIQUIDITY AND CAPITAL RESOURCES

The Bank uses a formal asset and liability management process to ensure adequate liquidity and control interest rate risk. The Bank's goal of liquidity management is to provide adequate funds to meet loan demand and any potential unexpected deposit withdrawals. The Bank accomplishes this goal by striving for consistent core deposit growth, holding adequate liquid assets and maintaining unused capacity to borrow funds. The Bank's objective of interest rate risk management is to maintain reasonable stability in the gross interest margin despite changes in the level of interest rates and the spread among interest rates.

Liquidity

Most of the capital needs of the Bank historically have been financed with earnings, and the Company's primary source of liquidity has been dividends received. The Bank's Board of Directors has adopted a liquidity policy that outlines specific liquidity target balances and ratios. Compliance with this policy is reviewed quarterly by the Bank's Asset Liability management committee and results are reported to the Bank's Board of Directors. At December 31, 2015, available liquidity was \$169.5 million compared to \$290.6 million as of December 31, 2014.

Management believes that the Company's traditional sources of cash generated from the Bank's operating activities are adequate to meet the Company's liquidity needs for normal ongoing operations; however, the Bank also has access to additional sources of funds, if necessary, through additional advances from the FHLB.

The consolidated statements of cash flows for the year ended December 31, 2015 detail cash flows from operating, investing and financing activities. At December 31, 2015, net cash provided by financing and operating activities was \$77.2 million and \$13.2 million, respectively, most of which was offset by net cash used in investing activities of \$58.4 million, resulting in a net increase in cash and cash equivalents of \$31.9 million to \$62.2 million.

Interest Rate Risk

Interest rates play a major part in the net interest income of a financial institution. The sensitivity to rate changes is known as "interest rate risk." The repricing of interest-earning assets and interest-bearing liabilities can influence the changes in net interest income. The Bank's ALCO reviews the actual dollar change in net interest income for different interest rate movements. ALCO has oversight over the asset-liability management of the Bank. This committee regularly reviews interest rate risk by forecasting the impact of alternative interest rate environments on net income and the market value of portfolio equity.

The Bank uses simulation analysis to monitor changes in net interest income due to changes in market interest rates. The simulation of rising, declining and flat interest rate scenarios allows management to monitor and adjust interest rate sensitivity to minimize the impact of market interest rate swings. The impact on net interest income over a twelve-month period of a shock of a 100, 200, and 300 basis point increase or decrease in market rates is analyzed on a quarterly basis. The Bank also monitors regulatory required interest rate risk analysis, which simulates more dramatic changes to rates.

The following table shows the results of our projections as of December 31, 2015 for net interest income expressed as a percentage change over net interest income in a flat rate scenario for an immediate change or "shock" in market interest rates over a twelve month period. Due to the historically low level of interest rates, the Bank does not believe downward shocks greater than 100 basis points are relevant.

Market rate change	Effect on net interest income
+300	1.7 %
+200	1.4 %
+100	0.7 %
(100)	(5.7) %

Interest Rate Risk, (continued)

Net interest income of the Bank on a fully taxable equivalent basis is influenced primarily by changes in:

- (1) the volume and mix of earning assets and sources of funding;
- (2) market rates of interest; and
- (3) income tax rates.

The impact of some of these factors can be controlled by management policies and actions. External factors also can have a significant impact on changes in net interest income from one period to another. Some examples of such factors are:

- (1) the strength of credit demands by customers;
- (2) Federal Reserve Board monetary policy; and
- (3) fiscal and debt management policies of the federal government, including changes in tax laws.

Another tool used to monitor the Bank's overall interest rate sensitivity is a gap analysis (the difference between the earning asset and interest bearing liability amounts scheduled to be re-priced to current market rates in subsequent periods). Table C below shows the Bank's rate-sensitive position at December 31, 2015, as measured by the gap analysis. Non-maturing balances such as money market, savings and NOW accounts have no contractual or stated maturities. Management has attempted to use historical data (pricing history) on these categories to best determine the impact of these non-maturing balances on the net interest margin as interest rates change. Management anticipates that rates will gradually increase through 2016 and has determined that the Bank is in an acceptable rate risk position. Table A under the heading "Net Interest Margin" above provides additional information regarding the largest components of interest-bearing liabilities.

TABLE C - Rate Sensitivity of Earning Assets and Interest-Bearing Liabilities

(Dollars in thousands)		Three months	Three to six	Six to twelve	Over one	
As of December 31, 2015		or less	months	months	year	Total
Earning assets						
Bank time deposits	\$	42,775	\$ -	\$ -	\$ -	42,775
Taxable investment securities		753	1,252	3,689	316,005	321,699
Tax-exempt investment securities		-	475	-	76,904	77,379
Loans and leases, net of deferred fees		33,307	29,622	59,544	600,159	722,632
Total earning assets	\$	76,835	\$ 31,349	\$ 63,233	\$ 993,068	\$ 1,164,485
Interest-bearing liabilities						
NOW and money market accounts	\$	179,768	\$ -	\$ -	\$ 364,171	\$ 543,939
Savings		-	-	-	109,340	109,340
Time up to \$100		21,919	25,470	30,290	21,610	99,289
Time over \$100		24,805	29,437	41,010	16,755	112,007
Other short-term debt		24,177	-	-	-	24,177
Total interest-bearing liabilities	\$	250,669	\$ 54,907	\$ 71,300	\$ 511,876	\$ 888,752
Period gap	\$	(173,834)	\$ (23,558)	\$ (8,067)	\$ 481,192	\$ 275,733
Cumulative gap	\$	(173,834)	\$ (197,392)	\$ (205,459)	\$ 275,733	

Capital Expenditures

Historically, internal liquidity has financed the capital needs of the Bank. In 2015, the Bank began construction on a new branch location in Williamson County, Tennessee.

Contractual Obligations

The following table summarizes the Company's contractual obligations as of December 31, 2015:

(dollars in thousands)	Payment due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations					
Operating lease obligations	\$ 4,745	\$ 358	\$ 614	\$ 586	\$ 3,187
Repurchase agreements and time deposits	235,473	197,108	24,028	14,327	10
Total	<u>\$ 240,218</u>	<u>\$ 197,466</u>	<u>\$ 24,642</u>	<u>\$ 14,913</u>	<u>\$ 3,197</u>

Dividends

Cash dividends declared in 2015 were 34.3% of net income compared to 35.5% of net income for 2014. The Company plans to continue an average annual payout ratio over 20% while continuing to maintain a capital to asset ratio reflecting financial strength and consistent with regulatory guidelines.

Regulatory Capital

Please refer to Note 18 in the Notes to Consolidated Financial Statements included elsewhere in this Annual Report to Shareholders for more information on the capital strength of the Company and the Bank.

OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2015, the Bank was a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments included commitments to extend credit and standby letters of credit. Please refer to Note 11 of the Notes to Consolidated Financial Statements included elsewhere in this Annual Report to Shareholders for more information on the Bank's commitments and contingencies.

SHAREHOLDER INFORMATION

The 4,739,502 shares of common stock of the Company outstanding at December 31, 2015 had an estimated market value of \$129.3 million, held by 1,960 shareholders, using a valuation of \$27.29 per share based on transactions reported by unaffiliated, third parties to the Company or its transfer agent. A small number of shareholders are not identified individually because some nominees, including the Bank's Trust Department, are listed as record owners when, in fact, these holdings represent more than one beneficial owner. No single shareholder's ownership exceeded 5% at December 31, 2015.

There is no established public trading market for shares of the Company's common stock. The table below shows the high and low price of the Company's common stock taken from reported prices by those buyers and sellers willing to disclose this information. This table also shows the semi-annual dividend declared per share of common stock, in each of the last two years. In 2015, the Company repurchased 161,074 shares of its common stock in several privately negotiated transactions.

		<u>High</u>	<u>Low</u>	<u>Dividend</u>
2015	First Quarter	\$ 26.50	\$ 25.15	\$ -
	Second Quarter	26.50	25.00	0.370
	Third Quarter	27.00	26.02	-
	Fourth Quarter	29.00	26.50	0.370
2014	First Quarter	\$ 25.00	\$ 25.00	\$ -
	Second Quarter	27.00	25.00	0.370
	Third Quarter	26.00	25.00	-
	Fourth Quarter	25.50	25.00	0.370

ADDITIONAL FINANCIAL DATA

The following table presents consolidated comparative data for the Company for the years shown:

	<u>December 31,</u>				
	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
	(dollars in thousands)				
Total assets	\$ 1,260,310	\$ 1,170,995	\$ 1,092,874	\$ 1,091,487	\$ 1,017,808
Average assets	1,213,440	1,121,840	1,087,487	1,054,316	975,671
Average loans (net)	683,319	607,957	572,913	518,158	534,841
Average deposits	1,054,006	974,205	938,032	893,486	820,250
Return on average assets	0.85%	0.91%	0.88%	0.90%	0.72%
Return on average equity	8.70%	9.32%	8.66%	8.22%	6.21%
Tier 1 capital to average assets	8.87%	9.67%	9.53%	9.69%	10.24%

ADDITIONAL FINANCIAL DATA, (CONTINUED)

	Selected Financial Information				
	2015	2014	2013	2012	2011
	(dollars in thousands, except per share data)				
Interest income					
Interest and fees on loans	\$ 30,522	\$ 28,300	\$ 28,653	\$ 27,951	\$ 29,838
Income on investment securities					
Taxable interest	5,713	5,738	5,501	4,967	4,219
Exempt from federal income tax	2,218	2,473	2,913	3,106	3,616
Dividends	178	186	197	207	197
	<u>8,109</u>	<u>8,397</u>	<u>8,611</u>	<u>8,280</u>	<u>8,032</u>
Other interest income	51	83	97	153	98
Total interest income	<u>38,682</u>	<u>36,780</u>	<u>37,361</u>	<u>36,384</u>	<u>37,968</u>
Interest expense					
Interest on deposits	2,131	2,358	2,694	3,343	4,223
Interest on other short term borrowings	94	70	213	498	719
Total interest expense	<u>2,225</u>	<u>2,428</u>	<u>2,907</u>	<u>3,841</u>	<u>4,942</u>
Net interest income	36,457	34,352	34,454	32,543	33,026
Provision for possible loan and lease losses	30	-	-	1,120	3,125
Net interest income after provision for loan losses	<u>36,427</u>	<u>34,352</u>	<u>34,454</u>	<u>31,423</u>	<u>29,901</u>
Non-interest income					
Trust department income	2,530	2,491	2,298	2,119	1,999
Service fees on deposit accounts	6,616	6,470	6,479	6,689	6,784
Other service fees, commissions, and fees	540	436	563	610	584
Other operating income	1,223	1,678	947	(81)	147
Securities gains	534	652	829	2,294	1,458
Total non-interest income	<u>11,443</u>	<u>11,727</u>	<u>11,116</u>	<u>11,631</u>	<u>10,972</u>
Non-interest expense					
Salaries and employee benefits	18,897	17,557	18,331	16,486	18,836
Net occupancy expense	2,192	2,032	2,581	2,528	2,488
Depreciation expense	1,489	1,441	1,397	1,334	1,224
Other operating expenses	11,637	11,251	10,950	10,262	10,585
Total non-interest expense	<u>34,215</u>	<u>32,281</u>	<u>33,259</u>	<u>30,610</u>	<u>33,133</u>
Income before provision for income taxes	13,655	13,798	12,311	12,444	7,740
Provision for income taxes	3,349	3,556	2,700	3,040	744
Net income	<u>\$ 10,306</u>	<u>\$ 10,242</u>	<u>\$ 9,611</u>	<u>\$ 9,404</u>	<u>\$ 6,996</u>
Earnings per common share	\$ 2.13	\$ 2.06	\$ 1.88	\$ 1.77	\$ 1.30
Weighted average shares outstanding	4,832,217	4,963,826	5,110,849	5,315,634	5,400,063
Dividends per common share	\$ 0.74	\$ 0.74	\$ 0.74	\$ 0.74	\$ 0.74

Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors
and Shareholders
First Farmers and Merchants Corporation
Columbia, Tennessee

We have audited the accompanying consolidated balance sheets of First Farmers and Merchants Corporation (Corporation) as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2015. The Corporation's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audits included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Corporation's internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 1, 2016, expressed an unqualified opinion on the effectiveness of the Corporation's internal control over financial reporting.

//s//**BKD, LLP**

Louisville, Kentucky
March 1, 2016

FIRST FARMERS AND MERCHANTS CORPORATION

COLUMBIA, TENNESSEE

Management's Report on Internal Control Over Financial Reporting

The management of First Farmers and Merchants Corporation is responsible for the preparation, integrity, and fair presentation of its published financial statements and all other information presented in its annual report. The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and, as such, include amounts based on informed judgments, assumptions and estimates made by management.

The management of First Farmers and Merchants Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system was designed to provide reasonable assurance to the Corporation's management and board of directors regarding the preparation and fair presentation of published financial statement. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Corporation's management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2015. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in the "Internal Control-Integrated Framework for 2013. Based on our assessment we believe that, as of December 31, 2015, the Corporation's internal control over financial reporting is effective based on those criteria.

BKD, LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Corporation included in this annual report, has issued an attestation report on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2015. The report, which expresses an unqualified opinion on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2015, is included in this annual report.

Date: March 1, 2016

By: /s/ T. Randy Stevens
T. Randy Stevens
Chief Executive Officer
(Principal Executive Officer)

Date: March 1, 2016

By: /s/ Robert E. Krimmel
Robert E. Krimmel
Chief Financial Officer
(Principal Financial and Accounting Officer)

Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors
and Shareholders
First Farmers and Merchants Corporation
Columbia, Tennessee

We have audited First Farmers and Merchants Corporation's (Corporation) internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying management report on internal control over financial reporting. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Audit Committee, Board of Directors
and Shareholders
March 1, 2016
Page 2

In our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Corporation and our report dated March 1, 2016, expressed an unqualified opinion thereon.

//s//**BKD, LLP**

Louisville, Kentucky
March 1, 2016

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

		December 31, 2015	December 31, 2014
ASSETS	Cash and due from banks	\$ 19,453	\$ 18,511
	Interest-bearing deposits	18,299	10,086
	Federal funds sold	24,476	1,700
	Total cash and cash equivalents	<u>62,228</u>	<u>30,297</u>
	Securities:		
	Available-for-sale	395,019	397,886
	Held-to-maturity (fair market value \$4,089 and \$22,263 as of December 31, 2015 and December 31, 2014, respectively)	4,059	21,985
	Total securities	<u>399,078</u>	<u>419,871</u>
	Loans, net of deferred fees	731,266	652,052
	Allowance for loan and lease losses	<u>(8,634)</u>	<u>(7,934)</u>
	Net loans	722,632	644,118
	Bank premises and equipment, net	25,518	25,773
	Other real estate owned	62	5
	Bank owned life insurance	26,552	26,176
	Goodwill	9,018	9,018
	Other assets	15,222	15,737
	TOTAL ASSETS	<u>\$ 1,260,310</u>	<u>\$ 1,170,995</u>
LIABILITIES	Deposits:		
	Noninterest-bearing	\$ 239,226	\$ 204,358
	Interest-bearing	864,575	815,597
	Total deposits	<u>1,103,801</u>	<u>1,019,955</u>
	Securities sold under agreements to repurchase	24,177	22,834
	Accounts payable and accrued liabilities	<u>14,542</u>	<u>13,622</u>
	TOTAL LIABILITIES	<u>1,142,520</u>	<u>1,056,411</u>
SHAREHOLDERS' EQUITY	Commitments and contingencies (Note 11)		
	Common stock - \$10 par value per share, 8,000,000 shares authorized; 4,739,502 and 4,900,576 shares issued and outstanding as of December 31, 2015 and December 31, 2014, respectively	47,395	49,006
	Retained earnings	71,583	67,609
	Accumulated other comprehensive loss	<u>(1,283)</u>	<u>(2,126)</u>
	TOTAL SHAREHOLDERS' EQUITY BEFORE NONCONTROLLING INTEREST – PREFERRED STOCK OF SUBSIDIARY	<u>117,695</u>	<u>114,489</u>
	Noncontrolling interest – preferred stock of subsidiary	95	95
	TOTAL SHAREHOLDERS' EQUITY	<u>117,790</u>	<u>114,584</u>
	TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 1,260,310</u>	<u>\$ 1,170,995</u>

The accompanying notes are an integral part of the consolidated financial statements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years ended December 31, 2015, 2014 and 2013
(Dollars in thousands, except per share data)

		Years ended December 31,		
		2015	2014	2013
INTEREST AND DIVIDEND INCOME	Interest and fees on loans	\$ 30,522	\$ 28,300	\$ 28,653
	Income on investment securities			
	Taxable interest	5,713	5,738	5,501
	Exempt from federal income tax	2,218	2,473	2,913
	Dividends	229	269	294
	Total interest income	38,682	36,780	37,361
INTEREST EXPENSE	Interest on deposits	2,131	2,358	2,694
	Interest on other borrowings	94	70	213
	Total interest expense	2,225	2,428	2,907
	Net interest income	36,457	34,352	34,454
	Provision for loan and lease losses	30	-	-
	Net interest income after provision	36,427	34,352	34,454
NON-INTEREST INCOME	Gains on loans sold	270	294	437
	Trust department income	2,530	2,491	2,298
	Service fees on deposit accounts	6,616	6,470	6,479
	Brokerage fees	540	410	361
	Earnings on bank owned life insurance	376	398	497
	Gain on sales of available-for-sale securities	534	652	829
	Gain (loss) on foreclosed property	33	516	(308)
	Other non-interest income	544	496	523
	Total non-interest income	11,443	11,727	11,116
NON-INTEREST EXPENSE	Salaries and employee benefits	18,897	17,557	18,331
	Net occupancy expense	2,192	2,032	2,581
	Depreciation expense	1,489	1,441	1,397
	Data processing expense	2,506	2,321	2,288
	Legal and professional fees	1,301	860	1,037
	Stationary and office supplies	289	304	293
	Advertising and promotions	1,163	1,352	1,090
	FDIC insurance premium expense	587	589	728
	Other real estate expense	3	68	128
	Other non-interest expense	5,772	5,741	5,370
	Total non-interest expenses	34,199	32,265	33,243
	Income before provision for income taxes	13,671	13,814	12,327
	Provision for income taxes	3,349	3,556	2,700
	Net income before noncontrolling interest – dividends on preferred stock of subsidiary	10,322	10,258	9,627
	Noncontrolling interest – dividends on preferred stock subsidiary	16	16	16
	Net income for common shareholders	\$ 10,306	\$ 10,242	\$ 9,611
	Weighted average shares outstanding	4,832,217	4,963,826	5,110,849
	Earnings per share	\$ 2.13	\$ 2.06	\$ 1.88

The accompanying notes are an integral part of the consolidated financial statements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Years Ended December 31, 2015, 2014 and 2013
(Dollars in thousands)

	Years ended December 31,		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
Net income for common shareholders	\$ 10,306	\$ 10,242	\$ 9,611
Other comprehensive income (loss)			
Unrealized appreciation (depreciation) on available-for-sale securities, net of taxes of \$685, \$4,742, and (\$8,507), respectively	1,097	7,571	(13,589)
Reclassification adjustment for realized gains included in net income, net of taxes of (\$206), (\$251) and (\$319), respectively	(328)	(401)	(510)
Change in unfunded portion of post-retirement benefit obligations, net of taxes of \$47, (\$185) and \$2,102, respectively	<u>74</u>	<u>(295)</u>	<u>3,360</u>
Other comprehensive income (loss)	843	6,875	(10,739)
Total comprehensive income (loss)	<u><u>\$ 11,149</u></u>	<u><u>\$ 17,117</u></u>	<u><u>\$ (1,128)</u></u>

The accompanying notes are an integral part of the consolidated financial statements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2015, 2014 and 2013
(Dollars in thousands, except per share data)

	Shares of stock	Preferred stock	Common stock	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance at December 31, 2012	5,180,000	\$ 95	\$ 51,800	\$ 59,162	\$ 1,738	\$ 112,795
Net income before dividends on preferred stock of subsidiary				9,627		9,627
Other comprehensive loss					(10,739)	(10,739)
Repurchase of common stock	(158,988)		(1,590)	(2,132)		(3,722)
Cash dividends declared, \$0.74 per share				(3,741)		(3,741)
Cash dividends – preferred stock of subsidiary				(16)		(16)
Balance at December 31, 2013	5,021,012	95	50,210	62,900	(9,001)	104,204
Net income before dividends on preferred stock of subsidiary				10,258		10,258
Other comprehensive income					6,875	6,875
Repurchase of common stock	(120,436)		(1,204)	(1,893)		(3,097)
Cash dividends declared, \$0.74 per share				(3,640)		(3,640)
Cash dividends – preferred stock of subsidiary				(16)		(16)
Balance at December 31, 2014	4,900,576	95	49,006	67,609	(2,126)	114,584
Net income before dividends on preferred stock of subsidiary				10,322		10,322
Other comprehensive income					843	843
Repurchase of common stock	(161,074)		(1,611)	(2,797)		(4,408)
Cash dividends declared, \$0.74 per share				(3,535)		(3,535)
Cash dividends – preferred stock of subsidiary				(16)		(16)
Balance at December 31, 2015	4,739,502	\$ 95	\$ 47,395	\$ 71,583	\$ (1,283)	\$ 117,790

The accompanying notes are an integral part of the consolidated financial statements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

		Years ended December 31,		
		2015	2014	2013
OPERATING	Net income available for common shareholders	\$ 10,306	\$ 10,242	\$ 9,611
ACTIVITIES	Adjustments to reconcile net income to net cash provided by operating activities			
	Provision for loan and lease losses	30	-	-
	Depreciation of premises and equipment	1,489	1,441	1,543
	Deferred tax benefit expense	614	545	1,785
	Net gains on sales of available-for-sale securities	(534)	(652)	(829)
	Gains on loans sold	(270)	(294)	(437)
	Proceeds from sale of mortgage loans held for sale	15,455	13,105	21,047
	Funding of mortgage loans held for sale	(14,831)	(12,838)	(18,481)
	(Gain) loss on other real estate owned	(33)	(516)	308
	Gain on sale of assets	-	-	38
	Amortization of investment security premiums, net of accretion of discounts	1,196	1,100	1,312
	Increase in cash surrender value of life insurance contracts	(376)	(398)	(497)
	Changes in:			
	Other assets	821	(8)	1,243
	Other liabilities	(701)	435	143
	Net cash provided by operating activities	13,166	12,162	16,786
INVESTING	Proceeds from sales of available-for-sale securities	79,119	47,798	137,150
ACTIVITIES	Proceeds from maturities and calls of available-for-sale securities	31,967	30,072	44,908
	Proceeds from maturities and calls of held-to-maturity securities	19,940	5,398	3,890
	Purchases of available-for-sale investment securities	(107,655)	(134,373)	(189,436)
	Purchases of held-to-maturity investment securities	(1,991)	-	-
	Net increase in loans	(78,634)	(45,952)	(38,267)
	Proceeds from sale of other real estate owned	66	1,466	2,378
	Proceeds from sale of assets	-	-	799
	Purchases of premises and equipment	(1,234)	(2,346)	(831)
	Purchase of life insurance policies	-	(175)	(258)
	Proceeds from redemption of life insurance policy	-	264	-
	Net cash used in investing activities	(58,422)	(97,848)	(39,667)
FINANCING	Net increase in deposits	83,846	62,618	24,488
ACTIVITIES	Net increase in securities sold under agreements to repurchase	1,343	4,739	1,027
	Payments to FHLB borrowings	-	-	(10,100)
	Repurchase of common stock	(4,408)	(3,097)	(3,722)
	Cash dividends paid on common stock	(3,594)	(3,685)	(3,800)
	Net cash provided by financing activities	77,187	60,575	7,893
	Increase (decrease) in cash and cash equivalents	31,931	(25,111)	(14,988)
	Cash and cash equivalents at beginning of period	30,297	55,408	70,396
	Cash and cash equivalents at end of period	\$ 62,228	\$ 30,297	\$ 55,408

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Dollars in thousands)

Supplemental disclosures of cash flow information:	Years ended December 31,		
	2015	2014	2013
Cash paid during the period for:			
Interest on deposits and borrowed funds	\$ 2,335	\$ 2,479	\$ 2,816
Income taxes	3,241	3,094	2,072
Loans to facilitate sale of other real estate owned	-	-	1,905
Real estate acquired in settlement of loans	90	5	312

The accompanying notes are an integral part of the consolidated financial statements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Policies

The accounting principles followed and the methods of applying those principles conform with accounting principles generally accepted in the United States (“GAAP”) and to general practices in the banking industry. The significant accounting policies applicable to First Farmers and Merchants Corporation (the “Company”) are summarized as follows.

Nature of Operations

The Company is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, First Farmers and Merchants Bank (the “Bank”). The Bank is primarily engaged in providing a full range of banking and financial services, including lending, investing of funds, obtaining deposits, trust and wealth management operations, and other financing activities to individual and corporate customers in the Middle Tennessee area. The Bank is subject to competition from other financial institutions. The Company and Bank are subject to the regulation of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

On November 20, 2015, the Company announced its Board of Directors approved a corporate reorganization plan (the “Plan”) providing for the termination of the Company’s reporting obligations under the Securities Exchange Act of 1934 (the “Exchange Act”). Under the Plan, holders of fewer than 400 shares of Company common stock will receive cash in exchange for their shares in an amount determined based on a valuation by an independent third party. Shareholders owning 400 or more shares will be unaffected by the Plan. The Plan will be considered and voted upon by its shareholders at the Company’s 2016 annual meeting.

Basis of Presentation

The accompanying consolidated financial statements present the accounts of the Company and its wholly-owned subsidiary, First Farmers and Merchants Bank. The Bank has the following direct and indirect subsidiaries: F&M West, Inc., Maury Tenn, Inc., and Maury Tenn Properties, Inc. Noncontrolling interests consist of preferred shares in Maury Tenn Properties, Inc. that are owned by third parties and Maury Tenn, Inc. The preferred shares in Maury Tenn Properties, Inc. receive dividends, which are included in the consolidated statements of income. Intercompany accounts and transactions have been eliminated in consolidation.

Certain items in prior financial statements have been reclassified to conform to the current presentation. These reclassifications had no effect on net income.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management of the Company and the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities. Those estimates and assumptions also affect disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan and lease losses, the fair value of financial instruments, the valuation of foreclosed real estate, valuation of goodwill, valuation of deferred tax assets and the liability related to post-retirement benefits.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Accounting Policies, (continued)

Concentrations of Credit Risk

The Company's banking activities include granting commercial, residential, and consumer loans to customers primarily located in Middle Tennessee and northern Alabama. The Company manages its portfolio and product mix in a manner to reduce economic risk. Concentrations of credit, as defined for regulatory purposes, are reviewed quarterly by management to ensure that internally established limits are not exceeded. At December 31, 2015, our concentrations of commercial real estate, rental and leasing loans were 130.1% of Tier 1 Capital plus the allowance for loan and lease losses. Health care and social assistance loans were 39.1%. Construction loans were 46.6%. Construction loans were 27.7%. Wholesale trade credits were 28.0%. These percentages are within our internally established limits regarding concentrations of credit.

Loans secured by non-farm, non-residential real estate comprised 22.0% of the loan portfolio at December 31, 2015. Management remains comfortable with the real estate exposure levels within the commercial loan portfolio. Management believes the commercial real estate portion remains well diversified across several different property types and several different geographic markets.

Cash and Due From Banks

Included in cash and due from banks are reserve amounts that are required to be maintained in the form of cash and/or balances due from the Federal Reserve Bank and other banks. At December 31, 2015, the Bank's required reserve was \$2.4 million at the Federal Reserve. From time to time throughout the year, the Bank's balances due from other financial institutions exceeded Federal Deposit Insurance Corporation (FDIC) insurance limits. The Bank had \$24.5 million of federal funds sold as of December 31, 2015. Federal funds sold are essentially uncollateralized loans to other financial institutions.

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents include cash on hand, cash due from banks and federal funds sold. Federal funds are sold for one-day periods.

Securities

Certain debt securities that management has the intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of tax. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

For debt securities with fair value below amortized cost which the Company does not intend to sell, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis, the Company recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Securities, (continued)

If declines in fair value are other-than-temporary, the carrying value of the securities is written down to fair value as a realized loss with a charge to income for the portion attributable to credit losses and a charge to other comprehensive income for the portion that is not credit related. For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that the Company more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security based on cash flow projections.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff is reported at their outstanding principal balances adjusted for unearned income, charge-offs, the allowance for loan and lease losses, any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past-due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Discounts and premiums on purchased commercial loans are amortized to income using the interest method over the remaining period to contractual maturity and adjusted for anticipated prepayments.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is established through provisions for loan and lease losses charged against income. Loan losses are charged against the allowance when management determines that the uncollectibility of a loan has been confirmed. Subsequent recoveries, if any, are credited to the allowance account in the period received.

The adequacy of the allowance for loan and lease losses is evaluated quarterly in conjunction with loan review reports and evaluations that are discussed in meetings with loan officers, credit administration and the Bank's Board of Directors. The Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors are considered in this evaluation. This process is inherently subjective as it requires material estimates that are susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans. The allowance for loan and lease losses is maintained at a level believed by management to be adequate to absorb estimated losses inherent in the loan portfolio.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Allowance for Loan and Lease Losses. (continued)

A loan is considered impaired when it is probable that the Bank will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

When any secured commercial loan is considered uncollectable, whether past due or not, a current assessment of the value of the underlying collateral is made. If the balance of the loan exceeds the fair value of the collateral, the loan is placed on nonaccrual and the loan is charged down to the value of the collateral less estimated cost to sell or a specific reserve equal to the difference between book value of the loan and the fair value assigned to the collateral is created until such time as the loan is foreclosed. When the foreclosed collateral has been legally assigned to the Bank, a charge off is taken, if necessary, in order that the remaining balance reflects the fair value estimated less costs to sell the collateral then transferred to other real estate owned or other repossessed assets. When any unsecured commercial loan is considered uncollectable the loan is charged off no later than at 90 days past due.

All closed-end consumer loans (excluding conventional 1-4 family residential loans and installment and revolving loans secured by real estate) are charged off upon reaching no later than 120 days (4 monthly payments) delinquent. If a loan is considered uncollectable, it is charged off earlier than 120 days delinquent. For conventional 1-4 family residential loans and installment and revolving loans secured by real estate, when a loan is 90 days past due, a current assessment of the value of the real estate is made. If the balance of the loan exceeds the fair value of the property, the loan is placed on nonaccrual and foreclosure proceedings are initiated. When the foreclosed property has been legally assigned to the Bank, a charge-off is taken with the remaining balance, reflecting the fair value less estimated costs to sell, transferred to other real estate owned.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to non-interest income. Gains and losses on loan sales are recorded in non-interest income. The Company does not retain servicing rights on loans sold. There were no loans held for sale at December 31, 2015. Loans held for sale at December 31, 2014 totaled \$354,000.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Other Real Estate

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net income or expense from foreclosed assets.

When foreclosed properties are acquired current appraisals are obtained on the properties. Additionally, periodic updated appraisals are obtained on unsold foreclosed properties. When an updated appraisal reflects a market value below the current book value, a charge is booked to current earnings to reduce the property to its new market value less expected selling costs. Our policy for determining the frequency of periodic reviews is based upon consideration of the specific properties and the known or perceived market fluctuations in a particular market and is typically between 12 and 24 months.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation is computed principally on an accelerated method over the estimated useful life of an asset, which ranges from 15 to 39 years for buildings and from three to 25 years for equipment. Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are charged to operations as incurred. Gains or losses from the disposition of property are reflected in operations, and the asset accounts and related allowances for depreciation are reduced.

Federal Reserve and Federal Home Loan Bank Stock

Federal Reserve and Federal Home Loan Bank stock are required investments for institutions that are members of the Federal Reserve and Federal Home Loan Bank systems. The required investment in the common stock is based on a predetermined formula, carried at cost and evaluated for impairment. At December 31, 2015 and 2014 Federal Reserve and Federal Home Loan Bank stock totaled \$3.9 million.

Goodwill

Goodwill is evaluated annually for impairment. Quantitative and qualitative assessments are performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not the fair value is less than the carrying amount, including goodwill. If, based on the evaluation, it is determined to be more likely than not that the fair value is less than the carrying value, then goodwill is tested further for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Income Taxes

The Company files consolidated income tax returns with its subsidiaries. The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance requires two components of income tax expense which are current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. With a few exceptions, the Company is no longer subject to U.S. federal tax examinations and state and local tax examinations by tax authorities for years before 2012.

The Company recognizes interest and penalties on income taxes as a component of income tax expense. As of December 31, 2015, the Company has accrued no interest and no penalties related to uncertain tax positions.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction.

Fair Value Measurements

Financial Accounting Standards Board ("FASB") ASC Topic 820, "Fair Value Measurements and Disclosures," defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. See Note 12 – Fair Value Measurement. In general, fair values of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as input, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Earnings Per Share

Earnings per share represents income available to shareholders divided by the weighted average number of shares of Company common stock outstanding during the period. Fully diluted earnings per share is not presented as there are no common stock equivalents.

The following is a summary of the earnings per share calculation for the periods presented:

	Years ended December 31,		
	2015	2014	2013
	(dollars in thousands, except per share data)		
Earnings per share calculation:			
Numerator – Net income available to common shareholders	\$ 10,306	\$ 10,242	\$ 9,611
Denominator – Weighted average common shares outstanding	4,832,217	4,963,826	5,110,849
Net income per common share available to common shareholders	<u>\$ 2.13</u>	<u>\$ 2.06</u>	<u>\$ 1.88</u>

In 2015, the Company renewed a plan to repurchase shares of its common stock. The plan allowed the purchase of up to 200,000 shares. The Company purchased 161,074, 120,436, and 158,988 shares in 2015, 2014, and 2013, respectively.

Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income and other comprehensive income (loss), net of applicable income tax expenses or benefits. Other comprehensive income (loss) includes unrealized appreciation or depreciation on available-for-sale securities and changes in the net actuarial gain or loss of the post-retirement benefit obligation.

The components of accumulated other comprehensive loss, included in shareholder's equity, are as follows:

	Years ended December 31,		
	2015	2014	2013
	(dollars in thousands)		
Net unrealized losses			
on available-for-sale securities	\$ (4,269)	\$ (5,517)	\$ (17,178)
Net actuarial gain on unfunded portion			
of post-retirement benefit obligation	2,183	2,062	2,542
	(2,086)	(3,455)	(14,636)
Tax benefit	803	1,329	5,635
Accumulated other comprehensive loss	<u>\$ (1,283)</u>	<u>\$ (2,126)</u>	<u>\$ (9,001)</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period end date.

Segment Reporting

Management analyzes the operations of the Company assuming one operating segment, community lending services.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued *ASU 2014-09, Revenue from Contracts with Customers, (Topic 606)*. ASU 2014-09 states a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August of 2015, the FASB issued *ASU 2015-14, Revenue from Contracts with Customers, (Topic 606): Deferral of the Effective Date*. ASU 2015-14 defers the effective date of Update 2014-09 for all entities by one year. As such, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. The Company is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but the Company does not expect it to have a material impact.

In June 2014, the FASB issued *ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. ASU 2014-11 aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. The amendments in ASU 2014-11 require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. The amendments in ASU 2014-11 also require expanded disclosures about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured. The Company adopted the amendments in this ASU 2014-11 effective January 1, 2015. As of December 31, 2015, all of the Company's repurchase agreements were typical in nature (i.e., not repurchase-to-maturity transactions or repurchase agreements executed as a repurchase financing) and are accounted for as secured borrowings. As such, the adoption of ASU 2014-11 did not have a material impact on the Company's Consolidated Financial Statements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)

Recent Accounting Pronouncements, (continued)

ASU 2014-14, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40). ASU 2014-14 applies to creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure. (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim. (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. ASU 2014-14 was effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of ASU 2014-14 did not have a material impact on the Company's Consolidated Financial Statements.

ASU 2016-1, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-1 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2016-2, Leases (Topic 842). ASU 2016-2, among other things, requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and *Topic 606*, Revenue from Contracts with Customers. ASU 2016-2 will be effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Nonpublic business entities should apply the amendments for fiscal years beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. Early application is permitted for all public business entities and all nonpublic entities upon issuance. The Company is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but the Company does not expect it to have a material impact.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – RECLASSIFICATIONS FROM ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) (“AOCI”)

Amounts reclassified from AOCI and the affected line items in the statements of income during the periods presented are as follows:

	Amounts reclassified from AOCI			Affected line item in the Statements of income
	December 31, 2015	December 31, 2014	December 31, 2013	
Unrealized gains on available-for-sale securities	\$ 534	\$ 652	\$ 829	Realized gain on sale of securities
	(206)	(251)	(319)	Tax expense
	<u>\$ 328</u>	<u>\$ 401</u>	<u>\$ 510</u>	Net reclassified amount
Amortization of defined benefit pension items	\$ 160	\$ 188	\$ (190)	
Actuarial gains (losses)	(62)	(72)	73	Tax (expense) benefit
	<u>\$ 98</u>	<u>\$ 116</u>	<u>\$ (117)</u>	Net reclassified amount
Total reclassifications out of AOCI	<u>\$ 426</u>	<u>\$ 517</u>	<u>\$ 393</u>	

NOTE 3 – SECURITIES

The amortized cost and fair value of securities available-for-sale and held-to-maturity at December 31, 2015 and 2014 are summarized as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(dollars in thousands)			
December 31, 2015:				
Available-for-sale securities:				
U.S. government sponsored agencies	\$ 132,543	\$ 40	\$ (1,526)	\$ 131,057
U.S. government sponsored agency mortgage backed securities	171,620	6	(4,559)	167,067
States and political subdivisions	71,493	1,916	(90)	73,319
Corporate bonds	23,632	54	(110)	23,576
	<u>\$ 399,288</u>	<u>\$ 2,016</u>	<u>\$ (6,285)</u>	<u>\$ 395,019</u>
Held-to-maturity securities:				
States and political subdivisions	<u>\$ 4,059</u>	<u>\$ 33</u>	<u>\$ (3)</u>	<u>\$ 4,089</u>
December 31, 2014:				
Available-for-sale securities:				
U.S. government sponsored agencies	\$ 162,289	\$ 50	\$ (3,085)	\$ 159,254
U.S. government sponsored agency mortgage backed securities	172,035	64	(4,129)	167,970
State and political subdivisions	51,374	1,658	(150)	52,882
Corporate bonds	17,705	129	(54)	17,780
	<u>\$ 403,403</u>	<u>\$ 1,901</u>	<u>\$ (7,418)</u>	<u>\$ 397,886</u>
Held-to-maturity securities:				
States and political subdivisions	<u>\$ 21,985</u>	<u>\$ 278</u>	<u>\$ -</u>	<u>\$ 22,263</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – SECURITIES, (CONTINUED)

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2015 and 2014 was approximately \$306.3 million and \$326.0 million, which was approximately 77% and 78%, respectively, of the Company's available-for-sale and held-to-maturity investment portfolio. The Company evaluates its investment portfolio on a quarterly basis for impairment.

The analysis performed as of December 31, 2015 and December 31, 2014 indicated that all impairment was considered temporary, market driven due primarily to fluctuations in market interest rates and not credit-related.

The following table shows the Company's investments' gross unrealized losses and fair value of the Company's investments with unrealized losses that were not deemed to be other-than-temporarily impaired, aggregated by investment class and length of time that individual securities had been in a continuous unrealized loss position at December 31, 2015 and 2014:

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(dollars in thousands)					
December 31, 2015:						
Available-for-sale securities:						
U.S. government sponsored agencies	\$ 70,454	\$ (425)	\$ 43,080	\$ (1,101)	\$ 113,534	\$ (1,526)
U.S. government sponsored agency mortgage backed securities	74,860	(1,073)	90,125	(3,486)	164,985	(4,559)
States and political subdivisions	8,472	(64)	2,556	(26)	11,028	(90)
Corporate bonds	14,504	(87)	1,854	(23)	16,358	(110)
	<u>\$ 168,290</u>	<u>\$ (1,649)</u>	<u>\$ 137,615</u>	<u>\$ (4,636)</u>	<u>\$ 305,905</u>	<u>\$ (6,285)</u>
Held-to-maturity securities:						
States and political subdivisions	<u>\$ 438</u>	<u>\$ (3)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 438</u>	<u>\$ (3)</u>
December 31, 2014:						
Available-for-sale securities:						
U.S. government sponsored agencies	\$ 46,977	\$ (219)	\$ 104,815	\$ (2,866)	\$ 151,792	\$ (3,085)
U.S. government sponsored agency mortgage backed securities	21,339	(77)	128,935	(4,052)	150,274	(4,129)
States and political subdivisions	14,539	(142)	1,418	(8)	15,957	(150)
Corporate bonds	4,783	(17)	3,207	(37)	7,990	(54)
	<u>\$ 87,638</u>	<u>\$ (455)</u>	<u>\$ 238,375</u>	<u>\$ (6,963)</u>	<u>\$ 326,013</u>	<u>\$ (7,418)</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – SECURITIES, (CONTINUED)

As shown in the tables above, at December 31, 2015, the Company had approximately \$6.3 million in unrealized losses on \$306.3 million of securities. The unrealized loss positions are most significant in two types of securities sectors which are U.S. government agencies and U.S. government sponsored agency mortgage backed securities. The unrealized losses associated with these investment securities are driven by changes in interest rates and the unrealized loss is recorded as a component of equity. These securities will continue to be monitored as a part of our ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond issuers. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. If a shortfall in future cash flows is identified, a credit loss will be deemed to have occurred and will be recognized as a change to earnings and a new cost basis for the security will be established.

The amortized cost and fair value of available-for-sale and held-to-maturity securities at December 31, 2015 and 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-sale		Held-to-maturity	
	Amortized cost	Fair value	Amortized cost	Fair value
December 31, 2015				
	(dollars in thousands)			
Within one year	\$ 5,678	\$ 5,695	\$ 475	\$ 476
One to five years	132,685	131,605	984	997
Five to ten years	49,992	50,396	610	611
After ten years	39,313	40,256	1,990	2,005
Mortgage-backed securities	171,620	167,067	-	-
	<u>\$ 399,288</u>	<u>\$ 395,019</u>	<u>\$ 4,059</u>	<u>\$ 4,089</u>

The carrying value of securities pledged as collateral to secure public deposits and for other purposes was \$253.6 million at December 31, 2015 and \$217.2 million at December 31, 2014.

The book value of securities sold under agreements to repurchase amounted to \$30.5 million and \$35.0 million at December 31, 2015 and 2014, respectively.

	Years ended December 31,		
	2015	2014	2013
	(dollars in thousands)		
Gross gains recognized on sales of securities	\$ 579	\$ 737	\$ 1,026
Gross losses recognized on sales of securities	(45)	(85)	(197)
Net realized gains on sales of securities available-for-sale	<u>\$ 534</u>	<u>\$ 652</u>	<u>\$ 829</u>

During 2014, the Company transferred one held-to-maturity bond with a net carrying value of \$450,000 to available-for-sale classification. Under ASC 320-10-26-6, the Company had concluded that there was sufficient evidence of deteriorating credit worthiness. Immediately following the reclassification, the Company sold the bond recognizing a realized gain of \$5,000.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS

The following table presents the Bank's loans by category as of the periods presented:

	December 31, 2015	December 31, 2014
	(dollars in thousands)	
<u>Commercial</u>		
Commercial and industrial	\$ 127,899	\$ 99,788
Non-farm, nonresidential real estate	161,009	163,461
Construction and development	51,330	50,424
Commercial loans secured by real estate	28,091	27,937
Other commercial	60,325	41,185
Total commercial	<u>428,654</u>	<u>382,795</u>
<u>Residential</u>		
Consumer loans	9,914	9,536
Single family residential	260,254	229,559
Other retail	32,444	30,162
Total residential and consumer	<u>302,612</u>	<u>269,257</u>
	\$ 731,266	\$ 652,052
Less:		
Allowance for possible loan and lease losses	<u>(8,634)</u>	<u>(7,934)</u>
Total net loans	<u>\$ 722,632</u>	<u>\$ 644,118</u>

The amount of capitalized fees and costs calculated in accordance with ASC 310-20 included in the above loan totals were \$941,000 and \$932,000 at December 31, 2015 and December 31, 2014, respectively.

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

At December 31, 2015, approximately 55% of the outstanding principal balance of the Company's commercial real estate loans was secured by owner-occupied properties, compared to 45% at December 31, 2014.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Company originates residential and consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.

The Company contracts with a third party vendor to perform loan reviews. The Company reviews and validates the credit risk program on an annual basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

The goal of the bank is to diversify loans to avoid a concentration of credit in a specific industry, person, entity, product, service, or any area vulnerable to a tax law change or an economic event. A concentration of credit occurs when obligations, direct or indirect, of the same or affiliated interests represent 15% or more of the Bank's capital structure. Commercial real estate rental and leasing represented the highest concentration at 120% of tier 1 capital. The Board of Directors recognizes that the Bank's geographic trade area imposes some limitations regarding loan diversification if the bank is to perform the function for which it has been chartered. Specifically, lending to qualified borrowers within the Bank's trade area will naturally cause concentrations of real estate loans in the primary communities served by the Bank and loans to employees of major employers in the area.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

The following table provides details regarding the aging of the Bank's loan portfolio:

December 31, 2015	30-59 days past due	60-89 days past due	90 days and greater past due	Total past due	Current	Total Loans
(dollars in thousands)						
Commercial:						
Commercial and industrial	\$ 245	\$ 25	\$ 245	\$ 515	\$ 127,384	\$ 127,899
Non-farm, non-residential real estate	2,486	123	279	2,888	158,121	161,009
Construction and development	7	-	-	7	51,323	51,330
Commercial loans secured by estate real estate	24	8	163	195	27,896	28,091
Other commercial	-	-	-	-	60,325	60,325
Total commercial loans	<u>2,762</u>	<u>156</u>	<u>687</u>	<u>3,605</u>	<u>425,049</u>	<u>428,654</u>
Retail:						
Consumer	43	36	7	86	9,828	9,914
Single family residential	1,918	664	164	2,746	257,508	260,254
Other retail	160	148	54	362	32,082	32,444
Total retail loans	<u>2,121</u>	<u>848</u>	<u>225</u>	<u>3,194</u>	<u>299,418</u>	<u>302,612</u>
Total	<u>\$ 4,883</u>	<u>\$ 1,004</u>	<u>\$ 912</u>	<u>\$ 6,799</u>	<u>\$ 724,467</u>	<u>\$ 731,266</u>

December 31, 2014	30-59 days past due	60-89 days past due	90 days and greater past due	Total past due	Current	Total loans
(dollars in thousands)						
Commercial:						
Commercial and industrial	\$ 263	\$ 63	\$ 1,428	\$ 1,754	\$ 98,034	\$ 99,788
Non-farm, non-residential real estate	413	145	330	888	162,573	163,461
Construction and development	-	-	-	-	50,424	50,424
Commercial loans secured by estate real estate	92	56	172	320	27,617	27,937
Other commercial	10	-	1,092	1,102	40,083	41,185
Total commercial loans	<u>778</u>	<u>264</u>	<u>3,022</u>	<u>4,064</u>	<u>378,731</u>	<u>382,795</u>
Retail:						
Consumer	72	7	42	121	9,415	9,536
Single family residential	2,361	395	464	3,220	226,339	229,559
Other retail	-	-	-	-	30,162	30,162
Total retail loans	<u>2,433</u>	<u>402</u>	<u>506</u>	<u>3,341</u>	<u>265,916</u>	<u>269,257</u>
Total	<u>\$ 3,211</u>	<u>\$ 666</u>	<u>\$ 3,528</u>	<u>\$ 7,405</u>	<u>\$ 644,647</u>	<u>\$ 652,052</u>

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include non-performing commercial loans but also include loans modified in troubled debt restructurings.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

The following table summarizes the impaired loans by loan type:

December 31, 2015	Unpaid contractual principal balance	Recorded investment with no allowance	Recorded investment with allowance	Total recorded investment	Related allowance	Average recorded investment year to date	Interest received	Interest accrued
(dollars in thousands)								
Commercial:								
Commercial and industrial	\$ 432	\$ 60	\$ 262	\$ 322	\$ 28	\$ 344	\$ 17	\$ 22
Non-farm, non-residential real estate	469	401	-	401	-	428	17	24
Commercial loans secured by real estate	192	-	163	163	29	169	6	13
Other commercial	-	-	-	-	-	-	-	-
Commercial total	<u>1,093</u>	<u>461</u>	<u>425</u>	<u>886</u>	<u>57</u>	<u>941</u>	<u>40</u>	<u>59</u>
Retail:								
Single family residential	1,612	510	830	1,340	102	1,415	81	83
Other retail	130	74	-	74	-	79	6	7
Retail total	<u>1,742</u>	<u>584</u>	<u>830</u>	<u>1,414</u>	<u>102</u>	<u>1,494</u>	<u>87</u>	<u>90</u>
Total	<u>\$ 2,835</u>	<u>\$ 1,045</u>	<u>\$ 1,255</u>	<u>\$ 2,300</u>	<u>\$ 159</u>	<u>\$ 2,435</u>	<u>\$ 127</u>	<u>\$ 149</u>

December 31, 2014	Unpaid contractual principal balance	Recorded investment with no allowance	Recorded investment with allowance	Total recorded investment	Related allowance	Average recorded investment year to date	Interest received	Interest accrued
(dollars in thousands)								
Commercial:								
Commercial and industrial	\$ 3,760	\$ 2,734	\$ 217	\$ 2,951	\$ 9	\$ 3,230	\$ 97	\$ 207
Non-farm, non-residential real estate	3,720	3,241	-	3,241	-	3,570	213	212
Commercial loans secured by real estate	1,053	564	166	730	33	826	67	77
Other commercial	1,256	1,092	-	1,092	-	1,171	89	84
Commercial total	<u>9,789</u>	<u>7,631</u>	<u>383</u>	<u>8,014</u>	<u>42</u>	<u>8,797</u>	<u>466</u>	<u>580</u>
Retail:								
Single family residential	1,094	539	439	978	10	786	44	42
Other retail	425	411	-	411	-	369	17	19
Retail total	<u>1,519</u>	<u>950</u>	<u>439</u>	<u>1,389</u>	<u>10</u>	<u>1,155</u>	<u>61</u>	<u>61</u>
Total	<u>\$ 11,308</u>	<u>\$ 8,581</u>	<u>\$ 822</u>	<u>\$ 9,403</u>	<u>\$ 52</u>	<u>\$ 9,952</u>	<u>\$ 527</u>	<u>\$ 641</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

December 31, 2013	Unpaid contractual principal balance	Recorded investment with no allowance	Recorded investment with allowance	Total recorded investment	Related allowance	Average recorded investment year to date	Interest received	Interest accrued
Commercial:								
Commercial and industrial	\$ 2,190	\$ 1,338	\$ 234	\$ 1,572	\$ 16	\$ 1,620	\$ 23	\$ 134
Non-farm, non-residential real estate	3,236	1,155	1,551	2,706	282	2,819	157	168
Construction and development	461	461	-	461	44	556	30	30
Other commercial	3,834	3,310	178	3,488	-	3,704	225	241
Commercial total	9,721	6,264	1,963	8,227	342	8,699	435	573
Retail:								
Single family residential	1,121	568	419	987	118	1,044	52	55
Other retail	11	-	11	11	11	11	-	-
Retail total	1,132	568	430	998	129	1,055	52	55
Total	\$ 10,853	\$ 6,832	\$ 2,393	\$ 9,225	\$ 471	\$ 9,754	\$ 487	\$ 628

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

Non-accrual loans, segregated by class of loans, were as follows:

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
	(dollars in thousands)	
<u>Commercial</u>		
Commercial and industrial	\$ 322	\$ 1,428
Non-farm, nonresidential real estate	401	409
Commercial loans secured by real estate	163	172
Other commercial	-	1,092
Total commercial loans	<u>886</u>	<u>3,101</u>
<u>Residential</u>		
Consumer loans	74	42
Single family residential	1,237	2,237
Total residential loans	<u>1,311</u>	<u>2,279</u>
Total non-accrual loans	<u>\$ 2,197</u>	<u>\$ 5,380</u>

Included in certain loan categories of impaired loans are certain loans that have been modified in a troubled debt restructuring where economic concessions have been granted to borrowers who have experienced financial difficulties. These concessions typically result from our loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Modifications of terms for our loans and their inclusion as troubled debt restructurings are based on individual facts and circumstances. Loan modifications that are included as troubled debt restructurings may involve either an increase or reduction of the interest rate, extension of the term of the loan, or deferral of principal and/or interest payments, regardless of the period of the modification. All of the loans identified as troubled debt restructuring were modified due to financial stress of the borrower. In order to determine if a borrower is experiencing financial difficulty, an evaluation is performed to determine the probability that the borrower will be in payment default on any of its debt in the foreseeable future with the modification. This evaluation is performed under the Company's internal underwriting policy.

When the Company modifies loans in a troubled debt restructuring, the Company evaluates any possible impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan or lease agreement, or the current fair value of the collateral, less selling costs for collateral dependent loans. If the Company determined that the value of the modified loan is less than the recorded investment in the loan, impairment is recognized through an allowance estimate or a charge-off to the allowance. In periods subsequent to modification, the Company evaluates all troubled debt restructurings, including those that have payment defaults, for possible impairment and recognize impairment through the allowance.

As of December 31, 2015, the Company did not have any commitments to extend additional funds to borrowers with loans modified and included as a troubled debt restructuring.

During 2015, certain loans were modified in troubled debt restructurings, where economic concessions were granted to borrowers consisting of reductions in the interest rates, payment extensions, forgiveness of principal, and forbearances.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

Presented below, segregated by class of loans, are troubled debt restructurings:

Twelve months ended December 31, 2015			
	Number of modifications	Post- modification outstanding balance	Net charge-offs resulting in modifications
		(dollars in thousands)	
Retail:			
Single family residential	2	\$ 111	\$ -
Total	2	\$ 111	\$ -
Twelve months ended December 31, 2014			
	Number of modifications	Post- modification outstanding balance	Net charge-offs resulting in modifications
		(dollars in thousands)	
Commercial:			
Nonfarm nonresidential	1	\$ 4,357	-
Retail:			
Single family residential	1	316	3
Total	2	\$ 4,673	\$ 3

The loan's accrual status is assessed at the time of its modification. As a result of the assessment, the accrual status may be modified. Commercial and consumer loans modified in a troubled debt restructuring are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a troubled debt restructuring subsequently default, the Company evaluates the loan for possible further impairment. The allowance for loan losses may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. The Company considers a loan in default when it is 90 days or more past due or transferred to non-accrual.

As of December 31, 2015 and 2014, the Company did not have any loans that were modified in troubled debt restructurings during the past twelve months that have subsequently defaulted.

As of December 31, 2015, the Company held one foreclosed residential real estate property that was the result of obtaining physical possession in accordance with ASC 310-40. The carrying value was \$62,000. In addition, the Company had no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to location requirement of the applicable jurisdiction.

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to (i) the weighted-average risk grade of commercial loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) non-performing loans and (v) the general economic conditions in the State of Tennessee.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

The Company uses a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 through 8. A description of the general characteristics of the eight risk grades is as follows:

Risk Rating 1 – Minimal Risk – Loans in this category are secured by a cash deposit and are substantially risk free.

Risk Rating 2 – Modest Risk – Loans in this category have borrowers that show profitability, liquidity, and capitalization better than industry norms and a strong market position in the region. The borrower of these loans have a proven history of profitability and financial stability, along with an abundance of financeable assets available to protect the Bank's position.

Risk Rating 3 – Average Risk – Loans in this category have borrowers that show a stable earnings history and financial condition in line with industry norms. The borrower's liquidity and leverage are in line with industry norms. The credit extension is considered sound, however, elements may be present which suggest the borrower may not be free from temporary impairments in the future.

Risk Rating 4 – Acceptable Risk – Loans in this category have sound risk profiles, in which the borrower shows satisfactory asset quality and liquidity, good debt capacity and coverage and good management in critical positions.

Risk Rating 5 – Pass/Watch – Loans in this category require a heightened level of supervision. The borrower may exhibit declining earnings, strained cash flow, increasing leverage or weakening market positions that indicate a trend toward an unacceptable risk. The borrowers liquidity, leverage and earnings performance is below or trending below industry norms.

Risk Rating 6 – Special Mention – Loans in this category are not currently adequate. These loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention loans are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Risk Rating 7 – Substandard – Loans in this category are inadequately protected by the current sound worth and paying capacity of the obligor of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Risk Rating 8 – Doubtful – Loans in this category have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

The following table presents risk grades and classified loans by class:

December 31, 2015

Commercial loan portfolio: Credit risk profile by internally assigned grade

	Commercial and industrial	Non-farm, non-residential real estate	Construction and development	Commercial loans secured by real estate	Other commercial	Commercial loan totals
	(dollars in thousands)					
Risk rating 1 - minimal risk	\$ 1,263	\$ 312	\$ -	\$ 103	\$ 77	\$ 1,755
Risk rating 2 - modest risk	5,633	295	-	-	49,017	54,945
Risk rating 3 - average risk	54,952	43,253	9,328	2,529	6,004	116,066
Risk rating 4 - acceptable risk	60,922	105,014	40,604	24,895	5,066	236,501
Risk rating 5 - pass/watch	4,793	11,532	1,398	471	-	18,194
Risk rating 6 - special mention	-	108	-	-	161	269
Risk rating 7 - substandard	336	495	-	93	-	924
Risk rating 8 - doubtful	-	-	-	-	-	-
TOTALS	<u>\$ 127,899</u>	<u>\$ 161,009</u>	<u>\$ 51,330</u>	<u>\$ 28,091</u>	<u>\$ 60,325</u>	<u>\$ 428,654</u>

Retail loan portfolio: Credit risk profiles based on delinquency status classification

	Consumer	Single family residential**	Other retail	Retail loan totals
	(dollars in thousands)			
Performing - risk ratings 1 - 6	\$ 9,896	\$ 258,216	\$ 32,388	\$ 300,500
Risk rated 7*	18	2,038	56	2,112
TOTALS	<u>\$ 9,914</u>	<u>\$ 260,254</u>	<u>\$ 32,444</u>	<u>\$ 302,612</u>

*Loans are classified as nonperforming loans and are automatically placed on nonaccrual status once they reach 90 days past due. For the purposes of this table, the total includes all risk rated 7 loans, of which may be performing or non-performing.

**Single family residential loans includes first mortgages, closed-end second mortgages, residential construction loans, and home equity lines of credit (HELOCs).

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – LOANS, (CONTINUED)

December 31, 2014

Commercial loan portfolio: Credit risk profile by internally assigned grade

	Commercial and industrial	Non-farm, non-residential real estate	Construction and development	Commercial loans secured by real estate	Other commercial	Commercial loan totals
	(dollars in thousands)					
Risk rating 1 - minimal risk	\$ 1,004	\$ 466	\$ -	\$ 113	\$ 1	\$ 1,584
Risk rating 2 - modest risk	3,908	314		-	30,408	34,630
Risk rating 3 - average risk	47,047	46,784	18,903	4,700	5,712	123,146
Risk rating 4 - acceptable risk	42,116	101,809	29,808	21,682	3,802	199,217
Risk rating 5 - pass/watch	3,143	9,763	1,713	1,115	-	15,734
Risk rating 6 - special mention	-	958	-	-	170	1,128
Risk rating 7 - substandard	2,570	3,367	-	327	1,092	7,356
Risk rating 8 - doubtful	-	-	-	-	-	-
TOTALS	\$ 99,788	\$ 163,461	\$ 50,424	\$ 27,937	\$ 41,185	\$ 382,795

Retail loan portfolio: Credit risk profiles based on delinquency status classification

	Consumer	Single family residential**	Other retail	Retail loan totals
	(dollars in thousands)			
Risk ratings 1 - 6	\$ 9,494	\$ 226,637	\$ 29,683	\$ 265,814
Nonperforming - risk rating 7*	42	2,922	479	3,443
TOTALS	\$ 9,536	\$ 229,559	\$ 30,162	\$ 269,257

*Loans are classified as nonperforming loans and are automatically placed on nonaccrual status once they reach 90 days past due. For the purposes of this table, the total includes all risk rated 7 loans, of which may be performing or non-performing.

**Single family residential loans includes first mortgages, closed-end second mortgages, residential construction loans, and home equity lines of credit (HELOCs).

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – ALLOWANCE FOR LOAN AND LEASE LOSSES

Allowance for Loan and Lease Losses. The allowance for loan and lease losses (“ALLL”) is a reserve established through a provision for possible loan losses charged to expense, which represents management’s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company’s allowance for possible loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, “Receivables” and allowance allocations calculated in accordance with ASC Topic 450, “Contingencies.” Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company’s process for determining the appropriate level of the allowance for possible loan losses is designed to account for credit deterioration as it occurs. The provision for possible loan losses reflects loan quality trends, including the levels of and trends related to nonaccrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for possible loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for possible loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management’s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management’s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company’s control, including, among other things, the performance of the Company’s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company’s allowance for possible loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Commercial loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor’s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 7 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for possible loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower’s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower’s industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company’s pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – ALLOWANCE FOR LOAN AND LEASE LOSSES, (CONTINUED)

The components of the general valuation allowance include (i) the additional reserves allocated to specific loan portfolio segments as a result of applying an environmental risk adjustment factor to the base historical loss allocation and (ii) the additional reserves that are not allocated to specific loan portfolio segments including allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

The allowance for loan losses is maintained at a level considered adequate to provide for the losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to change. The Company uses a rolling ten quarters historic loss period for all segments when estimating the historic charge off rates calculated in accordance with ASC Topic 450 and incorporates environmental factors for various components such as economic conditions, trends in delinquencies, loan review assessments, credit concentrations and level of underperforming ratios.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the bank's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of changes to interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

Loans identified as losses by management and internal loan review are charged off. Furthermore, consumer loan accounts are charged off automatically based on regulatory requirements.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – ALLOWANCE FOR LOAN AND LEASE LOSSES, (CONTINUED)

The following table summarizes the allocation in the ALLL by loan segment:

December 31, 2015	Commercial	Residential real estate	Consumer and other retail	Totals
		(dollars in thousands)		
Beginning balance	\$ 6,719	\$ 1,053	\$ 162	\$ 7,934
Less: charge-offs	-	(34)	(13)	(47)
Add: recoveries	683	12	22	717
Add: provisions	-	30	-	30
Ending balance	<u>\$ 7,402</u>	<u>\$ 1,061</u>	<u>\$ 171</u>	<u>\$ 8,634</u>

December 31, 2014	Commercial	Residential real estate	Consumer and other retail	Totals
		(dollars in thousands)		
Beginning balance	\$ 7,359	\$ 1,084	\$ 152	\$ 8,595
Less: charge-offs	(739)	(41)	(11)	(791)
Add: recoveries	99	10	21	130
Add: provisions	-	-	-	-
Ending balance	<u>\$ 6,719</u>	<u>\$ 1,053</u>	<u>\$ 162</u>	<u>\$ 7,934</u>

December 31, 2013	Commercial	Residential real estate	Consumer and other retail	Totals
		(dollars in thousands)		
Beginning balance	\$ 7,528	\$ 1,109	\$ 172	\$ 8,809
Less: charge-offs	(222)	(27)	(49)	(298)
Add: recoveries	53	2	29	84
Add: provisions	-	-	-	-
Ending balance	<u>\$ 7,359</u>	<u>\$ 1,084</u>	<u>\$ 152</u>	<u>\$ 8,595</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – ALLOWANCE FOR LOAN AND LEASE LOSSES, (CONTINUED)

The following tables detail the amount of the ALLL allocated to each portfolio segment as of December 31, 2015, 2014 and 2013, disaggregated on the basis of the Company's impairment methodology:

December 31, 2015	Commercial	Residential real estate	Consumer and other retail	Totals
		(dollars in thousands)		
Loans individually evaluated for impairment	\$ 57	\$ 102	\$ -	\$ 159
Loans collectively evaluated for impairment	7,345	959	171	8,475
Ending balance	<u>\$ 7,402</u>	<u>\$ 1,061</u>	<u>\$ 171</u>	<u>\$ 8,634</u>
 December 31, 2014	 Commercial	 Residential real estate	 Consumer and other retail	 Totals
		(dollars in thousands)		
Loans individually evaluated for impairment	\$ 42	\$ 10	\$ -	\$ 52
Loans collectively evaluated for impairment	6,677	1,043	162	7,882
Ending balance	<u>\$ 6,719</u>	<u>\$ 1,053</u>	<u>\$ 162</u>	<u>\$ 7,934</u>
 December 31, 2013	 Commercial	 Residential real estate	 Consumer and other retail	 Totals
		(dollars in thousands)		
Loans individually evaluated for impairment	\$ 342	\$ 118	\$ 11	\$ 471
Loans collectively evaluated for impairment	7,017	966	141	8,124
Ending balance	<u>\$ 7,359</u>	<u>\$ 1,084</u>	<u>\$ 152</u>	<u>\$ 8,595</u>

The following table shows loans as of December 31, 2015, 2014 and 2013 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology:

December 31, 2015	Commercial	Residential real estate	Consumer and other retail	Totals
		(dollars in thousands)		
Loans individually evaluated for impairment	\$ 886	\$ 1,340	\$ 74	\$ 2,300
Loans collectively evaluated for impairment	427,768	258,914	42,284	728,966
Ending balance	<u>\$ 428,654</u>	<u>\$ 260,254</u>	<u>\$ 42,358</u>	<u>\$ 731,266</u>
 December 31, 2014	 Commercial	 Residential real estate	 Consumer and other retail	 Totals
		(dollars in thousands)		
Loans individually evaluated for impairment	\$ 8,014	\$ 978	\$ 411	\$ 9,403
Loans collectively evaluated for impairment	374,781	228,170	39,698	642,649
Ending balance	<u>\$ 382,795</u>	<u>\$ 229,148</u>	<u>\$ 40,109</u>	<u>\$ 652,052</u>
 December 31, 2013	 Commercial	 Residential real estate	 Consumer and other retail	 Totals
		(dollars in thousands)		
Loans individually evaluated for impairment	\$ 8,227	\$ 987	\$ 11	\$ 9,225
Loans collectively evaluated for impairment	346,148	212,776	38,617	597,541
Ending balance	<u>\$ 354,375</u>	<u>\$ 213,763</u>	<u>\$ 38,628</u>	<u>\$ 606,766</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 – PREMISES AND EQUIPMENT

The following table presents the Company's assets by category:

	<u>2015</u>	<u>2014</u>
	(dollars in thousands)	
Land	\$ 9,296	\$ 9,152
Premises	22,951	22,858
Furniture and equipment	10,375	9,722
Leasehold improvements	1,846	1,859
Construction in progress	278	16
	<u>44,746</u>	<u>43,607</u>
Less accumulated depreciation	(19,228)	(17,834)
	<u>\$ 25,518</u>	<u>\$ 25,773</u>

NOTE 7 – RELATED PARTY TRANSACTIONS

Certain related parties (primarily directors and officers of the Company or the Bank, including their affiliates, families and companies in which they hold 10% or more ownership) were customers of, and had loans and other transactions with, the Bank in the ordinary course of business. An analysis of the activity with respect to such loans are shown in the table below. These totals exclude loans made in the ordinary course of business to other companies with which neither the Company nor the Bank had a relationship other than the association of one of its directors in the capacity of officer or director. These loan transactions were made on substantially the same terms as those prevailing at the time for comparable loans to other persons. They did not involve more than the normal risk of collectability or present other unfavorable features. No related party loans were charged off in 2015 or 2014.

Activity for related party transactions for the periods presented are:

	<u>2015</u>	<u>2014</u>
	(dollars in thousands)	
Related party extensions of credit, beginning of period	\$ 4,774	\$ 3,822
New loans	879	2,081
Repayments	(1,393)	(1,129)
Related party extension of credit, end of period	<u>\$ 4,260</u>	<u>\$ 4,774</u>

The aggregate balances of related party deposits at December 31, 2015 and 2014 were \$22.4 million and \$24.5 million, respectively.

The aggregate balances of related party repurchase agreements at December 31, 2015 and 2014 were \$13.8 million and \$13.1 million, respectively.

The Company and Bank utilize various services and purchased goods provided by certain related parties. Payments to directors for services provided during 2015 and 2014 totaled \$151,000 and \$170,000, respectively.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 – LEASES

Real property for three of the Bank's office locations and certain equipment are leased under noncancelable operating leases expiring at various times through 2034. In most cases, the leases provide for one or more renewal options of five to ten years under the same or similar terms. In addition, various items of office equipment are leased under cancelable operating leases. Total rental expense incurred under all operating leases, including short-term leases with terms of less than one month, amounted to approximately \$30,000, \$27,000 and \$18,000 for equipment leases and approximately \$380,000, \$304,000 and \$264,000 for building leases in 2015, 2014 and 2013, respectively. Future minimum lease commitments as of December 31, 2015 under all noncancelable operating leases with initial terms of one year or more are shown in the following table:

<u>Year</u>	<u>Lease payments</u>
	(dollars in thousands)
2016	\$ 358
2017	320
2018	294
2019	291
2020	295
Thereafter	3,187
Total	<u>\$ 4,745</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 – FEDERAL AND STATE INCOME TAXES

The following table presents components of income tax expense attributable to continuing operations:

	2015	2014	2013
Current	\$ 2,735	\$ 3,011	\$ 915
Deferred	614	545	1,785
Total provision for income taxes	<u>3,349</u>	<u>\$ 3,556</u>	<u>\$ 2,700</u>
Deferred tax effects of principal temporary differences	2015	2014	2013
Allowance for possible loan and lease losses	\$ 3,324	\$ 3,055	\$ 3,309
Deferred compensation	2,563	2,557	2,516
Write down of other real estate	-	9	314
Deferred gain on OREO sale	-	-	188
Amortization of core deposit intangible	(1,747)	(1,577)	(272)
Recognition of nonaccrual loan income	119	129	111
Unrealized losses on available-for-sale securities	1,644	2,124	6,613
Post-retirement benefit obligation	841	986	890
Accelerated depreciation	(691)	(973)	(822)
Amortization of goodwill	(1,229)	(1,109)	(2,591)
Dividend income - F&M West	-	-	(372)
Prepaid expenses	(135)	(135)	(178)
Other	(733)	31	240
Net deferred tax asset	<u>\$ 3,956</u>	<u>\$ 5,097</u>	<u>\$ 9,946</u>
Reconciliation of total income taxes reported with the amount of income taxes computed at the			
Federal statutory rate (34% each year)	2015	2014	2013
Tax expense at statutory rate	\$ 4,643	\$ 4,692	\$ 4,191
Increase (decrease) in taxes resulting from:			
Tax-exempt interest	(1,226)	(1,060)	(1,144)
Nondeductible interest expense	19	14	18
Employee benefits	(80)	(128)	(196)
Other nondeductible expenses			
(nontaxable income) - net	28	38	11
State income taxes net of federal tax benefit	106	-	-
Dividend income exclusion	-	-	-
Other	(141)	-	(180)
Total provision for income taxes	<u>\$ 3,349</u>	<u>\$ 3,556</u>	<u>\$ 2,700</u>
Effective tax rate	<u>24.4%</u>	<u>25.8%</u>	<u>21.9%</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 – FEDERAL AND STATE INCOME TAXES, (CONTINUED)

The Company and its subsidiaries file consolidated income tax returns with the Internal Revenue Service and State of Tennessee. The Company is not subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2012. There was no valuation allowance for deferred tax assets at December 31, 2015 and 2014.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences at December 31, 2015.

NOTE 10 – BORROWED FUNDS

The Bank is a party to the Blanket Agreement for Advances and Security Agreement (the “Blanket Agreement”) with the Federal Home Loan Bank of Cincinnati (the “FHLB”). Advances made to the Bank under the Blanket Agreement are collateralized by the FHLB stock and qualifying residential mortgage loans totaling 150% of the outstanding amount borrowed. These collateralization matters are outlined in the Blanket Agreement dated June 20, 2006 between the Bank and the FHLB. There were no outstanding advances at December 31, 2015 and 2014.

Stock held in the FHLB totaling \$3.0 million at December 31, 2015 and 2014 is carried at cost. The stock is restricted and can only be sold back to the FHLB at par. There were no FHLB borrowings outstanding at December 31, 2015 or 2014.

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as secured borrowings and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. As a result, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of offset for a repurchase agreement resembles a secured borrowing, whereby the collateral pledged by the Company would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third party financial institution in the counterparty's custodial account. The Company has the right to sell or repledge the investment securities. The Company is required by the counterparty to maintain adequate collateral levels. In the event the collateral fair value falls below stipulated levels, the Company will pledge additional securities. The Company closely monitors collateral levels to ensure adequate levels are maintained, while mitigating the potential risk of over-collateralization in the event of counterparty default.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 – BORROWED FUNDS, (CONTINUED)

The following table presents the remaining contractual maturities of the Company's repurchase agreements as of December 31, 2015, disaggregated by the class of collateral pledged.

December 31, 2015	Overnight and Continuous
	(dollars in thousands)
Class of collateral pledged:	
U.S. government agencies	\$ 24,177
U.S. government sponsored agency mortgage backed securities	-
States and political subdivisions	-
Corporate bonds	-
	<u>\$ 24,177</u>
 December 31, 2014	 Overnight and Continuous
	(dollars in thousands)
Class of collateral pledged:	
U.S. government agencies	\$ 22,834
U.S. government sponsored agency mortgage backed securities	-
States and political subdivisions	-
Corporate bonds	-
	<u>\$ 22,834</u>

Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The obligations are secured by investment securities and such collateral is held in safekeeping by a third party. The maximum amount of outstanding agreements at any month end during 2015 and 2014 totaled \$26.4 million and \$24.8 million, respectively, and the monthly average of such agreements totaled \$25.1 million and \$21.4 million for 2015 and 2014, respectively. The agreements at December 31, 2015, mature January 4, 2016.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 – SIGNIFICANT ESTIMATES, COMMITMENTS AND CONTINGENCIES

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Estimates related to the ALLL are reflected in the footnote regarding loans. Other significant estimates and concentrations not discussed in those footnotes include:

General Litigation

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Company.

Pension and Other Post-retirement Benefit Obligations

The Company has a noncontributory defined benefit post-retirement health care plan whereby it agrees to provide certain post-retirement benefits to eligible employees. The benefit obligation is the actuarial present value of all benefits attributed to service rendered prior to the valuation date based on the projected unit credit cost method. It is reasonably possible that events could occur that would change the estimated amount of this liability materially in the near term.

Current Economic Conditions

The current economic climate continues to present financial institutions with circumstances and challenges which in some cases have resulted in large and unanticipated declines in the fair values of investments and other assets, constraints on liquidity and capital and significant credit quality problems, including volatility in the valuation of real estate and other collateral supporting loans.

The accompanying financial statements have been prepared using values and information currently available to the Company.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in asset values, the ALLL and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity. Furthermore, the Company's regulators could require material adjustments to asset values or the allowance for loan losses for regulatory capital purposes that could affect the Company's measurement of regulatory capital and compliance with the capital adequacy guidelines under the regulatory framework for prompt corrective action.

Commitments and Credit Risk

The Company grants commercial, consumer and residential loans to customers throughout the State of Tennessee. The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in those particular financial instruments.

Commitments to Originate Loans

Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 – SIGNIFICANT ESTIMATES, COMMITMENTS AND CONTINGENCIES, (CONTINUED)

Mortgage loans in the process of origination represent amounts that the Company plans to fund within a normal period of 30 to 90 days, and which are intended for sale to investors in the secondary market. Total mortgage loans in process of origination were \$1.1 million and \$3.3 million, at December 31, 2015 and 2014, respectively. Total mortgage loans held for sale amounted to \$0 and \$354,000, at December 31, 2015 and 2014, respectively.

Standby Letters of Credit

Standby letters of credit are irrevocable conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Financial standby letters of credit are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. Performance standby letters of credit are issued to guarantee performance of certain customers under nonfinancial contractual obligations. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. Should the Company be obligated to perform under the standby letters of credit, the Company may seek recourse from the customer for reimbursement of amounts paid.

The Company had total outstanding standby letters of credit amounting to \$12.3 million and \$13.5 million, at December 31, 2015 and 2014, respectively, with terms ranging from seven days to 24 months.

Lines of Credit

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Lines of credit generally have fixed expiration dates. Since a portion of the line may expire without being drawn upon, the total unused lines do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate. Management uses the same credit policies in granting lines of credit as it does for on-balance-sheet instruments.

At December 31, 2015, the Company had granted unused lines of credit to borrowers aggregating approximately \$44.6 million and \$159.5 million for commercial lines and open-end consumer lines, respectively. At December 31, 2014, unused lines of credit to borrowers aggregated approximately \$41.0 million for commercial lines and \$104.4 million for open-end consumer lines.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – FAIR VALUE MEASUREMENT

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. Fair value measurement must maximize the use of observable inputs and minimize the use of unobservable inputs. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. FASB ASC Topic 820, “Fair Value Measurements and Disclosures” establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities.
- *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, market consensus, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- *Level 3 Inputs* - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity’s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company’s monthly and/or quarterly valuation process.

Recurring Measurements

The following table summarizes financial assets measured at fair value on a recurring basis by the level within the fair value hierarchy utilized to measure fair value:

	Recurring fair value measurements at December 31, 2015			
	Total carrying value	Level 1	Level 2	Level 3
	(dollars in thousands)			
Assets				
Available-for-sale investment securities:				
U.S. government sponsored agencies	\$ 131,057	\$ -	\$ 131,057	\$ -
U.S. government sponsored agency mortgage backed securities	167,067	-	167,067	-
State and political subdivision	73,319	-	73,319	-
Corporate bonds	23,576	-	23,576	-
Total assets at fair value	\$ 395,019	\$ -	\$ 395,019	\$ -

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – FAIR VALUE MEASUREMENT, (CONTINUED)

	Recurring fair value measurements at December 31, 2014			
	Total carrying value	Level 1	Level 2	Level 3
	(dollars in thousands)			
Assets				
Available-for-sale investment securities:				
U.S. government sponsored agencies	\$ 159,254	\$ -	\$ 159,254	\$ -
U.S. government sponsored agency mortgage backed securities	167,970	-	167,970	-
State and political subdivision	52,882	-	52,882	-
Corporate bonds	17,780	-	17,780	-
Total assets at fair value	<u>\$ 397,886</u>	<u>\$ -</u>	<u>\$ 397,886</u>	<u>\$ -</u>

The following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2015.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, the Company obtains fair value measurements from an independent pricing service, such as Interactive Data, which utilizes pricing models to determine fair value measurement. The Company reviews the pricing quarterly to verify the reasonableness of the pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other factors. U.S. government agencies, state and political subdivisions, U.S. government sponsored agency mortgage-backed securities and corporate bonds are classified as Level 2 inputs.

Nonrecurring Measurements

The following table summarizes financial assets measured at fair value on a nonrecurring basis as of December 31, 2015 and December 31, 2014, by the level within the fair value hierarchy utilized to measure fair value:

December 31, 2015	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Impaired loans (collateral-dependent)	\$ -	\$ -	\$ 672	\$ 672
December 31, 2014	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Impaired loans (collateral-dependent)	\$ -	\$ -	\$ 1,184	\$ 1,184

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – FAIR VALUE MEASUREMENT, (CONTINUED)

Impaired Loans (Collateral-Dependent)

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by the Chief Credit Officer. Appraisals are reviewed for accuracy and consistency by the Chief Credit Officer. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by the Chief Credit Officer by comparison to historical results. Fair value adjustments were approximately \$178,000 at December 31, 2015 and \$287,000 at December 31, 2014.

Loans considered impaired under ASC 310-35, "Impairment of a Loan," are loans for which, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are subject to nonrecurring fair value adjustments to reflect (1) subsequent partial write-downs that are based on the observable market price or current appraised value of the collateral or (2) the full charge-off of the loan carrying value.

Other Real Estate Owned

Other real estate owned ("OREO") is initially recorded at fair value at the time of acquisition, as determined by independent appraisal or evaluation by the Company, less costs to sell when the real estate is acquired in settlement of loans. Quarterly evaluations of OREO are performed to determine if there have been any subsequent decline in the value of OREO properties. OREO is classified within Level 3 of the fair value hierarchy. OREO assets are subject to nonrecurring fair value adjustments to reflect subsequent partial write-downs that are based on the observable market price or current appraised value of the collateral less selling costs. Fair value adjustments were approximately \$12,000 in the aggregate at December 31, 2015. There were no fair value adjustments at December 31, 2014.

Appraisals of OREO are obtained when the real estate is acquired and subsequently as deemed necessary by the Chief Credit Officer. Appraisals are required annually and reviewed for accuracy and consistency by the Chief Credit Officer. The appraised values are reduced by discounts to consider lack of marketability and estimated costs to sell. Appraisers are selected from the list of approved appraisers maintained by management.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
NOTE 12 – FAIR VALUE MEASUREMENT, (CONTINUED)

Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements:

Quantitative information about Level 3 fair value measurements				
December 31, 2015	Fair value	Valuation technique(s)	Unobservable input	Range (weighted average)
				(dollars in thousands)
		Market comparable properties	Marketability discount	25.0% - 46.0% (41.0%)
Impaired loans (collateral-dependent)	\$ 672			
Quantitative Information about Level 3 fair value measurements				
December 31, 2014	Fair value	Valuation technique(s)	Unobservable input	Range (weighted average)
				(dollars in thousands)
		Market comparable properties	Marketability discount	5.0% - 10.0% (7%)
Impaired loans (collateral-dependent)	\$ 1,184			

ASC Topic 825, “Financial Instruments,” requires disclosure of the fair value of financial assets and liabilities, including those financial assets and liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and due from banks – The carrying amount approximates fair value.

Interest bearing deposits in other banks – The carrying amount approximates fair value.

Federal funds sold – The carrying amount approximates fair value.

Securities held-to-maturity – Fair values are based on quoted market prices, if available. If a quoted price is not available, fair value is estimated using quoted prices for similar securities. The fair value estimate is provided to management from a third party using modeling assumptions specific to each type of security that are reviewed and approved by management. Quarterly sampling of fair values provided by additional third parties supplement the fair value review process.

Loans held for sale – The fair value is predetermined at origination based on sale price.

Loans (net of the allowance for loan losses) – The fair value of fixed rate loans and variable rate mortgage loans is estimated by discounting the future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. For other variable rate loans, the carrying amount approximates fair value.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – FAIR VALUE MEASUREMENT, (CONTINUED)

Federal Home Loan Bank stock – The carrying value of FHLB stock approximates fair value based on the redemption provisions of the FHLB.

Federal Reserve Bank stock – The carrying value of Federal Reserve Bank stock approximates fair value based on the redemption provisions of the Federal Reserve Bank.

Accrued interest receivable – The carrying amount approximates fair value.

Deposits – The fair value of fixed maturity time deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. For deposits including demand deposits, savings accounts, NOW accounts, and certain money market accounts, the carrying value approximates fair value.

Repurchase agreements – The fair value is estimated by discounting future cash flows using current rates.

Accrued interest payable – The carrying amount approximates fair value.

Commitments to extend credit and letters of credit – The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair values of these commitments are not material.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – FAIR VALUE MEASUREMENT, (CONTINUED)

The following tables present estimated fair values of the Company's financial instruments indicate the levels within the fair value hierarchy of the valuation techniques:

Fair value measurements at December 31, 2015 using

	Carrying amount	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(dollars in thousands)			
Financial assets				
Cash and due from banks	\$ 19,453	\$ 19,453	\$ -	-
Interest-bearing deposits in other banks	18,299	18,299	-	-
Federal funds sold	24,476	24,476	-	-
Federal Home Loan Bank and Federal Reserve Bank stock	3,879	-	3,879	-
Securities available-for-sale	395,019	-	395,019	-
Securities held-to-maturity	4,059	-	4,089	-
Loans, net	722,632	-	-	718,956
Accrued interest receivable	4,540	-	4,540	-
Financial liabilities				
Non-interest bearing deposits	239,226	239,226	-	-
Interest bearing deposits	864,575	-	864,036	-
Repurchase agreements	24,177	-	24,177	-
Accrued interest payable	503	-	503	-
Off-balance sheet credit related instruments:				
Commitments to extend credit and letters of credit	-	-	-	-

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – FAIR VALUE MEASUREMENT, (CONTINUED)

Fair value measurements at December 31, 2014 using

	Carrying amount	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(dollars in thousands)			
Financial assets				
Cash and due from banks	\$ 18,511	\$ 18,511	\$ -	\$ -
Interest-bearing deposits in other banks	10,086	10,086	-	-
Federal funds sold	1,700	1,700	-	-
Federal Home Loan Bank and Federal Reserve Bank stock	3,879	-	3,879	-
Securities available-for-sale	397,886	-	397,886	-
Securities held-to-maturity	21,985	-	22,263	-
Loans held for sale	354	354	-	-
Loans, net	644,118	-	-	650,770
Accrued interest receivable	4,337	-	4,337	-
Financial liabilities				
Non-interest bearing deposits	204,358	204,358	-	-
Interest bearing deposits	815,597	-	816,022	-
Repurchase agreements	22,834	-	22,834	-
Accrued interest payable	613	-	613	-
Off-balance sheet credit related instruments:				
Commitments to extend credit and letters of credit	-	-	-	-

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 – QUARTERLY RESULTS OF OPERATIONS (Unaudited)

The following table presents unaudited quarterly interim financial information for the Company for the periods presented:

	March 31, 2015	June 30, 2015	September 30, 2015	December 31, 2015	Total
			(dollars in thousands)		
Interest income	\$ 9,303	\$ 9,720	\$ 9,817	\$ 9,842	\$ 38,682
Interest expense	565	556	556	548	2,225
Net interest income	8,738	9,164	9,261	9,294	36,457
Provision for possible loan and lease losses, net	-	-	-	30	30
Non-interest income	2,885	2,774	2,907	2,877	11,443
Non-interest expenses	8,030	8,559	8,524	9,102	34,215
Income before income taxes	3,593	3,379	3,644	3,039	13,655
Income taxes	976	677	925	771	3,349
Net income	\$ 2,617	\$ 2,702	\$ 2,719	\$ 2,268	\$ 10,306
Basic earnings per share	\$ 0.53	\$ 0.56	\$ 0.57	\$ 0.48	\$ 2.13
Weighted average shares outstanding	4,897,245	4,853,265	4,808,352	4,771,648	4,832,217

	March 31, 2015	June 30, 2015	September 30, 2015	December 31, 2015	Total
			(dollars in thousands)		
Interest income	\$ 9,042	\$ 9,103	\$ 9,351	\$ 9,284	\$ 36,780
Interest expense	620	623	605	580	2,428
Net interest income	8,422	8,480	8,746	8,704	34,352
Provision for possible loan and lease losses, net	-	-	-	-	-
Non-interest income	2,651	3,091	3,177	2,808	11,727
Non-interest expenses	8,098	8,033	8,166	7,984	32,281
Income before income taxes	2,975	3,538	3,757	3,528	13,798
Income taxes	713	941	1,031	871	3,556
Net income	\$ 2,262	\$ 2,597	\$ 2,726	\$ 2,657	\$ 10,242
Basic earnings per share	\$ 0.45	\$ 0.52	\$ 0.55	\$ 0.54	\$ 2.06
Weighted average shares outstanding	5,017,789	4,977,506	4,934,815	4,909,910	4,963,826

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 – DEPOSITS

The Bank does not have any foreign offices and all deposits are serviced in its 19 domestic offices. Maturities of time deposits of \$100,000 or more at December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
	(dollars in thousands)	
Under 3 months	\$ 24,805	\$ 29,629
3 to 12 months	70,447	71,489
Over 12 months	16,755	18,399
Total	<u>\$ 112,007</u>	<u>\$ 119,517</u>

At December 31, 2015 and 2014, the Bank had \$47.1 million and \$53.3 million, respectively, of interest-bearing time deposits of \$250,000 or more. At December 31, 2015 and 2014, the Bank had \$223,000 and \$152,000, respectively, of deposit accounts in overdraft status and thus have been reclassified to loans in the accompanying consolidated balance sheets.

The following table presents maturities of interest-bearing time deposits as of December 31, 2015:

	(dollars in thousands)	
2016	\$	172,931
2017		17,972
2018		6,056
2019		6,237
2020		8,090
Thereafter		10
Total	<u>\$</u>	<u>211,296</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 – CONDENSED FINANCIAL INFORMATION OF THE CORPORATION

The following tables present the condensed balance sheets, statements of income, comprehensive income (loss), and cash flows of the Company:

CONDENSED BALANCE SHEETS

	As of December 31,	
	2015	2014
	(dollars in thousands)	
Cash	\$ 310	\$ 271
Investment in bank subsidiary	114,655	111,512
Investment in credit life insurance company	54	54
Investment in other securities	17	17
Dividends receivable from bank subsidiary	1,754	1,813
Cash surrender value - life insurance	4,546	4,474
Total assets	<u>\$ 121,336</u>	<u>\$ 118,141</u>
Liabilities		
Accrued liabilities	\$ 1,887	\$ 1,839
Dividends payable	1,754	1,813
Total liabilities	<u>3,641</u>	<u>3,652</u>
Shareholders' equity		
Common stock - \$10 par value, 8,000,000 shares authorized; 4,739,502 and 4,900,576 shares issued and outstanding, as of December 31, 2015 and December 31, 2014, respectively	47,395	49,006
Retained earnings	71,583	67,609
Accumulated other comprehensive loss	(1,283)	(2,126)
Total shareholders' equity	<u>117,695</u>	<u>114,489</u>
Total liabilities and shareholders' equity	<u>\$ 121,336</u>	<u>\$ 118,141</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 – CONDENSED FINANCIAL INFORMATION OF THE CORPORATION, (CONTINUED)

CONDENSED STATEMENTS OF INCOME

	Years ended December 31,		
	2015	2014	2013
		(dollars in thousands)	
Operating income			
Dividends from bank subsidiary	\$ 8,002	\$ 7,038	\$ 7,663
Other dividend income	-	8	15
Other	72	65	65
Operating expenses	(308)	(279)	(238)
Income before equity in undistributed net income of bank subsidiary	7,766	6,832	7,505
Equity in undistributed net income of bank subsidiary	2,540	3,410	2,106
Net income	<u>\$ 10,306</u>	<u>\$ 10,242</u>	<u>\$ 9,611</u>

CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Year ended December 31,		
	2015	2014	2013
		(dollars in thousands)	
Net income for common shareholders	\$ 10,306	\$ 10,242	\$ 9,611
Other comprehensive income (loss)			
Unrealized appreciation (depreciation) on available-for-sale securities, net of taxes of 685, \$4,742, and (\$8,507), respectively	1,097	7,571	(13,589)
Reclassification adjustment for realized gains included in net income, net of taxes of (\$206), (\$251) and (\$319), respectively	(328)	(401)	(510)
Change in unfunded portion of post-retirement benefit obligations, net of taxes of \$47, (\$185) and \$2,102, respectively	74	(295)	3,360
Other comprehensive income (loss)	843	6,875	(10,739)
Total comprehensive income (loss)	<u>\$ 11,149</u>	<u>\$ 17,117</u>	<u>\$ (1,128)</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 – CONDENSED FINANCIAL INFORMATION OF THE CORPORATION, (CONTINUED)

CONDENSED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
	2015	2014	2013
	(dollars in thousands)		
Operating activities			
Net income for the year	\$ 10,306	\$ 10,242	\$ 9,611
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in undistributed net income of bank subsidiary	(2,540)	(3,410)	(2,106)
Increase in cash surrender value of life insurance contracts	(72)	(65)	(65)
Increase (decrease) in other assets	59	245	(90)
Increase in payables	288	18	134
Total adjustments	(2,265)	(3,212)	(2,127)
Net cash provided by operating activities	8,041	7,030	7,484
Financing activities			
Payment to repurchase common stock	(4,408)	(3,097)	(3,722)
Cash dividends paid	(3,594)	(3,685)	(3,800)
Net cash used by financing activities	(8,002)	(6,782)	(7,522)
Decrease in cash	39	248	(38)
Cash at beginning of year	271	23	61
Cash at end of year	\$ 310	\$ 271	\$ 23

NOTE 16 – EMPLOYEE BENEFIT PLANS

The Bank contributes to a qualified profit-sharing plan covering employees who meet participation requirements. To be eligible to participate, employees must complete 1,000 hours of service within the twelve month time period following their date of hire. Employees must be age twenty or older. The amount of the contribution is at the discretion of the Bank's Board of Directors, up to the maximum deduction allowed for federal income tax purposes. Contributions to the plan, which amounted to approximately \$885,000, \$1.0 million and \$1.6 million in 2015, 2014 and 2013, respectively, are included in salaries and employee benefits expense.

The Bank formalized a nonqualified salary continuation agreement for a key officer. In connection with this agreement, the value of the single premium universal life insurance policies (approximately \$996,000 at December 31, 2015 and approximately \$986,000 at December 31, 2014) purchased in 1993 to fund the related liability (approximately \$40,000 at December 31, 2015 and \$56,000 at December 31, 2014) were included in other assets and other liabilities, respectively. The principal cost of this agreement is accrued over the anticipated remaining period of active employment, based on the present value of the expected retirement benefit.

The Company and Bank implemented a deferred compensation plan that permits directors to defer their director's fees and earn interest on the deferred amount in the amount of the wall street journal prime rate plus three percent. The agreements provide for a lump sum payment or 120 month payments of deferred fees plus accrued interest after retirement, separation from service, or death. The liability accrued for this plan totaled \$6.6 million at December 31, 2015 and 2014.. The charge to expense for the agreements was \$738,000, \$715,000 and \$722,000 for the years ended December 31 2015, 2014 and 2013, respectively.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – POST RETIREMENT BENEFIT PLAN

Effective July 1, 2013, the Company revised its retiree medical benefit plan for employees who were hired before March 27, 2007. Newly retiring employees will no longer be offered medical, dental or life insurance coverage. Instead, qualified retirees will receive a post retirement bonus. The Company will pay a post retirement bonus equal to \$20,000 to employees (i) who were hired prior to March 20, 2007; (ii) who retire on or after July 1, 2013; (iii) who are at least age 59 ½ at the time of retirement; and (iv) who have at least twenty-five years of service to the Company as of retirement. The bonus will be paid in a lump sum cash payment (subject to applicable tax withholding requirements) within 60 days after the employee's retirement, provided such retirement constitutes a "separation from service" under section 409A of the Internal Revenue Code. The Company still sponsors a defined benefit post-retirement health care plan for retirees who retired prior to July 1, 2007. Under this plan, premiums paid by retirees and spouses depend on date of retirement, age and coverage election.

The Company funding policy is to make the minimal annual contribution that is required by applicable regulations, plus such amounts as the Company may determine to be appropriate from time to time. The Company expects to contribute \$161,000 to the plan in 2016.

The following table provides further information about the plan:

	Post-retirement benefits	
	2015	2014
	(dollars in thousands)	
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 2,560	\$ 2,313
Service cost	36	33
Interest cost	105	111
Expected benefits paid	(174)	(183)
Actuarial gain (loss)	(286)	286
Benefit obligation at end of year	<u>\$ 2,241</u>	<u>\$ 2,560</u>
Change in fair value of assets		
Fair value of plans assets at beginning of year	\$ -	\$ -
Employer contribution	174	183
Benefits paid	(174)	(183)
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Reconciliation of funded status to benefit costs recognized		
Projected benefit obligation, end of year	\$ (2,241)	\$ (2,560)
Fair value of assets, end of year	-	-
Funded status, end of year	<u>\$ (2,241)</u>	<u>\$ (2,560)</u>

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – POST RETIREMENT BENEFIT PLAN, (CONTINUED)

Amounts recognized in accumulated other comprehensive income not yet recognized as components of net periodic benefit cost consist of:

	<u>2015</u>	<u>2014</u>
	(dollars in thousands)	
Unrecognized net actuarial gain	\$ (2,142)	\$ (2,016)
Unrecognized prior service cost	(41)	(46)
	<u>\$ (2,183)</u>	<u>\$ (2,062)</u>

Amounts recognized in statement of financial position are as follows:

	<u>2015</u>	<u>2014</u>
	(dollars in thousands)	
Current liability	\$ -	\$ -
Noncurrent liability	(2,241)	(2,560)
	<u>\$ (2,241)</u>	<u>\$ (2,560)</u>

A reconciliation of other comprehensive income is as follows:

	Post-retirement benefits		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(dollars in thousands)		
Accumulated other comprehensive income (loss) beginning of year	\$ (2,062)	\$ (2,542)	\$ 2,920
Amortization of net actuarial gain (loss)	160	188	(190)
Negative plan amendment gain	-	-	(2,662)
(Gain) loss incurred in current year	(286)	287	(2,558)
Prior service cost established in current year	5	5	(52)
Other comprehensive income (loss)	(121)	480	(5,462)
Ending balance (before tax effects)	<u>\$ (2,183)</u>	<u>\$ (2,062)</u>	<u>\$ (2,542)</u>

	Post-retirement benefits		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(dollars in thousands)		
Components of net periodic benefit cost			
Service cost	\$ 36	\$ 34	\$ 138
Interest cost	105	111	292
Amortization of prior service cost	(5)	(5)	-
Recognized net actuarial (gain) loss	(160)	(188)	190
Net periodic benefit income (cost)	<u>\$ (24)</u>	<u>\$ (48)</u>	<u>\$ 620</u>

The estimated net gain for the defined benefits post-retirement plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is \$174,000.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 – POST RETIREMENT BENEFIT PLAN, (CONTINUED)

	Post-retirement benefits	
	2015	2014
Weighted-average assumption used to determine benefit obligation:		
Discount rate	4.25%	4.25%
Rate of compensation increase	NA	NA

	Post-retirement benefits	
	2015	2014
Weighted-average assumptions used to determine benefit costs:		
Discount rate	4%	5%

The following table gives the Health Care Cost Trend, which is applied to gross charges, net claims and retiree paid premiums to reflect the Company's past practice and stated ongoing intention to maintain relatively constant cost sharing between the Company and retirees:

	2015	2014
Health care trend rate		
Initial		
Pre-65	9%	9%
Post-65	8%	8%
Ultimate (pre and post-65)	5%	5%
Years to ultimate		
Pre-65	8	8
Post-65	6	6

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid, net of participant contributions:

FYE	Company benefits (dollars in thousands)
2016	\$ 161
2017	154
2018	165
2019	163
2020	160
2021-2026	<u>975</u>
	<u>\$ 1,778</u>

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1-percentage-point increase	1-percentage-point decrease
	(dollars in thousands)	
Effect on total of service and interest cost	\$ 13	\$ (6)
Effect on post-retirement benefit obligation	245	(146)

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 – REGULATORY CAPITAL

The Company and the Bank are each required to comply with applicable capital adequacy standards established by the Federal Reserve Board. The current risk-based capital standards applicable to the Company and the Bank, parts of which are currently in the process of being phased-in, are based on the December 2010 final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision (the “Basel Committee”).

Prior to January 1, 2015, the risk-based capital standards applicable to the Company and the Bank (the “general risk-based capital rules”) were based on the 1988 Capital Accord, known as Basel I, of the Basel Committee. In July 2013, the federal bank regulators approved final rules (the “Basel III Capital Rules”) implementing the Basel III framework as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including the Company and the Bank, as compared to the general risk-based capital rules. The Basel III Capital Rules became effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period for certain provisions).

The Basel III Capital Rules, among other things, (i) introduce a new capital measure called “Common Equity Tier 1” (“CET1”), (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting certain revised requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (iv) expand the scope of the deductions/adjustments to capital as compared to existing regulations.

Under the Basel III Capital Rules, the minimum capital ratios effective as of January 1, 2015 are:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the “leverage ratio”).

The Basel III Capital Rules also introduced a new “capital conservation buffer”, composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019. The Basel III Capital Rules also provide for a “countercyclical capital buffer” that is only applicable to certain covered institutions and does not have any current applicability to the Company or the Bank. Banking institutions with a ratio of CET1 to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and the Bank to maintain an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, (iii) a minimum ratio of Total capital to risk-weighted assets of at least 10.5%; and (iv) a minimum leverage ratio of 4%.

The Basel III Capital Rules also provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that certain deferred tax assets and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter).

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 – REGULATORY CAPITAL, (CONTINUED)

In addition, under the general risk-based capital rules, the effects of accumulated other comprehensive income items included in capital were excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, the effects of certain accumulated other comprehensive income items are not excluded; however, non-advanced approaches banking organizations, including the Company and the Bank, are able to make a one-time permanent election to continue to exclude these items. Both the Company and the Bank have made this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of their available-for-sale securities portfolio.

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expanded the risk-weighting categories from the general risk-based capital rules to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories.

Management believes that, as of December 31, 2015, the Company and the Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements had been in effect.

Actual capital amounts and ratios are presented in the table below. Management believes, as of December 31, 2015, that the Company and the Bank met the guidelines to which they were subject.

(Dollars in thousands)		Actual		Minimum capital requirement		Minimum to be well capitalized	
As of December 31, 2015		Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 (to Risk weighted assets)	Consolidated	\$ 109,960	13.3 %	\$ 37,256	4.5 %	\$ -	-
	Bank	106,918	12.9 %	37,177	4.5 %	53,699	6.5%
Total capital (to Risk weighted Assets)	Consolidated	118,594	14.3 %	66,234	8.0 %	-	-
	Bank	115,552	14.0 %	66,092	8.0 %	82,615	10.0%
Tier 1 capital (to Risk weighted assets)	Consolidated	109,960	13.3 %	49,675	6.0 %	-	-
	Bank	106,918	12.9 %	49,569	6.0 %	66,092	8.0%
Tier 1 capital (to average assets)	Consolidated	109,960	8.9 %	49,599	4.0 %	-	-
	Bank	106,918	8.7 %	49,420	4.0 %	61,775	5.0%
As of December 31, 2014							
Total Capital (to Risk weighted assets)	Consolidated	\$ 115,532	14.8 %	\$ 62,628	8.0 %	\$ -	-
	Bank	112,554	14.4 %	62,628	8.0 %	78,285	10.0%
Tier 1 Capital (to Risk weighted assets)	Consolidated	107,598	13.7 %	31,314	4.0 %	-	-
	Bank	104,620	13.4 %	31,314	4.0 %	46,971	6.0%
Tier 1 Capital (to average assets)	Consolidated	107,598	9.7 %	44,513	4.0 %	-	-
	Bank	104,620	9.2 %	45,707	4.0 %	57,133	5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2015, approximately \$8,056 of retained earnings were available for dividend declaration without prior approval.

FIRST FARMERS AND MERCHANTS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 – SUBSEQUENT EVENTS

FASB ASC Topic 855, “Subsequent Events”, established general standards of accounting for a disclosure of events that occur after the balance sheet date but before financial statements are issued. The Company evaluated all events or transactions that occurred after December 31, 2015, through the date of the issued financial statements. During this period there were no material recognizable subsequent events that required recognition or disclosures in the December 31, 2015 financial statements.

FIRST FARMERS AND MERCHANTS CORPORATION

CERTIFICATION PURSUANT TO RULE 13a-14 OF THE
SECURITIES EXCHANGE ACT OF 1934, AS AMENDED,
AS ADOPTED PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002

I, T. Randy Stevens, certify that:

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

Date March 1, 2016

\s\ T. Randy Stevens
T. Randy Stevens, Chief Executive Officer

FIRST FARMERS AND MERCHANTS CORPORATION

CERTIFICATION PURSUANT TO RULE 13a-14 OF THE
SECURITIES EXCHANGE ACT OF 1934, AS AMENDED,
AS ADOPTED PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002

I, Robert E. Krimmel, certify that:

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

Date March 1, 2016

\s\ Robert E. Krimmel
Robert E. Krimmel, Chief Financial Officer

FIRST FARMERS AND MERCHANTS CORPORATION

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

In connection with the Annual Report of First Farmers and Merchants Corporation (the “Company”) on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned certify, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) Information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date March 1, 2016

/s/ T. Randy Stevens
T. Randy Stevens, Chief Executive Officer

Date March 1, 2016

/s/ Robert E. Krimmel
Robert E. Krimmel, Treasurer (principal accounting officer)

Please contact: Robert E. Kimmel, Chief Financial Officer, about any information contained in this report.