

FIRST FINANCIAL BANCORP /OH/

Form 10-K

February 25, 2014

TABLE OF CONTENTS

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, 2013

OR

•• TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES ACT OF 1934

Commission File Number 001-34762

FIRST FINANCIAL BANCORP.

(Exact name of registrant as specified in its charter)

Ohio

(State or other jurisdiction of
incorporation or organization)

31-1042001

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

255 East Fifth Street, Suite 700

Cincinnati, Ohio

(Address of principal executive offices)

45202

(Zip Code)

Registrant's telephone number, including area code: (877) 322-9530

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

Common Shares, no par value

Warrants, each to purchase one Common Share, no par value

Name of exchange on which registered:

The NASDAQ Stock Market LLC

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

x Yes •• No

Indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

•• Yes x No

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

x 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).

x Yes •• No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (subpart 229.405 of this chapter) 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. ••

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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. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

☐ Yes ☒ No

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the sales price of the last trade of such stock as of June 30, 2013, was \$829,690,000. (The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the registrant that such person is an affiliate of the registrant.)

As of February 24, 2014, there were issued and outstanding 57,510,991 common shares of the registrant.

Documents Incorporated by Reference:

Portions of the registrant's Annual Report to Shareholders for the year ended December 31, 2013 are incorporated by reference into Parts I, II and IV.

Portions of the registrant's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 27, 2014 are incorporated by reference into Part III.

TABLE OF CONTENTS

FORM 10-K CROSS REFERENCE INDEX

			Page
<u>Part I</u>	<u>Item 1</u>	<u>Business</u>	<u>1</u>
	<u>Item 1A</u>	<u>Risk Factors</u>	<u>10</u>
	<u>Item 1B</u>	<u>Unresolved Staff Comments</u>	<u>23</u>
	<u>Item 2</u>	<u>Properties</u>	<u>23</u>
	<u>Item 3</u>	<u>Legal Proceedings</u>	<u>23</u>
	<u>Item 4</u>	<u>Mine Safety Disclosures</u>	<u>24</u>
		<u>Supplemental Item - Executive Officers of the Registrant</u>	<u>25</u>
<u>Part II</u>	<u>Item 5</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>27</u>
	<u>Item 6</u>	<u>Selected Financial Data</u>	<u>29</u>
	<u>Item 7</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
	<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>30</u>
	<u>Item 8</u>	<u>Financial Statements and Supplementary Data</u>	<u>30</u>
	<u>Item 9</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>30</u>
	<u>Item 9A</u>	<u>Controls and Procedures</u>	<u>30</u>
	<u>Item 9B</u>	<u>Other Information</u>	<u>30</u>
<u>Part III</u>	<u>Item 10</u>	<u>Directors, Executive Officers, and Corporate Governance</u>	<u>31</u>
	<u>Item 11</u>	<u>Executive Compensation</u>	<u>31</u>
	<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>31</u>
	<u>Item 13</u>	<u>Certain Relationships and Related Transactions and Director Independence</u>	<u>31</u>
	<u>Item 14</u>	<u>Principal Accounting Fees and Services</u>	<u>31</u>
<u>Part IV</u>	<u>Item 15</u>	<u>Exhibits, Financial Statement Schedules</u>	<u>32</u>
<u>Signatures</u>			<u>36</u>

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K which are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including, without limitation, the statements specifically identified as forward-looking statements within this document. In addition, certain statements in future filings by us with the SEC, in press releases, and in oral and written statements made by or with our approval which are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include: (i) projections of income or expense, earnings per share, the payment or non-payment of dividends, capital structure and other financial items; (ii) statements of our plans and objectives or our management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as “believes,” “anticipates,” “expects,” “intends,” “targeted” and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying those statements.

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements to encourage companies to provide prospective information so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the forward-looking statements. We desire to take advantage of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements involve risks and uncertainties. Actual results may differ materially from those predicted by the forward-looking statements because of various factors and possible events, including those factors and events identified (i) in "Item 1A. Risk Factors" of the Annual Report on Form 10-K and (ii) under the heading "Forward-Looking Statements" in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of First Financial's 2013 Annual Report (included within Exhibit 13 to this Annual Report on Form 10-K and incorporated by reference into Item 7 of this Annual Report on Form 10-K). There is also the risk that our management or Board of Directors incorrectly analyzes these risks and uncertainties or that the strategies we develop to address them are unsuccessful.

Forward-looking statements speak only as of the date on which they are made, and, except as may be required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made to reflect unanticipated events. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are qualified in their entirety by the foregoing cautionary statements.

TABLE OF CONTENTS

PART I

Item 1. Business.

First Financial Bancorp.

First Financial Bancorp., an Ohio corporation (First Financial, the Company, we, us, our), was formed in 1982. First Financial is a mid-sized, regional bank holding company headquartered in Cincinnati, Ohio.

First Financial engages in the business of commercial banking and other banking and banking-related activities through its oldest wholly owned subsidiary, First Financial Bank, National Association (the Bank), which was founded in 1863.

The range of banking services provided by First Financial to individuals and businesses includes commercial lending, real estate lending, and consumer financing. Real estate loans are loans secured by a mortgage lien on the real property of the borrower, which may either be residential property (one to four family residential housing units) or commercial property (owner-occupied and/or investor income producing real estate, such as apartments, shopping centers, office buildings). In addition, First Financial offers deposit products that include interest-bearing and noninterest-bearing accounts, time deposits, and cash management services for commercial customers. A full range of trust and asset management services is also provided through First Financial's Wealth Management division.

Commercial loans are made to all types of businesses for a variety of purposes including, but not limited to, inventory, receivables, and equipment. First Financial works with businesses to meet their shorter term working capital needs while also providing long-term financing for their business plans. First Financial also offers lease and equipment financing through a wholly-owned subsidiary of the Bank, First Financial Equipment Finance LLC (First Equipment Finance), primarily in its principal markets. Credit risk for lending activities is managed through standardized loan policies, established and authorized credit limits, centralized portfolio management and the diversification of market area and industries. The overall strength of the borrower is evaluated through the credit underwriting process and includes a variety of analytical activities, including the review of historical and projected cash flows, historical financial performance, financial strength of the principals and guarantors, and collateral values, where applicable.

Commercial lending activities include equipment and leasehold improvement financing for franchisees, principally quick service and casual dining restaurants. The underwriting of these loans incorporates basic credit proficiencies combined with knowledge of select franchise concepts to measure the creditworthiness of proposed multi-unit borrowers. The focus is on a limited number of concepts that have sound economics, lower closure rates, and brand awareness within specified local, regional, or national markets. Loan terms for equipment are generally up to 84 months fully amortizing and up to 180 months on real estate related requests.

Commercial real estate loans are secured by a mortgage lien on the real property. The credit underwriting for both owner-occupied and investor income producing real estate loans includes detailed market analysis, historical and projected cash flow analysis, appropriate equity margins, assessment of lessees and lessors, type of real estate and other analysis. Risk of loss is managed by adherence to standard loan policies that establish certain levels of performance prior to the extension of a loan to the borrower. Market diversification within First Financial's service area, as well as a diversification by industry, are other means by which the risk of loss is managed by First Financial. First Financial does not have a significant exposure to residential builders and developers.

The majority of residential real estate loans originated by the Bank conform to secondary market underwriting standards and are sold within a short timeframe to unaffiliated third parties. The Bank generally does not retain servicing rights to the loans. The credit underwriting standards adhere to a certain level of documentation,

verifications, valuation, and overall credit performance of the borrower. The underwriting of these loans includes an evaluation of these and other pertinent factors prior to the extension of credit. These underwriting standards help in the management of the credit risk elements and increase the marketability of the loans.

Consumer loans are primarily loans made to individuals. These types of loans include new and used vehicle loans, second mortgages on residential real estate, and unsecured loans. Risk elements in the consumer loan portfolio are primarily focused on the borrower's cash flow and credit history, which are key indicators of the ability to repay. A certain level of security is provided through liens on automobile titles and second mortgage liens, where applicable. Consumer loans are generally smaller dollar amounts than other types of lending and are made to a large number of customers. Both factors help provide diversification within the portfolio. Economic conditions that affect consumers in First Financial's markets have a direct

TABLE OF CONTENTS

impact on the credit quality of these loans. Higher levels of unemployment, lower levels of income growth and weaker economic growth are factors that may adversely impact consumer loan credit quality.

Home equity lines of credit consist mainly of revolving lines of credit secured by residential real estate. Home equity lines of credit are generally governed by the same lending policies and subject to the same credit risk as described previously for residential real estate loans.

First Financial has minimal foreign currency transactions and, in general, does not have a significant exposure to foreign currencies. Foreign currency activities are generally related to services provided to commercial customers. Information regarding statistical disclosure required by the Securities and Exchange Commission's Industry Guide 3 is included in First Financial's Annual Report to Shareholders for the year ended December 31, 2013, and is incorporated herein by reference.

First Financial's executive office is located at 255 East Fifth Street, Suite 700, Cincinnati, Ohio 45202, and the telephone number is (877) 322-9530. First Financial makes available, free of charge, its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports, as soon as reasonably practicable after filing with the Securities and Exchange Commission (SEC), through its website, www.bankatfirst.com under the "Investor Information" link, under "SEC Filings." Copies of such reports also can be found on the SEC's website at www.sec.gov.

Employees

At December 31, 2013, First Financial and its subsidiaries had 1,422 full-time and part-time employees.

Subsidiaries

A listing of each of First Financial's subsidiaries can be found in Exhibit 21 to this Form 10-K.

Business Combinations

During the third quarter of 2009, through Federal Deposit Insurance Corporation (FDIC)-assisted transactions, First Financial acquired the banking operations of Peoples Community Bank (Peoples), Irwin Union Bank and Trust Company (Irwin Union Bank) and Irwin Union Bank, F.S.B. (Irwin FSB) (Irwin Union Bank and Irwin FSB, collectively, Irwin). Prior to the FDIC-assisted transactions, the Company also acquired three Indiana banking centers including related deposits and loans, from Irwin in a separate and unrelated transaction. The acquisitions of the Peoples and Irwin franchises significantly expanded the First Financial footprint, opened new markets and strengthened the Company through the generation of additional capital.

In connection with the Peoples and Irwin FDIC-assisted transactions, First Financial entered into loss sharing agreements with the FDIC. Under the terms of these agreements the FDIC will reimburse First Financial for losses with respect to certain loans (covered loans) and other real estate owned (covered OREO) (collectively, covered assets), beginning with the first dollar of loss. Covered loans represent approximately 12% of First Financial's loans at December 31, 2013. These agreements provide for loss protection on single-family, residential loans for a period of ten years and First Financial is required to share any recoveries of previously charged-off amounts for the same time period, on the same pro-rata basis with the FDIC. All other loans are provided loss protection for a period of five years and recoveries of previously charged-off loans must be shared with the FDIC for a period of eight years, again on the same pro-rata basis.

First Financial must follow specific servicing and resolution procedures, as outlined in the loss sharing agreements, in order to receive reimbursement from the FDIC for losses on covered assets. The Company has established separate and dedicated teams of finance, credit and technology staff to execute and monitor all activity related to each agreement, including the required periodic reporting to the FDIC. First Financial services all covered assets with the same resolution practices and diligence as it does for the assets that are not subject to a loss sharing agreement.

On December 17, 2013, First Financial and the Bank entered into an Agreement and Plan of Merger with The First Bexley Bank, an Ohio state-chartered commercial bank (“First Bexley”), pursuant to which First Bexley will merge with and into the Bank (the “First Bexley Merger”). First Bexley’s shareholders will be entitled to receive merger consideration equal to \$30.50 for each common share of First Bexley consisting of \$24.40 in common shares of First Financial and \$6.10 in cash, subject to certain adjustments depending upon changes in the price of First Financial’s common shares. Closing of the First Bexley Merger, which is anticipated to occur in the second quarter of 2014, is subject to customary conditions, including, among others, approval of the Agreement and Plan of Merger by First Bexley’s shareholders, receipt of required regulatory approvals and effectiveness of a registration statement to be filed by First Financial with the Securities and Exchange Commission (“SEC”), and approval for listing on the NASDAQ, with respect to the common shares to be issued in the Bexley Merger.

TABLE OF CONTENTS

On December 19, 2013, First Financial and the Bank entered into an Agreement and Plan of Merger with Insight Bank, an Ohio state-chartered commercial bank (“Insight”), pursuant to which Insight will merge with and into the Bank (the “Insight Merger”). Insight’s shareholders will be entitled to receive merger consideration equal to \$20.50 for each common share of Insight, 80% of which (\$16.40) will be paid in common shares of First Financial and 20% of which (\$4.10) will be paid in cash, subject to adjustment depending upon changes in the price of First Financial’s common shares. Closing of the Insight Merger, which is anticipated to occur in the second quarter of 2014, is subject to customary conditions, including, among others, approval of the Agreement and Plan of Merger by Insight’s shareholders, receipt of required regulatory approvals and effectiveness of a registration statement to be filed by First Financial with the SEC, and approval for listing on the NASDAQ, with respect to the common shares to be issued in the Insight Merger.

Market and Competitive Information

First Financial, through the regionalization efforts and business model of the Bank, delivers a community banking philosophy to its clients. First Financial currently serves a combination of metropolitan and non-metropolitan markets primarily in Indiana, Ohio, and Kentucky through its full-service banking centers. Market selection is based upon a number of factors, but markets are primarily chosen for their potential for growth, long-term profitability, and customer reach. First Financial’s goal is to develop a competitive advantage through a local market focus, building long-term relationships with clients and helping them reach greater levels of financial success.

We also compete on a nationwide basis with respect to franchisee lending through our franchise finance subsidiary, First Franchise Capital.

The Company’s markets support many different types of business activities, such as manufacturing, agriculture, education, healthcare, and professional services. Within these markets, growth is projected to continue in key demographic groups and populations. First Financial’s market evaluation includes demographic measures such as income levels, median household income, and population growth within key segments. The Midwest markets that First Financial serves have historically not experienced the level of economic highs and lows seen in other sections of the country. Its markets are generally marked by less volatility in business activity, although material fluctuations may occur. In recent years, the overall national economy was negatively impacted by the deterioration of the sub-prime lending market, which quickly developed into a credit and liquidity crisis in other sectors of the financial services industry. This resulted in the implementation of a number of government sponsored programs designed to invest capital and liquidity into the financial services sector for the purposes of strengthening consumer confidence and stimulating lending activity. However, First Financial’s strong liquidity and capital position, combined with conservative lending practices, have allowed the Company, to this point, to significantly mitigate macro-economic risk.

First Financial believes that it is well positioned to compete in these markets. Smaller than super-regional and multi-national bank holding companies, First Financial believes that it can meet the needs of its markets through a decision-making network of local management. First Financial believes that it is better positioned to compete for business than other smaller banks that may have size or geographic limitations. First Financial’s targeted customers include individuals and small to medium sized businesses within the geographic region of the Bank’s banking center network. Through the delivery systems of banking centers, ATMs, internet banking, and telephone-based transactions, First Financial meets the needs of its customers in an ever-changing marketplace.

First Financial faces strong competition from financial institutions and other non-financial organizations. Its competitors include local and regional financial institutions, savings and loans, and bank holding companies, as well as some of the largest banking organizations in the United States. In addition, other types of financial institutions,

such as credit unions, offer a wide range of loan and deposit services that are competitive with those offered by First Financial. The consumer is also served by brokerage firms and mutual funds that provide checking services, credit cards, and other services similar to those offered by First Financial. Major stores compete for loans by offering credit cards and retail installment contracts. It is anticipated that competition from other financial and non-financial services entities will continue and, for certain products and services, intensify.

Supervision and Regulation

We, our subsidiary bank, and its subsidiaries, are subject to an extensive system of laws and regulations that are intended primarily for the protection of customers and depositors and not for the protection of security holders. These laws and regulations govern such areas as capital, permissible activities, allowance for loan losses, loans and investments, and rates of

TABLE OF CONTENTS

interest that can be charged on loans. Described below are elements of selected laws and regulations. The descriptions are not intended to be complete and are qualified in their entirety by reference to the full text of the statutes and regulations described.

Bank Holding Company Regulation

We are subject to the provisions of the Bank Holding Company Act of 1956, as amended (the BHCA) and subject to supervision and examination by the Federal Reserve Board. The BHCA requires prior approval by the Federal Reserve Board of the acquisition of 5% or more of the voting stock or substantially all the assets of any bank within the United States. In addition, subject to regulatory approval, First Financial can acquire thrift institutions. Acquisitions are subject to certain anti-competitive limitations.

The BHCA and the regulations of the Federal Reserve Board prohibit a bank holding company and its subsidiaries from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services. The BHCA also imposes certain restrictions upon dealings by affiliated banks with the holding company and among themselves, including restrictions on inter-bank borrowing and upon dealings in the securities or obligations of the holding company or other affiliates.

In addition, bank holding companies that satisfy certain requirements may elect to become financial holding companies. Financial holding companies are permitted to engage in certain activities that are “financial in nature” (e.g. insurance underwriting, securities brokerage, merchant banking) and that are not permitted for bank holding companies. First Financial’s current strategic plans do not include utilizing these expanded activities and as a result it has not elected to become a financial holding company.

The Federal Reserve Board also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, issue cease and desist or removal orders, and require that a bank holding company divest subsidiaries (including a subsidiary bank). In general, the Federal Reserve Board may initiate enforcement actions for violations of laws and regulations and unsafe or unsound practices. Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each subsidiary bank and to commit resources to support such subsidiary bank. Under this policy, the Federal Reserve Board may require a bank holding company to contribute additional capital to an undercapitalized subsidiary bank and may disapprove of the payment of dividends to the shareholders if the Federal Reserve Board believes the payment of such dividends would be an unsafe or unsound practice.

Depository Institution Regulation

The Bank, as a national banking association, is subject to supervision and regular examination by the Office of the Comptroller of the Currency (OCC). All depository institutions and their deposits are insured up to the legal limits by the Deposit Insurance Fund (DIF) which is administered by the FDIC and is subject to the provisions of the Federal Deposit Insurance Act (FDIA).

Insurance of Accounts

The FDIC currently maintains the DIF, which was created in 2006 in the merger of the Bank Insurance Fund and the Savings Association Insurance Fund. The deposit accounts of our subsidiary bank are insured by the DIF to the maximum amount provided by law. The general insurance limit is \$250,000. This insurance is backed by the full faith and credit of the United States Government.

As insurer, the FDIC is authorized to conduct examinations of and to require reporting by DIF-insured institutions. It also may prohibit any DIF-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the DIF. The FDIC also has the authority to take enforcement actions against insured institutions.

The FDIC assesses deposit insurance premiums on each insured institution quarterly based on annualized rates for one of four risk categories. Each institution is assigned to one of four risk categories based on its capital, supervisory ratings and other factors. Well capitalized institutions that are financially sound with only a few minor weaknesses are assigned to Risk Category I. Risk Categories II, III and IV present progressively greater risks to the DIF. The Bank currently is in Risk Category I.

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the FDIC adopted rules, under which insurance premium assessments are based on an institution's quarterly average total assets minus its quarterly average tangible equity (defined as Tier 1 capital) instead of its deposits. Under these rules, an institution with total assets of less than \$10 billion is assigned to a Risk Category as described above, and a range of initial base assessment rates applies to

TABLE OF CONTENTS

each category, subject to adjustment downward based on unsecured debt issued by the institution and, except for an institution in Risk Category I, adjustment upward if the institution's brokered deposits exceed 10% of its domestic deposits, to produce total base assessment rates. All base assessment rates are subject to further adjustment upward if the institution holds more than a de minimis amount of unsecured debt issued by another FDIC-insured institution. The FDIC may increase or decrease its rates by 2.0 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize a predecessor to the Deposit Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2019.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged or is engaging in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement entered into with the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

On November 12, 2009, the FDIC adopted regulations that required insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and all of 2010, 2011 and 2012, along with their quarterly risk-based assessment for the fourth quarter of 2009. The FDIC collected the Bank's prepaid assessments amounting to \$17.0 million on December 30, 2009. First Financial Bank had no remaining prepaid FDIC assessments at December 31, 2013.

Pursuant to the Dodd-Frank Act, the FDIC has established 2.0% as the designated reserve ratio (DRR), that is, the ratio of the DIF to insured deposits of the total industry. The FDIC has adopted a plan under which it will meet the statutory minimum DRR of 1.35% by September 30, 2020, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than \$10 billion of the increase in the statutory minimum DRR to 1.35% from the former statutory minimum of 1.15%. The FDIC has not yet announced how it will implement this offset or how larger institutions will be affected by it.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA), every FDIC-insured institution is obligated, consistent with safe and sound banking practices, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA requires the appropriate federal banking regulator, in connection with the examination of an insured institution, to assess the institution's record of meeting the credit needs of its community and to consider this record in its evaluation of certain applications, such as a merger or the establishment of a branch. An unsatisfactory rating may be used as the basis for the denial of an application and will prevent a bank holding company of the institution from making an election to become a financial holding company. As of its last examination, the Bank received a Community Reinvestment Act rating of "satisfactory."

Privacy Rules

Federal banking regulators, as required under the Gramm-Leach-Bliley Act, have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to non-affiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to non-affiliated third parties. The privacy provisions of the Gramm-Leach-Bliley Act affect how consumer information is transmitted through diversified financial services

companies and conveyed to outside vendors.

Fiscal and Monetary Policies

The earnings of banks, and, therefore, the earnings of First Financial (and its subsidiaries), are affected by the fiscal and monetary policies of the United States government and its agencies, including the Federal Reserve Board. An important function of the Federal Reserve Board is to regulate the national supply of bank credit in an effort to prevent recession and to restrain inflation. Among the procedures used to implement these objectives are open market operations in U.S. Government securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements on member bank deposits. These policies are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits.

TABLE OF CONTENTS

Limits on Dividends and Other Payments

There are various legal limitations on the extent to which a subsidiary bank may finance or otherwise supply funds to its parent holding company. Under applicable federal and state laws, a subsidiary bank may not, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, its bank holding company. A subsidiary bank is also subject to collateral security requirements for any loan or extension of credit permitted by such exceptions. The Bank may not pay dividends out of its surplus if, after paying these dividends, it would fail to meet the required minimum levels under the risk-based capital guidelines and minimum leverage ratio requirements established by the OCC. In addition, the Bank must have the approval of the OCC if a dividend in any year would cause the total dividends for that year to exceed the sum of the Bank's current year's net income and the retained net income for the preceding two years, less required transfers to surplus. Payment of dividends by the Bank may be restricted at any time at the discretion of its regulatory authorities, if such regulatory authorities deem such dividends to constitute unsafe and/or unsound banking practices or if necessary to maintain adequate capital.

The ability of First Financial to obtain funds for the payment of dividends and for other cash requirements is largely dependent on the amount of dividends which may be declared by the Bank. However, because the Federal Reserve Board expects us to serve as a source of strength to the Bank, as discussed above, payment of dividends by the Bank may be restricted at any time at the discretion of the OCC if the OCC deems such dividends to constitute an unsafe and/or unsound banking practice. These provisions could have the effect of limiting our ability to pay dividends on our shares.

The Federal Reserve Board has issued a policy statement with regard to the payment of cash dividends by bank holding companies. The policy statement provides that, as a matter of prudent banking, a bank holding company should not maintain a rate of cash dividends unless its net income available to common shareholders has been sufficient to fully fund the dividends, and the prospective rate of earnings retention appears to be consistent with the bank holding company's capital needs, asset quality, and overall financial condition. Accordingly, a bank holding company should not pay cash dividends that exceed its net income or can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act, implementing far-reaching changes to the regulation of the financial services industry, was signed into law in 2010. The Dodd-Frank Act requires various federal agencies to adopt a broad range of regulations with significant discretion. Although some of the regulations have been adopted, many still have not, and the effect they will have on us and our subsidiaries cannot currently be known. Among the provisions already implemented that have or may have an effect on us or its subsidiaries are the following:

- the Consumer Financial Protection Bureau has been formed with broad powers to adopt and enforce consumer protection regulations that would apply to all banks and thrifts. Smaller financial institutions, including the Bank, will be subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws;

• the federal law prohibiting the payment of interest on commercial demand deposit accounts was eliminated effective July 21, 2011;

• the standard maximum amount of deposit insurance per customer was permanently increased to \$250,000;

•

the assessment base for determining deposit insurance premiums has been expanded from domestic deposits to average assets minus average tangible equity;

public companies in all industries are now required to provide shareholders the opportunity to cast a non-binding advisory vote on executive compensation;

- the Federal Reserve Board has imposed on financial institutions with assets of \$10 billion or more a cap on the debit card interchange fees the financial institutions may charge. Although the cap is not applicable to the Bank, it may have an adverse effect on the Bank as the debit cards issued by the Bank and other smaller banks, which have higher interchange fees, may become less competitive; and

new capital regulations for bank holding companies, which impose stricter requirements, and trust preferred securities issued after May 19, 2010 will no longer constitute Tier 1 capital.

TABLE OF CONTENTS

Additionally, new corporate governance requirements applicable generally to all public companies in all industries will require other new compensation practices and disclosure requirements, including requiring companies to “claw back” incentive compensation under certain circumstances, to consider the independence of compensation advisors and to make additional disclosures in proxy statements with respect to compensation matters.

Many aspects of the act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on First Financial, its customers or the financial industry more generally. Provisions in the legislation that affect deposit insurance assessments and payment of interest on demand deposits could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

Regulatory Capital

The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies, and the OCC has adopted risk-based capital guidelines for national banks. Capital levels as measured by these standards are used, among other reasons, to categorize financial institutions for purposes of certain prompt corrective action regulatory provisions. The minimum guideline for the ratio of total capital to risk-weighted assets (including certain off-balance sheet items such as standby letters of credit) is 8%. At least half of the minimum total risk-based capital ratio (4%) must be composed of common shareholders’ equity, minority interests in certain equity accounts of consolidated subsidiaries and a limited amount of qualifying preferred stock and qualified trust preferred securities, less goodwill and certain other intangible assets, including the unrealized net gains and losses, after applicable taxes, on available-for-sale securities carried at fair value (commonly known as Tier 1 risk-based capital). The remainder of total risk-based capital (commonly known as Tier 2 risk-based capital) may consist of certain types and amounts of each of hybrid capital instruments, mandatory convertible debt, subordinated debt, preferred stock not qualifying as Tier 1 capital, allowance for loan losses, and net unrealized gains on available-for-sale equity securities. Under the guidelines, capital is compared to the relative risk related to the balance sheet. To derive the risk included in the balance sheet, one of four risk weights (0%, 20%, 50% and 100%) is applied to different balance sheet and off-balance sheet assets, primarily based on the relative credit risk of the counterparty. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Federal Reserve Board has established minimum leverage ratio guidelines for bank holding companies. The Federal Reserve Board guidelines provide for a minimum ratio of Tier 1 capital to average assets (excluding the allowance for loan losses, goodwill and certain other intangibles), or “leverage ratio,” of 3% for bank holding companies that meet certain criteria, including having the highest regulatory rating, and 4% for all other bank holding companies. The guidelines further provide that bank holding companies making acquisitions will be expected to maintain strong capital positions substantially above the minimum levels. The OCC has also adopted minimum leverage ratio guidelines for national banks.

The federal banking agencies have established a system of prompt corrective action to resolve certain of the problems of undercapitalized institutions. This system is based on five capital level categories for insured depository institutions: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.” The federal banking agencies may (or in some cases must) take certain supervisory actions depending upon a bank’s capital level. For example, the banking agencies must appoint a receiver or conservator for a bank within 90 days after it becomes “critically undercapitalized” unless the bank’s primary regulator determines, with the concurrence of the FDIC, that other action would better achieve regulatory purposes. Banking operations otherwise may be significantly affected depending on a bank’s capital category. For example, a bank that is not “well capitalized” generally is prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market, and the holding company of any undercapitalized depository institution must guarantee, in part, specific aspects of the bank’s capital plan for the plan to be acceptable.

In order to be “well-capitalized” under current capital requirements, a bank must have total risk-based capital of at least 10%, Tier 1 risk-based capital of at least 6% and a leverage ratio of at least 5%, and the bank must not be subject to any written agreement, order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. Our management believes that both First Financial and the Bank meet the requirements to be deemed “well-capitalized” according to the guidelines described above.

The risk-based capital guidelines currently in effect are based on the “International Convergence of Capital Measurement and Capital Standards” (Basel I), published by the Basel Committee on Banking Supervision in 1988. In July 2013, the United States adopted what is commonly known as “Basel III” and banking regulators issued final rules applicable to smaller banks, such as us.

TABLE OF CONTENTS

Among the most significant changes, the new rules:

- Establish new minimum capital requirements which retain the current minimum total capital ratio of 8.0%, but increase the minimum Tier 1 risk-based capital ratio from 4% to 6%;

- Establish a new minimum common equity Tier 1 capital ratio of 4.5%, and specify the criteria to determine what constitutes common equity Tier 1 capital;

- Establish a new capital conservation buffer requiring banks to hold an additional 2.5% of common equity Tier 1 capital in excess of the minimum, and restrict the payments of dividends and distributions and certain bonus payments to executives if capital ratios fall below the buffer amount;

- Retain the minimum leverage ratio of 4%;

- Establish stricter eligibility requirements for capital instruments;

- Replace the external credit ratings approach to standards of creditworthiness with a simplified supervisory formula approach;

- Establish stricter limitations on the extent to which deferred tax assets, mortgage servicing assets and significant investments in unconsolidated financial institutions may be included in Tier 1 capital; and

- Increase risk weights for past-due loans and loan commitments, certain commercial real estate loans and selected other changes in risk weights.

We will begin transitioning to the new rules on January 1, 2015. The new minimum capital requirements are effective January 1, 2015, whereas other capital requirements, such as the capital conservation buffer, phase in through January 1, 2019. First Financial expects to be in compliance with these requirements as they become applicable.

Executive and Incentive Compensation

In June 2010, the Federal Reserve Board, the OCC and the FDIC issued joint interagency guidance on incentive compensation policies (the Joint Guidance) 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. This principles-based 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