OLD SECOND BANCORP INC
Form 10-K
March 20, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from to

Commission file number 0-10537

OLD SECOND BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-3143493**
(State of Incorporation)	(IRS Employer Identification Number)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices, including zip code)

(630) 892-0202

(Registrant s telephone number, including Area Code)

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

Title of Class	**Name of each exchange on which registered**
Common Stock, $1.00 par value	The Nasdaq Stock Market
Preferred Securities of Old Second Capital Trust I	The Nasdaq Stock Market

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

Preferred Share Purchase Rights

(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 o No x

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

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

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 x No o

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

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, on June 30, 2012, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $17.3 million. The number of shares outstanding of the registrant s common stock, par value $1.00 per share, was 14,120,918 at March 12, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders are incorporated by reference into Part III.

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PART I

Item 1. Business

General

Old Second Bancorp, Inc. (the Company or the Registrant) was organized under the laws of Delaware on September 8, 1981. It is a registered bank holding company under the Bank Holding Company Act of 1956 (the BHCA). The Company s office is located at 37 South River Street, Aurora, Illinois 60507.

The Company conducts a full service community banking and trust business through its wholly owned subsidiaries, which together with the Registrant are referred to as the Company :

- Old Second National Bank (the Bank).
- Old Second Capital Trust I, which was formed for the exclusive purpose of issuing trust preferred securities in an offering that was completed in July 2003.
- Old Second Capital Trust II, which was formed for the exclusive purpose of issuing trust preferred securities in an offering that was completed in April 2007.
- Old Second Affordable Housing Fund, L.L.C., which was formed for the purpose of providing down payment assistance for home ownership to qualified individuals.
- Station I, LLC, a wholly owned subsidiary of Old Second National Bank, which was formed in August 2008 to hold property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.
- Station II, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in August 2008 but not activated until February 2010, to hold additional property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.
- Station III, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in February 2011 but not activated until January 2012, to hold additional property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.
- Station IV, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in February 2011 but not activated until September 2012, to hold additional property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.

- Station V, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in December 2012 but not yet activated, to hold additional property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.

- Station VI, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in December 2012 but not yet activated, to hold additional property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.

- Station VII, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in December 2012 but not yet activated, to hold additional property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with a borrower.

- River Street Advisors, LLC, a wholly-owned subsidiary of Old Second National Bank, which was formed in May 2010 to provide investment advisory/management services.

Inter-company transactions and balances are eliminated in consolidation. The Company provides financial services through its 27 banking locations that are located throughout the Chicago metropolitan area. These locations included retail offices located in Cook, Kane, Kendall, DeKalb, DuPage, LaSalle,

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and Will counties in Illinois as of December 31, 2012. The Company expanded its franchise from long standing offices in the western suburbs into Cook County and traditionally growing southern Chicago suburbs with an acquisition in February 2008.

Business of the Company and its Subsidiaries

The Bank s full service banking businesses include the customary consumer and commercial products and services that banks provide including demand, NOW, money market, savings, time deposit, individual retirement and Keogh deposit accounts; commercial, industrial, consumer and real estate lending, including installment loans, student loans, agricultural loans, lines of credit and overdraft checking; safe deposit operations; trust services; wealth management services, and an extensive variety of additional services tailored to the needs of individual customers, such as the acquisition of U.S. Treasury notes and bonds, the sale of traveler s checks, money orders, cashier s checks and foreign currency, direct deposit, discount brokerage, debit cards, credit cards, and other special services. The Bank also offers a full complement of electronic banking services such as Internet banking and corporate cash management products including remote deposit capture, mobile deposit capture, investment sweep accounts, zero balance accounts, automated tax payments, ATM access, telephone banking, lockbox accounts, automated clearing house transactions, account reconciliation, controlled disbursement, detail and general information reporting, wire transfers, vault services for currency and coin, and checking accounts. Commercial and consumer loans are made to corporations, partnerships and individuals, primarily on a secured basis. Commercial lending focuses on business, capital, construction, inventory and real estate lending. Installment lending includes direct and indirect loans to consumers and commercial customers. Additionally, the Bank provides a wide range of wealth management, investment, agency, and custodial services for individual, corporate, and not-for-profit clients. These services include the administration of estates and personal trusts, as well as the management of investment accounts for individuals, employee benefit plans, and charitable foundations. The Bank also originates residential mortgages, offering a wide range of mortgage products including conventional, government, and jumbo loans. Secondary marketing of those mortgages is also handled at the Bank.

Operating segments are components of a business about which separate financial information is available and that are evaluated regularly by the Company s management in deciding how to allocate resources and assess performance. Public companies are required to report certain financial information about operating segments. The Company s management evaluates the operations of the Company as one operating segment, i.e. community banking. As a result, disclosure of separate segment information is not required. The Company offers the products and services described above to its external customers as part of its customary banking business.

Market Area

The Bank is the principal operating subsidiary of the Company. The Bank s primary market area is Aurora, Illinois, and its surrounding communities as well as southwestern Cook County. The city of Aurora is located in northeastern Illinois, approximately 40 miles west of Chicago. Aurora is strategically situated on U.S. Interstate 88 and is centrally located near our banking offices in Kane, Kendall, DeKalb, DuPage, LaSalle, and Will counties in Illinois. Based upon the most recent 2010 U.S. census estimates, these 6 counties together represent a market of more than 2.4 million people. Likewise, the City of Aurora has a reported population of 197,899 residents per 2010 U.S. census data. Aurora is the second largest city in the State of Illinois and is located primarily in Kane County but also areas of DuPage, Will and Kendall counties. Aurora has also experienced heavy growth as its population increased approximately 38% from the 2000 to 2010, according to U.S. census data.

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Lending Activities

In 2009, the Company received an investment from the U.S. Department of Treasury (the Treasury) through the TARP Capital Purchase Program (the CPP). While the Company remains committed to using these funds to enable the Bank to continue to make loans to qualified borrowers in its market area, to date management of capital and continuing improvement in asset quality has been paramount ahead of loan growth . The Bank continued throughout 2012 to emphasize management of capital and asset quality over generating loan growth. In addition, management intends to reduce its portfolio concentrations in real estate in keeping with the requirements of the Consent Order between the Bank and the Office of the Comptroller of the Currency (the OCC) as described in the Supervision and Regulation section and provided in Note 15 Regulatory & Capital Matters to the Consolidated Financial Statements. In 2012, the Bank originated approximately $451.2 million in loans, which included residential mortgage loans of just over $303.6 million that were subsequently sold to investors.

General. The Bank provides a broad range of commercial and retail lending services to corporations, partnerships, individuals and government agencies. The Bank actively markets its services to qualified borrowers. Lending officers actively solicit the business of new borrowers entering our market areas as well as long-standing members of the local business community. The Bank has established lending policies that include a number of underwriting factors to be considered in making a loan, including location, amortization, loan to value ratio, cash flow, pricing, documentation and the credit history of the borrower. The Bank s loan portfolios are comprised primarily of loans in the areas of commercial real estate, residential real estate, construction, general commercial and consumer lending. As of December 31, 2012, residential mortgages made up approximately 36% of the Bank s loan portfolio, commercial real estate loans comprised approximately 50%, construction lending comprised approximately 4%, general commercial loans comprised approximately 8%, and consumer and other lending comprised less than 2%. It is the Bank s policy to comply at all times with the various consumer protection laws and regulations including, but not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act, the Truth in Lending Act, and the Home Mortgage Disclosure Act. The Bank does not discriminate in application procedures, loan availability, pricing, structure, or terms on the basis of race, color, religion, national origin, sex, marital status, familial status, handicap, age (provided the applicant has the legal capacity to enter into a binding contract), whether income is derived from public assistance, whether a borrower resides, or his property is located, in a low- or moderate-income area, or whether a right was exercised under the Consumer Credit Protection Act. The Bank strives to offer all of its credit services throughout its market area, including low- and moderate-income areas.

Commercial Loans. As noted above, the Bank is an active commercial lender, primarily located west and south of the Chicago metropolitan area and active in other parts of the Chicago and Aurora metropolitan areas. The Bank s areas of emphasis include loans to wholesalers, manufacturers, business services companies, professionals, and retailers. The Bank provides a wide range of business loans, including lines of credit for working capital and operational purposes and term loans for the acquisition of equipment and other purposes. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. In addition, the Bank may take personal guarantees to help assure repayment. Loans may be made on an unsecured basis if warranted by the overall financial condition of the borrower. Commercial lines of credit are generally for one year and have floating rates. Commercial term loans range principally from one to eight years with the majority falling in the one to five year range. Interest rates are primarily fixed although some have interest rates that change based on the prime rate or LIBOR. While management would like to continue to diversify the loan portfolio, overall demand for working capital and equipment financing continued to be muted in our primary market area in 2012. Repayment of commercial loans is largely dependent upon the cash flows generated by the operations of the commercial enterprise. The Bank s underwriting procedures identify the sources of those cash flows and seek to match the repayment terms of the commercial loans to the sources. Secondary repayment sources are typically found in collateralization and guarantor support.

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Commercial Real Estate Loans. While management has been actively working to reduce the Bank s concentrations in real estate loans, including commercial real estate loans, a large portion of the loan portfolio continues to be comprised of commercial real estate loans. As of December 31, 2012, approximately $288.2 million, or 49.7%, of the total commercial real estate loan portfolio of $580.0 million was to owner occupied borrowers. A primary repayment risk for a commercial real estate loan is interruption or discontinuance of cash flows from operations. Such cash flows are usually derived from rent in the case of nonowner occupied commercial properties. Repayment could also be influenced by economic events, which may or may not be under the control of the borrower, or changes in governmental regulations that negatively impact the future cash flow and market values of the affected properties. With the exception of owner-occupied, multi-family apartments and select investor properties (including medical related) the Bank is not focused on initiating new commercial real estate loans at this time. Repayment risk can also arise from general downward shifts in the valuations of classes of properties over a given geographic area such as the price adjustments that have been observed by the Company beginning in 2008. Property valuations could continue to be affected by changes in demand and other economic factors, which could further influence cash flows associated with the borrower and/or the property. The Bank attempts to mitigate these risks through staying apprised of market conditions and by maintaining underwriting practices that provide for adequate cash flow margins and multiple repayment sources as well as remaining in regular contact with the borrowers. In most cases, the Bank has collateralized these loans and/or has taken personal guarantees to help assure repayment. Commercial real estate loans are primarily made based on the identified cash flow of the borrower and/or the property at origination and secondarily on the underlying real estate acting as collateral. Additional credit support is provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the real estate and enforcement of a personal guarantee, if any exists.

Construction Loans. The Bank is not actively seeking construction loans at this time, with the exception of existing borrowers whose businesses are expanding. Construction lending is very limited in the current economic environment, as such loans in this category decreased from $71.4 million at December 31, 2011 to $42.2 million at December 31, 2012. The Bank uses underwriting and construction loan guidelines to determine whether to issue loans to reputable contractors. Construction loans are structured most often to be converted to permanent loans at the end of the construction phase or, infrequently, to be paid off upon receiving financing from another financial institution. Construction loans are generally limited to our local market area. Lending decisions have been based on the appraised value of the property as determined by an independent appraiser, an analysis of the potential marketability and profitability of the project and identification of a cash flow source to service the permanent loan or verification of a refinancing source. Construction loans generally have terms of up to 12 months, with extensions as needed. The Bank disburses loan proceeds in increments as construction progresses and as inspections warrant.

Construction development loans involve additional risks and the Bank is not actively seeking any new development loans at this time because of the ongoing economic environment. Development lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. This generally involves more risk than other lending because it is based on future estimates of value and economic circumstances. While appraisals are required prior to funding, and loan advances are limited to the value determined by the appraisal, there is the possibility of an unforeseen event affecting the value and/or costs of the project. Development loans are primarily used for single-family developments, where the sale of lots and houses are tied to customer preferences and interest rates. If the borrower defaults prior to completion of the project, the Bank may be required to fund additional amounts so that another developer can complete the project. The Bank is located in an area where a large amount of development activity has occurred as rural and semi-rural areas are being suburbanized. This type of growth presents

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some economic risks should the shift in local demand for housing that occurred in conjunction with recent economic conditions become permanent. The Bank addresses these risks by closely monitoring local real estate activity, adhering to proper underwriting procedures, closely monitoring construction projects, and limiting the amount of construction development lending.

Activity in this sector slowed considerably with the downward economic trends in real estate and other markets that the Company and the U.S. economy have experienced since 2008. Very few construction loans were made in 2011 and 2012 compared to years prior to 2009 due to the unfavorable economic environment for new home sales.

Residential Real Estate Loans. Residential first mortgage loans, second mortgages, and home equity line of credit mortgages are included in this category. First mortgage loans may include fixed rate loans that are generally sold to investors. The Bank is a direct seller to the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and to several large financial institutions. The Bank periodically retains servicing rights for sold mortgages. The periodic retention of such servicing rights also allows the Bank an opportunity to have regular contact with mortgage customers and can help to solidify community involvement. Other loans that are not sold include adjustable rate mortgages, lot loans, and constructions loans that are held in portfolio by the Bank. Home equity lending has continued to slow in the past year but is still a significant portion of the Bank s business.

Consumer Loans. The Bank also provides many types of consumer loans including motor vehicle, home improvement, signature loans and small personal credit lines. Consumer loans typically have shorter terms and lower balances with higher yields as compared to other loans but generally carry higher risks of default. Consumer loan collections are dependent on the borrower s continuing financial stability and thus are more likely to be affected by adverse personal circumstances.

Competition

The Company s market area is highly competitive, and the Bank s lines of business and activities require us to compete with many other companies. A number of these financial institutions are affiliated with large bank holding companies headquartered outside of our principal market area as well as other institutions that are based in Aurora s surrounding communities and in Chicago, Illinois. All of these financial institutions operate banking offices in the greater Aurora area or actively compete for customers within the Company s market area. The Bank also faces competition from finance companies, insurance companies, credit unions, mortgage companies, securities brokerage firms, United States Government securities, money market funds, loan production offices and other providers of financial services. Many of our non-bank competitors are not subject to the same extensive federal regulations that govern bank holding companies and banks, such as the Company. Such non-bank competitors may, as a result, have certain advantages over us in providing some services.

The Bank competes for loans principally through the range and quality of the client service and responsiveness to client needs that it provides in addition to competing on interest rates and loan fees. Management believes that its long-standing presence in the community and personal one-on-one service philosophy enhances its ability to compete favorably in attracting and retaining individual and business customers. The Bank actively solicits deposit-related clients and competes for deposits by offering personal attention, competitive interest rates, and professional services made available through practiced bankers and multiple delivery channels that fit the needs of its market.

The Bank is subject to vigorous competition from other financial institutions in the market. The Bank operated 27 branches in the seven counties of Kane, Kendall, LaSalle, Will, DeKalb, DuPage, and

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southwestern Cook County as of December 31, 2012. As of June 30, 2012, the Bank was the deposit market leader in Kane and Kendall counties where it has a concentrated number of branches. In Kane and Kendall counties, the Bank faced competition from over 216 bank branches representing 43 different FDIC financial institutions per June 30, 2011 Federal Deposit Insurance Corporation (FDIC) share of deposit data. The Bank s branches in the remaining counties in which it operates face many of these same competitors as well as competition from other non-FDIC insured credit unions and financial service firms. Competition for residential mortgage lending also includes a number of mortgage brokerage operations as well as traditional banks, thrifts and credit unions. The Bank s wealth management division includes traditional trust services as well as investment advisory, brokerage, and employee benefit administration services. This diverse array of products and services allows us to compete against other larger banks as well as specialized brokerage companies. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services without having a physical presence in our market.

Employees

At December 31, 2012, the Company employed 481 full-time equivalent employees. The Company places a high priority on staff development, which involves extensive training, including customer service training. New employees are selected on the basis of both technical skills and customer service capabilities. None of the Company s employees are covered by a collective bargaining agreement with the Company.

Internet

The Company maintains a corporate web site at http://www.oldsecond.com. The Company makes available free of charge on or through its web site the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission (the SEC). Many of the Company s policies, committee charters and other investor information including our Code of Business Conduct and Ethics, are available on the web site. The Company s reports, proxy and informational statements and other information regarding the Company are available free of charge on the SEC s website (www.sec.gov). The Company will also provide copies of its filings free of charge upon written request to: J. Douglas Cheatham, Executive Vice President and Chief Financial Officer, Old Second Bancorp, Inc., 37 South River Street, Aurora, Illinois 60507.

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SUPERVISION AND REGULATION

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the OCC, the Board of Governors of the Federal Reserve System (the Federal Reserve), FDIC and the newly-created Bureau of Consumer Financial Protection (the CFPB). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (the FASB) and securities laws administered by the SEC and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to the operations and results of the Company and the Bank, and the nature and extent of future legislative, regulatory, or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation, and enforcement on the operations of financial institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These federal and state laws, and the regulations of the bank regulatory authorities issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends. In addition, substantial turmoil in the credit markets in past years prompted the enactment of unprecedented legislation that has allowed the Treasury to make equity capital available to qualifying financial institutions to help restore confidence and stability in the U.S. financial markets, which imposes additional requirements on institutions in which the Treasury invests.

In addition, the Company and the Bank are subject to regular examination by their respective regulatory authorities, which results in examination reports and ratings (that are not publicly available) that can impact the conduct and growth of business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory or regulatory provision.

Financial Regulatory Reform

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) into law. The Dodd-Frank Act represents a sweeping reform of the supervisory and regulatory framework applicable to financial institutions and capital

markets in the United States, certain aspects of which are described below in more detail. The Dodd-Frank Act creates new federal governmental entities responsible for overseeing different aspects of the U.S. financial services industry, including identifying emerging systemic risks. It also shifts certain authorities and responsibilities among federal financial institution regulators, including the supervision of holding company affiliates and the regulation of consumer financial services and products. In particular, and

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among other things, the Dodd-Frank Act: creates the CFPB, which is authorized to regulate providers of consumer credit, savings, payment and other consumer financial products and services; narrows the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expands the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; imposes more stringent capital requirements on bank holding companies and subjects certain activities, including interstate mergers and acquisitions, to heightened capital conditions; significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property; restricts the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater; requires the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5% of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards to be determined by regulation; creates a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; provides for enhanced regulation of advisers to private funds and of the derivatives markets; enhances oversight of credit rating agencies; and prohibits banking agency requirements tied to credit ratings.

Numerous provisions of the Dodd-Frank Act are required to be implemented through rulemaking by the appropriate federal regulatory agencies. Many of the required regulations have been issued and others have been released for public comment, but there remain a number that have yet to be released in any form. Furthermore, while the reforms primarily target systemically important financial service providers, their influence is expected to filter down in varying degrees to smaller institutions over time. Management of the Company and the Bank will continue to evaluate the effect of the changes; however, in many respects, the ultimate impact of the Dodd-Frank Act will not be fully known for years, and no current assurance may be given that the Dodd-Frank Act, or any other new legislative changes, will not have a negative impact on the results of operations and financial condition of the Company and the Bank.

The Increasing Regulatory Emphasis on Capital

The Company is subject to various regulatory capital requirements administered by the federal banking regulators noted above. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action (described below), the Company must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classifications are also subject to judgments by the regulators regarding qualitative components, risk weightings and other factors.

While capital has historically been one of the key measures of the financial health of both bank holding companies and depository institutions, its role is becoming fundamentally more important in the wake of the financial crisis, as the regulators have recognized that the amount and quality of capital held by banking organizations was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, will ultimately establish strengthened capital standards for banks and bank holding companies, will require more capital to be held in the form of common stock and will disallow certain funds from being included in capital determinations. Once fully implemented, these provisions will represent regulatory capital requirements that are meaningfully more stringent than those in place currently.

Company and Bank Required Capital Levels. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and were able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions. As a consequence, over a phase-in period of three years, the components of holding company permanent capital known as Tier 1 capital are being restricted to capital instruments that are considered to be Tier 1 capital for insured depository institutions.

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A result of this change is that the proceeds of trust preferred securities are being excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank holding companies with less than $15 billion of assets. Because the Company has assets of less than $15 billion, it is able to maintain its trust preferred proceeds as Tier 1 capital but will have to comply with new capital mandates in other respects, and will not be able to raise Tier 1 capital in the future through the issuance of trust preferred securities. In addition, the Basel III proposal, discussed below, includes a phase-out of trust preferred securities for all bank holding companies, including the Company.

Under current federal regulations, the Bank is subject to, and, after the phase-in period, the Company will be subject to, the following minimum capital standards:

- a leverage requirement, consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others, and

- a risk-based capital requirement, consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. For this purpose, Tier 1 capital consists primarily of common stock, noncumulative perpetual preferred stock and related surplus less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus Tier 2 capital, which includes other non-permanent capital items, such as certain other debt and equity instruments that do not qualify as Tier 1 capital, and a portion of the Bank s allowance for loan and lease losses.

The capital standards described above are minimum requirements. Federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is well-capitalized may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept brokered deposits. Under the capital regulations of the Federal Reserve, in order to be well-capitalized, a banking organization must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater. The Federal Reserve s 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 guidelines indicate that the Federal Reserve will continue to consider a tangible Tier 1 leverage ratio (deducting all intangibles) in evaluating proposals for expansion or to engage in new activity.

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

Prompt Corrective Action. A banking organization s capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators powers depends on whether the institution in question is adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized, in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution s asset growth and restricting its activities; (iii) requiring the institution to issue

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additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2012, the Bank exceeded its minimum regulatory capital requirements under OCC capital adequacy guidelines. However, as discussed under The Bank Enforcement Actions, the Bank has agreed with the OCC to maintain certain heightened regulatory capital ratios. As of December 31, 2012, the Bank exceeded the heightened regulatory capital ratios to which it had agreed. As of December 31, 2012, the Company had regulatory capital in excess of the Federal Reserve s requirements and met the Dodd-Frank Act requirements.

Basel III. The current risk-based capital guidelines described above, which apply to the Bank and are being phased in for the Company, are based upon the 1988 capital accord known as Basel I adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, as implemented by the U.S. federal banking regulators on an interagency basis. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as Basel II, for large or core international banks (generally defined for U.S. purposes as having total assets of $250 billion or more, or consolidated foreign exposures of $10 billion or more). Basel II emphasized internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on a strengthened set of capital requirements for banking organizations around the world, known as Basel III, to address deficiencies recognized in connection with the global financial crisis. Basel III requires, among other things:

- a new required ratio of minimum common equity equal to 4.5% of risk-weighted assets,

- an increase in the minimum required amount of Tier 1 capital from the current level of 4% of total assets to 6% of risk-weighted assets, and

- a continuation of the current minimum required amount of total capital at 8% of risk-weighted assets.

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% in common equity attributable to a capital conservation buffer to be phased in over three years. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the conservation buffer increases the ratios depicted above to 7% for common equity, 8.5% for Tier 1 capital and 10.5% for total capital.

On June 12, 2012, the federal banking regulators (the OCC, the Federal Reserve and the FDIC) (the Agencies) formally proposed for comment, in three separate but related proposals, rules to implement Basel III in the United States. The proposals are: (i) the Basel III Proposal, which applies the Basel III capital framework to almost all U.S. banking organizations; (ii) the Standardized Approach Proposal, which applies certain elements of the Basel II standardized approach for credit risk weightings to almost all U.S. banking organizations; and (iii) the Advanced Approaches Proposal, which applies changes made to Basel II and Basel III in the past few years to large U.S. banking organizations subject to the advanced Basel II capital framework. The comment period for these notices of proposed rulemaking ended October 22, 2012.

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The Basel III Proposal and the Standardized Approach Proposal are expected to have a direct impact on the Company and the Bank. The Basel III Proposal is applicable to all U.S. banks that are subject to minimum capital requirements, including federal and state banks, as well as to bank and savings and loan holding companies other than small bank holding companies (generally bank holding companies with consolidated assets of less than $500 million). There will be separate phase-in/phase-out periods for: (i) minimum capital ratios; (ii) regulatory capital adjustments and deductions; (iii) nonqualifying capital instruments; (iv) capital conservation and countercyclical capital buffers; (v) a supplemental leverage ratio for advanced approaches banks; and (vi) changes to the FDIC s prompt corrective action rules.

The criteria in the U.S. proposal for common equity and additional Tier 1 capital instruments, as well as Tier 2 capital instruments, are broadly consistent with the Basel III criteria. A number of instruments that now qualify as Tier 1 capital will not qualify, or their qualification will change, if the Basel III Proposal becomes final. For example, cumulative preferred stock and certain hybrid capital instruments, including trust preferred securities, which the Company may retain under the Dodd-Frank Act, will no longer qualify as Tier 1 capital of any kind. Noncumulative perpetual preferred stock, which now qualifies as simple Tier 1 capital, would not qualify as common equity Tier 1 capital, but would qualify as additional Tier 1 capital.

In addition to the changes in capital requirements included within the Basel III Proposal, the Standardized Approach Proposal revises a large number of the risk weightings (or their methodologies) for bank assets that are used to determine the capital ratios. For nearly every class of assets, the proposal requires a more complex, detailed and calibrated assessment of credit risk and calculation of risk weightings. For example, under the current risk-weighting rules, residential mortgages have a risk weighting of 50%. Under the proposed new rules, two categories of residential mortgage lending would be created: (i) traditional lending would be category 1, where the risk weightings range from 35 to 100%; and (ii) nontraditional loans would fall within category 2, where the risk weightings would range from 50 to 150%. There is concern in the U.S. that the proposed methodology for risk weighting residential mortgage exposures and the higher risk weightings for certain types of mortgage products will increase costs to consumers and reduce their access to mortgage credit.

In addition, there is significant concern noted by the financial industry in connection with the Basel III rulemaking as to the proposed treatment of accumulated other comprehensive income (AOCI). The proposed treatment of AOCI would require unrealized gains and losses on available-for-sale securities to flow through to regulatory capital as opposed to the current treatment, which neutralizes such effects. There is concern that this treatment would introduce capital volatility, due not only to credit risk but also to interest rate risk, and affect the composition of firms securities holdings.

While the Basel III accord called for national jurisdictions to implement the new requirements beginning January 1, 2013, in light of the volume of comments received by the Agencies and the concerns expressed above, the Agencies have indicated that the commencement date for the proposed Basel III rules has been delayed and it is unclear when the Basel III regime, as it may be implemented by final rules, will become effective in the United States.

The Company

General. The Company, as the sole shareholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the BHCA). In accordance with Federal Reserve policy, and as now codified by the Dodd-Frank Act, the Company is legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of the Company s operations and such additional information regarding the Company and its subsidiaries as the Federal

Reserve may require.

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Enforcement Action. On July 22, 2011, the Company entered into a Written Agreement (the Written Agreement) with the Federal Reserve Bank of Chicago (the Reserve Bank). Under the terms of the Written Agreement, the Company is required to, among other things: (i) fully utilize its financial and managerial resources to serve as a source of strength to the Bank; (ii) obtain the written approval of the Reserve Bank (and in certain cases, the Federal Reserve) prior to the declaration or payment of any dividends, the acceptance of dividends or any other form of capital distribution from the Bank, and the payment of principal, interest, or other sums on subordinated debentures or trust preferred securities; (iii) obtain the written approval of the Reserve Bank prior to incurring, increasing, or guaranteeing any debt, or repurchasing or redeeming any stock; (iv) develop, submit to the Reserve Bank, and implement a capital plan, and notify the Reserve Bank if any of the Company s quarterly capital ratios fall below the minimum ratios set forth in the approved capital plan, along with a written plan to increase any applicable capital ratio to or above the approved minimum level; and (v) for each calendar year that the Written Agreement is in effect, submit to the Reserve Bank annual cash flow projections. The Company is also required to submit certain reports to the Reserve Bank with respect to the foregoing requirements. The Company believes that it is in compliance with the provisions of the Written Agreement.

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA and the Dodd-Frank Act), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see The Increasing Regulatory Emphasis on Capital above.

The BHCA generally prohibits the Company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be so closely related to banking ... as to be a proper incident thereto. This authority would permit the Company to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature or incidental to any such financial activity or that the Federal Reserve determines by order to be complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The Company is not operating as a financial holding company.

Federal law also prohibits any person or company from acquiring control of an FDIC-insured

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depository institution or its holding company without prior notice to the appropriate federal bank regulator. Control is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 10% and 24.99% ownership.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines, as affected by the Dodd-Frank Act and Basel III. For a discussion of capital requirements, see The Increasing Regulatory Emphasis on Capital above.

U.S. Government Investment in Bank Holding Companies. Events in the U.S. and global financial markets in 2008 and 2009, including the deterioration of the worldwide credit markets, created significant challenges for financial institutions throughout the country. In response to this crisis affecting the U.S. banking system and financial markets, on October 3, 2008, the U.S. Congress passed, and the President signed into law, the Emergency Economic Stabilization Act of 2008 (the EESA). The EESA authorized the Secretary of the Treasury to implement various temporary emergency programs designed to strengthen the capital positions of financial institutions and stimulate the availability of credit within the U.S. financial system. Financial institutions participating in certain of the programs established under the EESA are required to adopt the Treasury s standards for executive compensation and corporate governance.

On October 14, 2008, the Treasury announced that it would provide Tier 1 capital (in the form of perpetual preferred stock) to eligible financial institutions. This program, known as the TARP Capital Purchase Program (the CPP), allocated $250 billion from the $700 billion authorized by the EESA to the Treasury for the purchase of senior preferred shares from qualifying financial institutions (the CPP Preferred Stock). Under the program, eligible institutions were able to sell equity interests to the Treasury in amounts equal to between 1% and 3% of the institution s risk-weighted assets. The CPP Preferred Stock is non-voting and pays dividends at the rate of 5% per annum for the first five years and thereafter at a rate of 9% per annum. In conjunction with the purchase of the CPP Preferred Stock, the Treasury received warrants to purchase common stock from the participating public institutions with an aggregate market price equal to 15% of the preferred stock investment. Participating financial institutions were required to adopt the Treasury s standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the CPP. These requirements are discussed in more detail in the Compensation Discussion and Analysis section in the Company s proxy statement, which is incorporated by reference in this Form 10-K.

Pursuant to the CPP, on January 16, 2009, the Company entered into a Letter Agreement with the Treasury, pursuant to which the Company issued (i) 73,000 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series B and (ii) a warrant to purchase 815,339 shares of the Company s common stock for an aggregate purchase price of $73.0 million in cash. The Company s federal regulators, as well as the Treasury s Office of the Inspector General, maintain significant oversight over the Company as a participating institution, to evaluate how it is using the capital provided and to ensure that it strengthens its efforts to help its borrowers avoid foreclosure, which is one of the core aspects of the EESA.

Dividend Payments. The Company s ability to pay dividends to its shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As a Delaware corporation, the Company is subject to the limitations of the Delaware General Corporation Law (the DGCL). The DGCL allows the Company to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or, if the Company has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

As a general matter, the Federal Reserve indicates that the board of directors of a bank holding company should eliminate, defer or significantly reduce the dividends if: (i) the company s net income available to

shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company s capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to prohibit the payment of dividends by banks and bank holding companies.

By virtue of express restrictions set forth in the Written Agreement, the Company may not pay any dividend unless it complies with certain provisions of the Written Agreement and receives a prior written determination of no supervisory objection from the Federal Reserve.

Furthermore, the Company s ability to pay dividends on its common stock is restricted by the terms of certain of its other securities. For example, under the terms of certain of the Company s junior subordinated debentures, it may not pay dividends on its capital stock unless all accrued and unpaid interest payments on the subordinated debentures have been fully paid. Additionally, the terms of the CPP Preferred Stock provide that no dividends on any common or preferred stock that ranks equal to or junior to the CPP Preferred Stock may be paid unless and until all accrued and unpaid dividends for all past dividend periods on the CPP Preferred Stock have been fully paid. On August 31, 2010, the Company announced that it had elected to begin deferring the interest payments due on the junior subordinated debentures described above, as well as the dividend payments due on the CPP Preferred Stock, and therefore may not pay common stock dividends until such time as these deferred payments have been made in full.

Federal Securities Regulation. The Company s common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the Exchange Act). Consequently, the Company is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

Corporate Governance. The Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies. The Dodd-Frank Act will increase stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called golden parachute payments, and authorizing the SEC to promulgate rules that would allow stockholders to nominate and solicit voters for their own candidates using a company s proxy materials. The legislation also directs the Federal Reserve to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the Company is publicly traded.

The Bank

General. The Bank is a national bank, chartered by the OCC under the National Bank Act. The deposit accounts of the Bank are insured by the FDIC s Deposit Insurance Fund (the DIF) to the maximum extent provided under federal law and FDIC regulations, and the Bank is a member of the Federal Reserve System. As a national bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the OCC, the chartering authority for national banks. The FDIC, as administrator of the DIF, also has regulatory authority over the Bank.

Enforcement Action. On May 16, 2011, the Bank entered into a Stipulation and Consent to the Issuance of a Consent Order (the Consent Order) with the OCC. Pursuant to the Consent Order, the Bank has agreed to take certain actions and operate in compliance with the Consent

Order s provisions during its terms.

Under the terms of the Consent Order, the Bank is required to, among other things: (i) adopt and adhere to a three-year written strategic plan that establishes objectives for the Bank s overall risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital adequacy,

reduction in nonperforming assets and its product development; (ii) adopt and maintain a capital plan; (iii) by September 30, 2011, achieve and thereafter maintain a total risk-based capital ratio of at least 11.25% and a Tier 1 capital ratio of at least 8.75%; (iv) seek approval of the OCC prior to paying any dividends on its capital stock; (v) develop a program to reduce the Bank s credit risk; (vi) obtain or update appraisals on certain loans secured by real estate; (vii) implement processes to ensure that real estate valuations conform to applicable standards; (viii) take certain actions related to credit and collateral exceptions; (ix) reaffirm the Bank s liquidity risk management program; and (x) appoint a compliance committee of the Bank s Board of Directors to help ensure the Bank s compliance with the Consent Order. The Bank is also required to submit certain reports to the OCC with respect to the foregoing requirements and the Bank s Board of Directors has appointed a compliance committee to monitor and coordinate the Bank s performance under the Consent Order. The Bank believes that it is in compliance with the provisions of the Consent Order.

Because the Bank is deemed to be in troubled condition by virtue of the Consent Order, it also is required to: (i) obtain the prior approval of the OCC for the appointment of new directors and the hiring or promotion of senior executive officers; and (ii) comply with restrictions on severance payments and indemnification payments to institution-affiliated parties.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators.

On November 12, 2009, the FDIC adopted a final rule that required insured depository institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. As such, on December 31, 2009, the Bank prepaid the FDIC its assessments based on its actual September 30, 2009 assessment base, adjusted quarterly by an estimated 5% annual growth rate through the end of 2012. The FDIC also used the institution s total base assessment rate in effect on September 30, 2009, increasing it by an annualized 3 basis points beginning in 2011. The FDIC began to offset prepaid assessments on March 30, 2010, representing payment of the regular quarterly risk-based deposit insurance assessment for the fourth quarter of 2009. Any prepaid assessment not exhausted after collection of the amount due on June 30, 2013, will be returned to the institution.

Amendments to the Federal Deposit Insurance Act also revise the assessment base against which an insured depository institution s deposit insurance premiums paid to the DIF will be calculated. Under the amendments, the assessment base will no longer be the institution s deposit base, but rather its average consolidated total assets less its average tangible equity. This may shift the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. The FDIC is given until September 3, 2020 to meet the 1.35% reserve ratio target. Several of these provisions could increase the Bank s FDIC deposit insurance premiums.

The Dodd-Frank Act permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per insured depositor, retroactive to January 1, 2009. Although the legislation provided that non-interest-bearing transaction accounts had unlimited deposit insurance coverage, that program ended on December 31, 2012.

FICO Assessments. The Financing Corporation (FICO) is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Competitive Equality Banking Act of 1987 to function as a financing vehicle for the recapitalization of the

former Federal Savings and Loan Insurance Corporation. FICO issued 30-year noncallable bonds of approximately $8.1 billion that mature in 2017 through 2019. FICO s authority to issue bonds ended on

December 12, 1991. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO s outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2012, the FICO assessment rate was approximately 0.0064%, which reflects the change from an assessment base computed on deposits to an assessment base computed on assets as required by the Dodd-Frank Act.

Supervisory Assessments. National banks are required to pay supervisory assessments to the OCC to fund the operations of the OCC. The amount of the assessment is calculated using a formula that takes into account the bank s size and its supervisory condition.During the year ended December 31, 2012, the Bank paid supervisory assessments to the OCC totaling $787,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see The Increasing Regulatory Emphasis on Capital, as well as Enforcement Actions.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under the National Bank Act, a national bank may pay dividends out of its undivided profits in such amounts and at such times as the bank s board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year that, in the aggregate, exceed the bank s year-to-date net income plus the bank s retained net income for the two preceding years.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable OCC guidelines as of December 31, 2012.

By virtue of express restrictions set forth in the Consent Order, however, the Bank may not pay any dividend unless it complies with certain provisions of the Consent Order and receives a prior written determination of no supervisory objection from the OCC.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on covered transactions between the Bank and its affiliates. The Company is an affiliate of the Bank for purposes of these restrictions, and covered transactions subject to the restrictions include extensions of credit to the Company, investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. The Dodd-Frank Act enhances the requirements for certain transactions with affiliates as of July 21, 2011, including an expansion of the definition of covered transactions and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company and its subsidiaries, to principal shareholders of the Company and to related interests of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank, or a principal shareholder of the Company, may obtain credit from banks with which the Bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails

to comply with any of the standards set forth in the guidelines, the institution s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator s order is cured, the regulator may restrict the institution s rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

As described in further detail above, the Bank is currently subject to a Consent Order with the OCC pursuant to which it has agreed to implement a variety of programs and policies to reduce its level of credit risk. In addition, the Bank agreed to maintain certain regulatory capital ratios at levels in excess of the general minimums required to be considered well capitalized under applicable OCC regulations. See Enforcement Actions for further detail.

Branching Authority. National banks headquartered in Illinois, such as the Bank, have the same branching rights in Illinois as banks chartered under Illinois law, subject to OCC approval. Illinois law grants Illinois-chartered banks the authority to establish branches anywhere in the State of Illinois, subject to receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) has historically been permitted only in those states the laws of which expressly authorize such expansion. However, the Dodd-Frank Act permits well-capitalized and well-managed banks to establish new branches across state lines without these impediments.

Financial Subsidiaries. Under federal law and OCC regulations, national banks are authorized to engage, through financial subsidiaries, in any activity that is permissible for a financial holding company and any activity that the Secretary of the Treasury, in consultation with the Federal Reserve, determines is financial in nature or incidental to any such financial activity, except (i) insurance underwriting, (ii) real estate development or real estate investment activities (unless otherwise permitted by law), (iii) insurance company portfolio investments and (iv) merchant banking. The authority of a national bank to invest in a financial subsidiary is subject to a number of conditions, including, among other things, requirements that the bank must be well-managed and well-capitalized (after deducting from capital the bank s outstanding investments in financial subsidiaries). The Bank has not applied for approval to establish any financial subsidiaries.

Transaction Account Reserves. Federal Reserve regulations require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts): For 2013: the first $12.4 million of otherwise reservable balances are exempt from the reserve requirements; for transaction accounts aggregating more than $12.4 million to $79.5 million, the reserve requirement is 3% of total transaction accounts; and for net transaction accounts in excess of $79.5 million, the reserve requirement is $2,013,000 plus 10% of the aggregate amount of total transaction accounts in excess of $79.5 million. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank was in compliance with the requirements for 2012 and is in compliance with the 2013 requirements.

Consumer Financial Services

There are numerous developments in federal and state laws regarding consumer financial products and services that impact the Bank s business. Importantly, the current structure of federal consumer

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protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit unfair, deceptive or abusive acts and practices. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like the Bank, will continue to be examined by their applicable bank regulators.

Ability-to-Repay Requirement and Qualified Mortgage Rule. The Dodd-Frank Act contains additional provisions that affect consumer mortgage lending. First, it significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property and augments federal law combating predatory lending practices. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower s ability to repay, while also establishing a presumption of compliance for certain qualified mortgages. Most significantly, the new standards limit the total points and fees that the Bank and/or a broker may charge on conforming and jumbo loans to 3% of the total loan amount. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans that the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability-to-repay standards. The risk retention requirement generally will be 5%, but could be increased or decreased by regulation.

On January 10, 2013, the CFPB issued a final rule, effective January 10, 2014, which implements the Dodd-Frank Act s ability-to-repay requirements and clarifies the presumption of compliance for qualified mortgages. In assessing a borrower s ability to repay a mortgage-related obligation, lenders generally must consider eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) monthly payment on the subject transaction; (iv) monthly payment on any simultaneous loan; (v) monthly payment for all mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. The final rule also includes guidance regarding the application of, and methodology for evaluating, these factors.

Further, the final rule also clarifies that qualified mortgages do not include no-doc loans and loans with negative amortization, interest-only payments, balloon payments, terms in excess of 30 years, or points and fees paid by the borrower that exceed 3% of the loan amount, subject to certain exceptions. In addition, for qualified mortgages, the monthly payment must be calculated on the highest payment that will occur in the first five years of the loan, and the borrower s total debt-to-income ratio generally may not be more than 43%. The final rule also provides that certain mortgages that satisfy the general product feature requirements for qualified mortgages and that also satisfy the underwriting requirements of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (while they operate under federal conservatorship or receivership) or the U.S. Department of Housing and Urban Development, Department of Veterans Affairs, or Department of Agriculture or Rural Housing Service are also considered to be qualified mortgages. This second category of qualified mortgages will phase out as the aforementioned federal agencies issue their own rules regarding qualified mortgages, the conservatorship of Fannie Mae and Freddie Mac ends, and, in any event, after seven years.

As set forth in the Dodd-Frank Act, subprime (or higher-priced) mortgage loans are subject to the ability-to-repay requirement, and the final rule provides for a rebuttable presumption of lender compliance for those loans. The final rule also applies the ability-to-repay requirement to prime loans, while also providing a conclusive presumption of compliance (*i.e.*, a safe harbor) for prime loans that are also qualified mortgages. Additionally, the final rule generally prohibits prepayment penalties (subject to certain exceptions) and sets forth a 3-year record retention period with respect to documenting and

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demonstrating the ability-to-repay requirement and other provisions.

Changes to Mortgage Loan Originator Compensation. Effective April 2, 2011, previously existing regulations concerning the compensation of mortgage loan originators were amended. As a result of these amendments, mortgage loan originators may not receive compensation based on a mortgage transaction s terms or conditions other than the amount of credit extended under the mortgage loan. Further, the new standards limit the total points and fees that a bank and/or a broker may charge on conforming and jumbo loans to 3.0% of the total loan amount. Mortgage loan originators may receive compensation from a consumer or from a lender, but not both. These rules contain requirements designed to prohibit mortgage loan originators from steering consumers to loans that provide mortgage loan originators with greater compensation. In addition, the rules contain other requirements concerning recordkeeping.

Foreclosure and Loan Modifications. Federal and state laws further impact foreclosures and loan modifications, with many of such laws having the effect of delaying or impeding the foreclosure process on real estate secured loans in default. Mortgages on commercial property can be modified, such as by reducing the principal amount of the loan or the interest rate, or by extending the term of the loan, through plans confirmed under Chapter 11 of the U.S. Bankruptcy Code. In recent years, legislation has been introduced in the U.S. Congress that would amend the U.S. Bankruptcy Code to permit the modification of mortgages secured by residences, although at this time the enactment of such legislation is not presently proposed. The scope, duration and terms of potential future legislation with similar effect continue to be discussed. We cannot predict whether any such legislation will be passed or the impact, if any, it would have on our business.

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GUIDE 3 STATISTICAL DATA REQUIREMENTS

The statistical data required by Guide 3 of the Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934 is set forth in the following pages. This data should be read in conjunction with the consolidated financial statements, related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations as set forth in Part II Items 7 and 8. All dollars in the tables are expressed in thousands.

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I. **Distribution of Assets, Liabilities and Stockholders Equity; Interest Rate and Interest Differential.**

The following table sets forth certain information relating to the Company s average consolidated balance sheets and reflects the yield on average earning assets and cost of average liabilities for the years indicated. Dividing the related interest by the average balance of assets or liabilities derives rates. Average balances are derived from daily balances.

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ANALYSIS OF AVERAGE BALANCES,

TAX EQUIVALENT INTEREST AND RATES

Years ended December 31, 2012, 2011 and 2010

	2012			2011			2010		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
ASSETS									
Interest bearing deposits	$ 48,820	$ 119	0.24%	$ 92,830	$ 230	0.24%	$ 64,894	$ 156	0.24%
Federal funds sold				533	1	0.19	2,009	3	0.15
Securities:									
Taxable	395,225	7,212	1.82	161,986	3,989	2.46	154,485	4,766	3.09
Non-taxable (tax equivalent)	10,350	640	6.18	13,220	749	5.67	45,435	2,761	6.08
Total securities	405,575	7,852	1.94	175,206	4,738	2.70	199,920	7,527	3.77
Dividends from FRB and FHLB stock	12,294	305	2.48	13,963	290	2.08	13,467	251	1.86
Loans and loans held-for-sale (1)	1,270,162	67,110	5.20	1,535,054	80,513	5.17	1,909,064	99,791	5.16
Total interest earning assets	1,736,851	75,386	4.28	1,817,586	85,772	4.66	2,189,354	107,728	4.86
Cash and due from banks	26,197			27,402			37,670		
Allowance for loan losses	(45,047)			(69,471)			(74,487)		
Other noninterest-bearing assets	232,624			239,947			273,819		
Total assets	$ 1,950,625			$ 2,015,464			$ 2,426,356		
LIABILITIES AND STOCKHOLDERS EQUITY									
NOW accounts	$ 274,299	$ 270	0.10	$ 264,470	$ 422	0.16	$ 402,954	$ 1,125	0.28
Money market accounts	314,363	576	0.18	295,212	835	0.28	356,627	2,243	0.63
Savings accounts	211,632	216	0.10	191,857	322	0.17	185,175	699	0.38
Time deposits	552,489	8,809	1.59	701,189	14,478	2.06	840,647	18,795	2.24
Total interest bearing deposits	1,352,783	9,871	0.73	1,452,728	16,057	1.11	1,785,403	22,862	1.28
Securities sold under repurchase agreements	4,826	2	0.04	1,957	1	0.05	14,883	28	0.19
Other short-term borrowings	12,268	17	0.14	2,742			5,095	18	0.35
Junior subordinated debentures	58,378	4,925	8.44	58,378	4,577	7.84	58,378	4,309	7.38
Subordinated debt	45,000	903	1.97	45,000	822	1.80	45,000	838	1.84
Notes payable and other borrowings	500	17	3.34	500	16	3.16	500	13	2.56
Total interest bearing liabilities	1,473,755	15,735	1.07	1,561,305	21,473	1.37	1,909,259	28,068	1.47
Noninterest bearing deposits	377,624			354,196			322,480		
Accrued interest and other liabilities	27,285			20,238			18,767		
Stockholders equity	71,961			79,725			175,850		
Total liabilities and stockholders equity	$ 1,950,625			$ 2,015,464			$ 2,426,356		

	2012	2011	2010
Net interest income (tax equivalent)	$ 59,651	$ 64,299	$ 79,660
Net interest income (tax equivalent) to total earning assets	3.43%	3.54%	3.64%
Interest bearing liabilities to earnings assets	84.85%	85.90%	87.21%

(1) Interest income from loans is shown tax equivalent as discussed below and includes fees of $2,111, $2,194 and $2,546 for 2012, 2011 and 2010, respectively.

Nonaccrual loans are included in the above stated average balances.

Notes: For purposes of discussion, net interest income and net interest income to earning assets have been adjusted to a non-GAAP tax equivalent (TE) basis using a marginal rate of 35% to more appropriately compare returns on tax-exempt loans and securities to other earning assets. The table below provides a reconciliation of each non-GAAP TE measure to the GAAP equivalent:

Effect of Tax Equivalent Adjustment	2012	2011	2010
Interest income (GAAP)	$ 75,081	$ 85,423	$ 106,681
Taxable equivalent adjustment - loans	81	87	81
Taxable equivalent adjustment - securities	224	262	966
Interest income (TE)	75,386	85,772	107,728
Less: interest expense (GAAP)	15,735	21,473	28,068
Net interest income (TE)	$ 59,651	$ 64,299	$ 79,660
Net interest income (GAAP)	$ 59,346	$ 63,950	$ 78,613
Net interest income to total interest earning assets	3.42%	3.52%	3.59%
Net interest income to total interest earning assets (TE)	3.43%	3.54%	3.64%

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The following table allocates the changes in net interest income to changes in either average balances or average rates for earnings assets and interest bearing liabilities. The changes in interest due to both volume and rate have been allocated proportionately to the change due to balance and due to rate. Interest income is measured on a tax-equivalent basis using a 35% rate as per the note to the analysis of averages balance table on the preceding page.

ANALYSIS OF YEAR-TO-YEAR CHANGES IN NET INTEREST INCOME

	2012 Compared to 2011			2011 Compared to 2010		
	Change Due to			Change Due to		
	Average Balance	Average Rate	Total Change	Average Balance	Average Rate	Total Change
EARNING ASSETS/INTEREST INCOME						
Interest bearing deposits	$ (107)	$ (4)	$ (111)	$ 69	$ 5	$ 74
Federal funds sold		(1)	(1)	(3)	1	(2)
Securities:						
Taxable	3,930	(707)	3,223	246	(1,023)	(777)
Tax-exempt	(188)	79	(109)	(1,837)	(175)	(2,012)
Dividends from FRB and FHLB Stock	(24)	39	15	10	29	39
Loans and loans held-for-sale	(13,771)	368	(13,403)	(19,618)	340	(19,278)
TOTAL EARNING ASSETS	(10,160)	(226)	(10,386)	(21,133)	(823)	(21,956)
INTEREST BEARING LIABILITIES/ INTEREST EXPENSE						
NOW accounts	16	(168)	(152)	(313)	(390)	(703)
Money market accounts	58	(317)	(259)	(336)	(1,072)	(1,408)
Savings accounts	38	(144)	(106)	26	(403)	(377)
Time deposits	(2,733)	(2,936)	(5,669)	(2,955)	(1,362)	(4,317)
Securities sold under repurchase agreements	1		1	(15)	(12)	(27)
Other short-term borrowings		17	17	(6)	(12)	(18)
Junior subordinated debentures		348	348		268	268
Subordinated debt		81	81		(16)	(16)
Notes payable and other borrowings		1	1		3	3
INTEREST BEARING LIABILITIES	(2,620)	(3,118)	(5,738)	(3,599)	(2,996)	(6,595)
NET INTEREST INCOME	$ (7,540)	$ 2,892	$ (4,648)	$ (17,534)	$ 2,173	$ (15,361)

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II. Investment Portfolio

The following table presents the composition of the securities portfolio by major category as of December 31, of each year indicated:

SECURITIES PORTFOLIO COMPOSITION

	2012		2011		2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
SECURITIES AVAILABLE FOR SALE						
U.S. Treasury	$ 1,500	$ 1,507	$ 1,501	$ 1,524	$ 1,501	$ 1,521
U.S. government agencies	49,848	49,850	43,112	43,398	37,810	37,426
U.S. government agency mortgage-backed	127,716	128,738	152,473	154,007	75,257	76,731
States and political subdivisions	14,639	15,855	12,152	13,809	17,538	17,854
Corporate bonds	36,355	36,886	32,357	31,389		
Collateralized mortgage obligations	168,795	169,600	25,616	25,122	3,817	3,996
Asset-backed securities	165,347	167,493	28,755	28,341		
Collateralized debt obligations	17,941	9,957	17,892	9,974	17,869	11,073
Equity securities					49	46
	$ 582,141	$ 579,886	$ 313,858	$ 307,564	$ 153,841	$ 148,647

The Company s holdings of U.S. government agency and U.S. government agency mortgage-backed securities are comprised of government-sponsored enterprises, such as Fannie Mae, Freddie Mac and the FHLB, which are not backed by the full faith and credit of the U.S. government.

SECURITIES AVAILABLE FOR SALE MATURITY AND YIELDS

The following table presents the expected maturities or call dates and weighted average yield (non tax equivalent) of securities by major category as of December 31, 2012:

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury	$ 1,507	1.34%	$		$		$		$ 1,507	1.34%
U.S. government agencies			8,061	1.06%	12,315	2.15%	29,474	3.48%	49,850	2.76%
	483	4.41%	2,343	4.59%	8,262	3.94%	4,767	4.40%	15,855	4.20%

States and political subdivisions										
Corporate bonds	3,001	1.57%	19,444	1.99%	14,441	3.07%			36,886	2.38%
	4,991	1.77%	29,848	1.93%	35,018	2.92%	34,241	3.61%	104,098	2.81%
Mortgage-backed securities and collateralized mortgage obligations									298,338	1.77%
Asset-backed securities									167,493	1.30%
Collateralized debt obligations									9,957	1.75%
	$ 4,991	1.77%	$ 29,848	1.93%	$ 35,018	2.92%	$ 34,241	3.61%	$ 579,886	1.82%

As of December 31, 2012, net unrealized losses of $2,255,000, offset by deferred income taxes of $928,000, resulted in a decrease in equity capital of $1,327,000. As of December 31, 2011, net unrealized losses of $6,294,000, offset by deferred income taxes of $2,592,000, resulted in a decrease in equity capital of $3,702,000. At December 31, 2012, the fair value of the collateralized debt obligations issued by Trapeza CDO XIII, Ltd. and held by the Company totaled $10.0 million and, were greater than 10% of stockholders equity. Additional detailed information related to these securities is provided in Part II, Item 8, Financial Statements and Supplementary Data Note 3 of the Notes to the Consolidated Financial Statements.

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III. Loan Portfolio

Types of Loans

The following table presents the composition of the loan portfolio at December 31, for the years indicated:

	2012	2011	2010	2009	2008
Commercial	$ 87,136	$ 98,241	$ 173,718	$ 206,779	$ 243,272
Real estate - commercial	579,687	704,415	821,101	925,013	928,747
Real estate - construction	42,167	70,919	129,601	273,719	373,371
Real estate - residential	414,141	477,196	556,609	642,335	700,595
Consumer	3,414	4,172	5,587	10,447	19,972
Overdraft	994	457	739	830	761
Lease Financing Receivables	6,060	2,087	2,774	3,703	4,396
Other	16,451	11,498	N/A	N/A	N/A
Gross loans	1,150,050	1,368,985	1,690,129	2,062,826	2,271,114
Allowance for loan losses	(38,597)	(51,997)	(76,308)	(64,540)	(41,271)
Loans, net	$ 1,111,453	$ 1,316,988	$ 1,613,821	$ 1,998,286	$ 2,229,843

The above loan totals include net unearned and deferred loan fees and costs.

Maturity and Rate Sensitivity Of Loans to Changes in Interest Rates

The following table sets forth the remaining contractual maturities for certain loan categories at December 31, 2012:

		Over 1 Year Through 5 Years		Over 5 Years		
	One Year or Less	Fixed Rate	Floating Rate	Fixed Rate	Floating Rate	Total
Commercial	$ 38,927	$ 16,082	$ 23,391	$ 6,187	$ 2,549	$ 87,136
Real estate - commercial	200,087	238,020	45,923	66,927	28,730	579,687
Real estate - construction	16,651	20,715	1,750	933	2,118	42,167
Real estate - residential	62,969	57,922	69,047	34,251	189,952	414,141
Consumer	973	803	1,302	15	321	3,414
Overdraft	994					994
Lease financing receivables		5,883		177		6,060
Other	7,306	8,012	1,133			16,451
Total	$ 327,907	$ 347,437	$ 142,546	$ 108,490	$ 223,670	$ 1,150,050

The above loan table includes net unearned and deferred loans fees and costs, column one includes demand notes.

While there are no significant concentrations of loans where the customers ability to honor loan terms is dependent upon a single economic sector, the real estate related categories represented 90.1% and 91.5% of the portfolio at December 31, 2012, and 2011, respectively. The Company had no concentration of loans exceeding 10% of total loans, which were not otherwise disclosed as a category of loans at December 31, 2012.

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Risk Elements

The following table sets forth the amounts of nonperforming assets at December 31, of the years indicated:

	2012	2011	2010	2009	2008
Nonaccrual loans	$ 77,519	$ 126,786	$ 212,225	$ 174,978	$ 106,510
Troubled debt restructured loans accruing interest	4,987	11,839	15,637	14,171	
Loans past due 90 days or more and still accruing interest	89	318	1,013	561	2,119
Total nonperforming loans	82,595	138,943	228,875	189,710	108,629
Other real estate owned	72,423	93,290	75,613	40,200	15,212
Receivable from foreclosed loan participation				1,505	
Receivable from swap terminations			3,520		
Total nonperforming assets	$ 155,018	$ 232,233	$ 308,008	$ 231,415	$ 123,841
OREO as % of nonperforming assets	46.7%	40.2%	24.5%	17.4%	12.3%

Accrual of interest is discontinued on a loan when principal or interest is ninety days or more past due, unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual status, interest previously accrued but not collected in the current period is reversed against current period interest income. Interest income of approximately $813,000 and $1,784,000 was recorded and collected during 2012 and 2011, respectively, on loans that subsequently went to nonaccrual status at year-end. Interest income, which would have been recognized during 2012 and 2011, had these loans been on an accrual basis throughout the year, was approximately $6,488,000 and $10,555,000, respectively. As of December 31, 2012, and 2011, there were $5,441,000 and $5,351,000 respectively in restructured residential mortgage loans that were still accruing interest based upon their prior performance history. Additionally, the nonaccrual loans above include $11,505,000 and $16,189,000 in restructured loans for the period ending December 31, 2012, and 2011, respectively.

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IV. Summary of Loan Loss Experience

Analysis of Allowance For Loan Losses

The following table summarizes, for the years indicated, activity in the allowance for loan losses, including amounts charged off, amounts of recoveries, additions to the allowance charged to operating expense, and the ratio of net charge-offs to average loans outstanding:

	2012	2011	2010	2009	2008
Average total loans (exclusive of loans held-for-sale)	$ 1,263,172	$ 1,527,311	$ 1,900,604	$ 2,206,189	$ 2,181,675
Allowance at beginning of year	51,997	76,308	64,540	41,271	16,835
Addition resulting from acquisition					3,039
Charge-offs:					
Commercial	344	366	2,247	3,493	115
Real estate - commercial	13,508	19,576	29,665	4,148	1,277
Real estate - construction	4,969	10,430	39,321	60,173	6,146
Real estate - residential	8,406	10,229	13,216	6,238	1,420
Consumer and other loans	638	568	560	926	426
Total charge-offs	27,865	41,169	85,009	74,978	9,384
Recoveries:					
Commercial	115	173	320	22	202
Real estate - commercial	3,576	3,947	900		4
Real estate - construction	3,420	1,262	3,674	1,123	16
Real estate - residential	583	1,807	1,799	47	
Consumer and other loans	487	782	416	340	244
Total recoveries	8,181	7,971	7,109	1,532	466
Net charge-offs	19,684	33,198	77,900	73,446	8,918
Provision for loan losses	6,284	8,887	89,668	96,715	30,315
Allowance at end of year	$ 38,597	$ 51,997	$ 76,308	$ 64,540	$ 41,271
Net charge-offs to average loans	1.56%	2.17%	4.10%	3.33%	0.41%
Allowance at year end to average loans	3.06%	3.40%	4.01%	2.93%	1.89%

The provision for loan losses is based upon management s estimate of losses inherent in the portfolio and its evaluation of the adequacy of the allowance for loan losses. Factors which influence management s judgment in estimating loan losses are the composition of the portfolio, past loss experience, loan delinquencies, nonperforming loans, and other factors that, in management s judgment, deserve evaluation in estimating loan losses.

Allocation of the Allowance For Loan Losses

The following table shows the Company s allocation of the allowance for loan losses by types of loans and the amount of unallocated allowance, at December 31, of the years indicated:

	2012		2011		2010		2009		2008	
	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans	Amount	Loan Type to Total Loans
Commercial	$ 4,517	7.6%	$ 5,070	7.2%	$ 6,764	10.3%	$ 4,547	10.0%	$ 2,912	10.7%
Real estate - commercial	20,100	50.4%	30,770	51.5%	42,242	48.5%	24,598	44.8%	13,741	40.9%
Real estate - construction	3,837	3.7%	7,937	5.2%	18,344	7.7%	29,895	13.3%	20,546	16.5%
Real estate - residential	4,535	36.0%	6,335	34.9%	6,999	33.0%	3,770	31.2%	2,365	30.8%
Consumer	1,178	0.3%	884	0.3%	880	0.3%	703	0.5%	557	0.9%
Lease financing receivables		0.1%		0.1%		0.2%		0.2%	50	0.2%
Unallocated	4,430	1.9%	1,001	0.8%	1,079		1,027		1,100	
Total	$ 38,597	100.0%	$ 51,997	100.0%	$ 76,308	100.0%	$ 64,540	100.0%	$ 41,271	100.0%

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The allowance for loan losses is a valuation allowance for loan losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Allocations of the allowance may be made for specific loans, but the entire allowance is available for losses inherent in the loan portfolio. In addition, federal regulatory authorities, as part of the examination process, periodically review the allowance for loan losses. Regulators can require management to record adjustments to the allowance level based upon their assessment of the information available to them at the time of examination. Although management believes the allowance for loan losses is sufficient to cover probable losses inherent in the loan portfolio, there can be no assurance that the allowance will prove sufficient to cover actual loan losses

Potential Problem Loans

The Company utilizes an internal asset classification system as a means of reporting problem and potential problem assets. At the scheduled board of directors meetings of the Bank, loan listings are presented, which show significant loan relationships listed as Special Mention, Substandard, and Doubtful. Loans classified as Substandard include those that have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. The Company s loan policy definition of a problem loan is described in the Item 7, Management Discussion and Analysis of Financial Condition and Results of Operations, under specific allocations. Assets classified as Doubtful have all the weaknesses inherent as those 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. Assets that do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management s close attention are deemed to be Special Mention.

Management s determination as to the classification of assets and the amount of estimated valuation allowances is subject to review by the OCC, the Bank s primary regulator, which can also order the establishment of additional specific or general loss allowances. There can be no assurance that regulators, in reviewing the loan portfolio, will not require us to materially adjust our allowance for loan losses. The OCC, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the allowance for loan losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that (1) institutions have effective systems and controls to identify, monitor and address asset quality problems; (2) management has analyzed all significant factors that affect the collectability of the portfolio in a reasonable manner; and (3) management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Management believes it has established an adequate estimated allowance for probable loan losses. Management reviews its process quarterly, makes changes as needed, and reports those results at meetings of our Audit Committee. However, there can be no assurance that regulators, in reviewing the loan portfolio, would not request us to materially adjust our allowance for loan losses at the time of their examination.

Although management believes that adequate specific and general loan loss allowances have been established, actual losses are dependent upon future events and, as such, further additions to the level of specific and general loan loss allowances may become necessary. Management defines potential problem loans as performing loans rated Substandard, that do not meet the definition of a nonperforming loan. These potential problem loans carry a higher probability of default and require additional attention by management.

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V. Deposits

The following table sets forth the amount and maturities of deposits of $100,000 or more at December 31, 2012:

3 months or less	$	20,701
Over 3 months through 6 months		15,594
Over 6 months through 12 months		52,609
Over 12 months		103,044
	$	191,948

VI. Return on Equity and Assets

The following table presents selected financial ratios as of December 31, for the years indicated:

	2012	**2011**
Return on average total assets	0.00%	(0.32)%
Return on average equity	(0.10)%	(8.15)%
Average equity to average assets	3.69%	3.96%
Dividend payout ratio	0.00%	0.00%

VII. Short-Term Borrowings

There were no categories of short-term borrowings having an average balance greater than 30% of stockholders equity of the Company at the end of the year.

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Item 1.A. Risk Factors

RISK FACTORS

The material risks and uncertainties that management believes affect the Company are described below. Before making an investment decision with respect to any of the Company s securities, you should carefully consider the risks and uncertainties as described below, together with all of the information included herein. The risks and uncertainties described below are not the only risks and uncertainties the Company faces. Additional risks and uncertainties not presently known or currently deemed immaterial also may have a material adverse effect on the Company s results of operations and financial condition. If any of the following risks actually occur, the Company s results of operations and financial condition could suffer, possibly materially. The risks discussed below also include forward-looking statements, and actual results may differ substantially from those discussed or implied in these forward-looking statements.

Earnings Risk

The Company has incurred a net loss in the past and cannot ensure further losses will not be incurred.

The Company incurred a net loss of $72,000 for 2012 and $6.5 million for 2011, as well as a net loss of $108.6 million for 2010. In light of the persistent challenging economic environment and continuing depressed real estate markets, we cannot ensure we will not incur future losses. Any future losses may affect our ability to meet our expenses or raise additional capital, and may delay the time in which we can resume dividend payments on our common and preferred stock as well as distributions on our trust preferred securities. Furthermore, any future losses would likely cause a decline in our holding company regulatory capital ratios, which could materially and adversely affect our financial condition, liquidity and results of operations.

If we fail to maintain sufficient capital, whether due to losses, an inability to raise additional capital or otherwise, our financial condition, liquidity and results of operations, as well as our ability to maintain regulatory compliance, would be adversely affected.

The Company and the Bank must meet minimum regulatory capital requirements and maintain sufficient liquidity. We also face significant capital and other regulatory requirements as a financial institution and a participant in the CPP. Our ability to raise additional capital, when and if needed, will depend on conditions in the economy and capital markets, and a number of other factors including investor perceptions regarding the Company, banking industry and market condition, and governmental activities many of which are outside our control, and on our financial condition and performance. Accordingly, we cannot assure you that we will be able to raise additional capital if needed or on terms acceptable to us. If we fail to meet these capital and other regulatory requirements, our financial condition, liquidity and results of operations could be materially and adversely affected.

Specifically, pursuant to the May 2011 Consent Order with the OCC, the Bank agreed to maintain a Tier 1 leverage ratio of at least 8.75% and a total risk-based capital ratio of at least 11.25%. The Bank was in compliance with the heightened capital requirements required by the OCC as of December 31, 2012. However, if the Bank fails to be in full compliance with the agreed-upon capital ratios in the future, the OCC may take

additional regulatory enforcement actions.

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Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

At December 31, 2012, our nonperforming loans (which consist of nonaccrual loans and loans past due 90 days or more, still accruing interest and restructured loans still accruing interest) and our nonperforming assets (which include nonperforming loans plus other real estate owned (OREO)) are reflected in the table below (in millions):

	12/31/2012	12/31/2011	% Change
Nonperforming loans	$ 82.6	$ 138.9	(40.5)%
OREO	72.4	93.3	(22.4)%
Nonperforming assets	$ 155.0	$ 232.2	(33.2)%

Our nonperforming assets adversely affect our net income in various ways. For example, we do not record interest income on nonaccrual loans and OREO has expenses in excess of lease revenues collected, thereby adversely affecting our income and returns on assets and equity. Our loan administration costs also increase because of our nonperforming assets. The resolution of nonperforming assets requires significant time commitments from management, which can be detrimental to the performance of their other responsibilities. While we have made progress, there is no assurance that we will not experience further increases in nonperforming loans in the future, or that our nonperforming assets will not result in further losses in the future.

Interest Rate and Credit Risks

The Company is subject to interest rate risk.

The Company s earnings and cash flows are largely dependent upon its net interest income. Interest rates are highly sensitive to many factors that are beyond the Company s control, including general economic conditions our competition and policies of various governmental and regulatory agencies, particularly the Federal Reserve. Changes in monetary policy, including changes in interest rates, could influence the amount of interest the Company earns on loans and securities and the amount of interest it incurs on deposits and borrowings. Such changes could also affect the Company s ability to originate loans and obtain deposits as well as the average duration of the Company s securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company s 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 the Company s results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company s financial condition and results of operations.

The Company is subject to lending risks.

There are inherent risks associated with the Company s lending activities. Underwriting and documentation controls cannot mitigate all credit risk, especially those outside the Company s control. These risks include the impact of changes in interest rates and changes in the economic conditions in the markets in which the Company operates as well as those across the United States. Increases in interest rates and/or continuing weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing those loans.

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The Company is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Company to regulatory enforcement action that could result in the assessment of significant civil monetary penalties against the Company.

An increase in non-performing loans could result in a net loss of earnings, an increase in the provision for loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on the Company s financial condition and results of operations.

Our loan portfolio is concentrated heavily in residential and commercial real estate loans, including construction loans, which involve risks specific to real estate values and the real estate markets in general, all of which have been experiencing significant weakness.

Our loan portfolio generally reflects the profile of the communities in which we operate. Because we are in areas that saw rapid growth between 2000 and 2007, real estate lending of all types is a significant portion of our loan portfolio with total real estate lending at $1.04 billion, or approximately 90.1% of our December 31, 2012 loan portfolio. Given that the primary (if not only) source of collateral on these loans is real estate, additional adverse developments affecting real estate values in our market area could increase the credit risk associated with our real estate loan portfolio.

The effects of ongoing real estate challenges, combined with the ongoing correction in commercial and residential real estate market prices and reduced levels of home sales, have adversely affected our real estate loan portfolio and have the potential to further adversely affect such portfolio in several ways, each of which could further adversely impact our operating results and/or financial condition.

Real estate market volatility and future changes in disposition strategies could result in net proceeds that differ significantly from fair value appraisals of loan collateral and OREO and could negatively impact the Company s operating performance.

Many of the Company s non-performing real estate loans are collateral-dependent, meaning the repayment of the loan is largely dependent upon the successful operation of the property securing the loan. For collateral-dependent loans, the Company estimates the value of the loan based on appraised value of the underlying collateral less costs to sell. The Company s OREO portfolio consists of properties acquired through foreclosure in partial or total satisfaction of certain loans as a result of borrower defaults. OREO is recorded at the lower of the recorded investment in the loans for which the property served as collateral or estimated fair value, less estimated selling costs.

In determining the value of OREO properties and loan collateral, an orderly disposition of the property is generally assumed. Significant judgment is required in estimating the fair value of property, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility.

The Company s allowance for loan losses may be insufficient to absorb potential losses in our loan portfolio.

The Company maintains an allowance for loan losses (allowance) at a level believed adequate to absorb estimated losses inherent in the existing loan portfolio. The level of the allowance reflects management s continuing evaluation of industry concentrations; specific credit risks; credit loss experience; current loan portfolio quality; present economic, political, and regulatory conditions; and unidentified losses inherent in the current loan portfolio.

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Determination of the allowance is inherently subjective since it requires significant estimates and management judgment of credit risks and future trends, all of which may undergo material changes. For example, the final allowance for December 31, 2012 included an amount reserved for other not specifically identified risk factors. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans, and other factors, both within and outside of the Company s control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review the Company s allowance and may require an increase in the provision for loan losses or the recognition of additional loan charge-offs, based on judgments different from those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, the Company will need additional provisions to increase the allowance. Any increases in the allowance will result in a decrease in net income and capital and may have a material adverse effect on the Company s financial condition and results of operations.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

The Company may rely on information furnished by or on behalf of customers and counterparties in deciding whether to extend credit or enter into other transactions. This information could include financial statements, credit reports, and other financial information. The Company may also rely on representations of those customers, counterparties, or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports, or other financial information could have a material adverse impact on the Company s business, financial condition, and results of operations.

Funding Risks

The Company could experience an unexpected inability to obtain needed liquidity.

Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits, and to take advantage of interest rate market opportunities and is essential to a financial institution s business. The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets, and its access to alternative sources of funds. The Company seeks to ensure its funding needs are met by maintaining a level of liquidity through asset and liability management. If the Company becomes unable to obtain funds when needed, it could have a material adverse effect on the Company s business, financial condition, and results of operations.

Loss of customer deposits could increase the Company s funding costs.

The Company relies on bank deposits to be a low cost and stable source of funding. The Company competes with banks and other financial services companies for deposits. If the Company s competitors raise the rates they pay on deposits, the Company s funding costs may increase, either because the Company raises its rates to avoid losing deposits or because the Company loses deposits and must rely on more expensive sources of funding. Higher funding costs could reduce the Company s net interest margin and net interest income and could have a material adverse effect on the Company s financial condition and results of operations.

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The recent repeal of federal prohibitions on payment of interest on business demand deposits could increase our interest expense and have a material adverse effect on us.

All federal prohibitions on the ability of financial institutions to pay interest on business demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, some financial institutions have commenced offering interest on these demand deposits to compete for customers. If competitive pressures require us to pay interest on these demand deposits to attract and retain business customers, our interest expense would increase and our net interest margin would decrease. This could have a material adverse effect on us. Further, the effect of the repeal of the prohibition could be more significant in a higher interest rate environment as business customers would have a greater incentive to seek interest on demand deposits.

Operational Risks

Our business is concentrated in and dependent upon the welfare of several counties in Illinois and the State of Illinois.

Our primary market area is Aurora, Illinois, and surrounding communities as well as southwestern Cook County. The city of Aurora is located in northeastern Illinois, approximately 40 miles west of Chicago. The Bank operates primarily in Kane, Kendall, DeKalb, DuPage, LaSalle, Will and Cook Counties in Illinois, and, as a result, our financial condition, results of operations and cash flows are subject to changes and fluctuations in the economic conditions in those areas. We have developed a strong presence in the counties we serve, with particular concentration in Aurora, Illinois, and surrounding communities.

The communities that we serve grew rapidly over the past decade, and we intend to continue concentrating our business efforts in these communities. Our future success is largely dependent upon the overall economic health of these communities. However, since late 2007, the United States economy has generally experienced difficult economic conditions. Weak economic conditions are characterized by, among other indicators, deflation, unemployment, fluctuations in debt and equity capital markets, increased delinquencies on mortgage, commercial and consumer loans, residential and commercial real estate price declines and lower home sales and commercial activity. All of those factors are generally detrimental to our business. If the overall economic conditions fail to significantly improve or decline further, particularly within our primary market areas, we could experience a lack of demand for our products and services, an increase in loan delinquencies and defaults and high or increased levels of problem assets and foreclosures. Moreover, because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets.

Similarly, we have credit exposure to entities or in industries that could be impacted by the continued financial difficulties at the state level. Exposure to health care, construction and social services organizations has been reviewed to evaluate credit impact from a possible reorganization of state finances. Credit downgrades, partial charge-offs and specific reserves could develop in this exposure with resulting impact on our financial condition if the State of Illinois encounters more severe payment issuance capabilities.

The Company and its subsidiaries are subject to changes in accounting principles, policies, or guidelines.

The Company s financial performance is impacted by accounting principles, policies, and guidelines. Some of these policies require the use of estimates and assumptions that may affect the value of the Company s assets or liabilities and financial results. Some of the Company s accounting policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying the Company s financial statements are incorrect, it may experience material losses.

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From time to time, the FASB and the SEC change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of the Company s external financial statements. These changes are beyond the Company s control, can be difficult to predict, and could materially impact how the Company reports its results of operations and financial condition.

Changes in these standards are continuously occurring, and given the current economic environment, more drastic changes may occur. The implementation of such changes could have a material adverse effect on the Company s financial condition and results of operations.

The Company s controls and procedures may fail or be circumvented.

Management regularly reviews and updates the Company s loan underwriting and monitoring process, internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company s controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company s business, financial condition, and results of operations.

Loss of key employees may disrupt relationships with certain customers.

The Company s business is primarily relationship-driven in that many of its key employees have extensive customer relationships. Loss of key employees with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While the Company believes its relationships with its key personnel are strong, it cannot guarantee that all of its key personnel will remain with the organization. Loss of such key personnel, should they enter into an employment relationship with one of the Company s competitors, could result in the loss of some of its customers, which could have a negative impact on the company s business, financial condition, and results of operations.

The Company s information systems may experience an interruption or breach in security.

The Company relies heavily on internal and outsourced technologies, communications, and information systems to conduct its business. As the Company s reliance on technology has increased, so have the potential risks of a technology-related operation interruption (such as disruptions in the Company s customer relationship management, general ledger, deposit, loan, or other systems) or the occurrence of a cyber incident (such as unauthorized access to the Company s systems). Cyber incidents can result from deliberate attacks or unintentional events including (i) gaining unauthorized access to automated systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruptions; (ii) causing denial-of-service attacks on websites; or (iii) intelligence gathering and social engineering aimed at obtaining information. The occurrence of operational interruption or a deficiency in the cyber security of the Company s technology systems (internal or outsourced) could negatively impact the Company s financial condition or results of operations.

The Company is dependent upon outside third parties for processing and handling of Company records and data.

The Company relies on software developed by third party vendors to process various Company transactions. In some cases, the Company has contracted with third parties to run its proprietary software on behalf of the Company. These systems include, but are not limited to, general ledger, payroll, wealth

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management record keeping, and securities portfolio management. While the Company performs a review of controls instituted by the vendor over these programs in accordance with industry standards and institutes its own user controls, the Company must rely on the continued maintenance of these many controls by the outside party, including safeguards over the security of customer data. In addition, the Company maintains backups of key processing output daily in the event of a failure on the part of any of these systems. Nonetheless, the Company may incur a temporary disruption in its ability to conduct its business or process its transactions, or incur damage to its reputation if the third party vendor fails to adequately maintain internal controls or institute necessary changes to systems. Such disruption or breach of security may have a material adverse effect on the Company s financial condition and results of operations.

The Company s estimate of fair values for its investments may not be realizable if it were to sell these securities today.

The Company s available-for-sale securities are carried at fair value. Accounting standards require the Company to categorize these securities according to a fair value hierarchy. As of December 31, 2012, 0.3% percent of the Company s available-for-sale securities were categorized in Level 1 of the fair value hierarchy (meaning that the fair values were based on quoted market prices). Approximately, 98.0% of the Company s available-for-sale securities were categorized in Level 2 of the fair value hierarchy (meaning that their fair values were determined by quoted prices for similar instruments or other observable inputs). The remaining securities were categorized as Level 3 (meaning that their fair values were determined by inputs that are unobservable in the market and therefore require a greater degree of management judgment).

The determination of fair value for securities categorized in Level 3 involves significant judgment due to the complexity of factors contributing to the valuation, many of which are not readily observable in the market. The market disruptions in recent years made the valuation process even more difficult and subjective.

External Risks

The Company operates in a highly competitive industry and market area.

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Our competitors primarily include national and regional banks as well as community banks within the markets we serve. The Company also faces competition from savings and loan associations, credit unions, personal loan and finance companies, retail and discount stockbrokers, investment advisors, mutual funds, insurance companies, and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative and regulatory changes. Banks, securities firms, and insurance companies can merge under the umbrella of a financial holding company, which can offer the wide spectrum of financial services to many customer segments. Many large scale competitors can leverage economies of scale and be able to offer better pricing for products and services compared to what the Company can offer.

The Company s ability to compete successfully depends on developing, maintaining, and building long-term customer relationships, offering community banking services with features and pricing in line with customer interests, consistently achieving outstanding levels of customer service as well as adapting to many and frequent change in banking as well as local or regional economies. Failure to excel in these areas could significantly weaken the Company s competitive position, which could adversely affect the Company s growth and profitability. These weaknesses could have a significant negative impact on the

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Company s business, financial condition, and results of operations.

Legal/Compliance Risks

We may be materially and adversely affected by the highly regulated environment in which we operate.

We are subject to extensive federal and state regulation, supervision and examination. Banking regulations are primarily intended to protect depositors funds, FDIC funds, customers and the banking system as a whole, rather than stockholders. These regulations affect our lending practices, capital structure, investment practices, dividend policy, and growth, among other things.

As a bank holding company, we are subject to extensive regulation and supervision and undergo periodic examinations by our regulators, who have extensive discretion and authority to prevent or remedy unsafe or unsound practices or violations of law by banks and bank holding companies. Failure to comply with applicable laws, regulations or policies could result in sanctions by regulatory agencies, civil monetary penalties, and/or damage to our reputation, which could have a material adverse effect on us. Although we have policies and procedures designed to mitigate the risk of any such violations, there can be no assurance that such violations will not occur.

The primary federal and state banking laws and regulations that affect us are described in this report under the section captioned Supervision and Regulation in Item 1. These laws, regulations, rules, standards, policies and interpretations are constantly evolving and may change significantly over time. For example, on July 21, 2010, the Dodd-Frank Act was signed into law, which significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act, together with the regulations to be developed thereunder, includes provisions affecting large and small financial institutions alike, including several provisions that affect how community banks, thrifts and small bank and thrift holding companies will be regulated. In addition, the Federal Reserve, in recent years, has adopted numerous new regulations addressing banks overdraft and mortgage lending practices. Further, the CFPB was recently established, with broad powers to supervise and enforce consumer protection laws, and additional consumer protection legislation and regulatory activity is anticipated in the near future.

In September 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, adopted Basel III, which constitutes a strengthened set of capital requirements for banking organizations in the United States and around the world. Basel III is currently the subject of notices of proposed rulemakings released in June of 2012 by the respective federal bank regulatory agencies. The comment period for these notices of proposed rulemakings ended on October 22, 2012, but final regulations have not yet been released. Basel III was intended to be implemented beginning January 1, 2013 and to be fully-phased in on a global basis on January 1, 2019. However, on November 9, 2012, the U.S. federal bank regulatory agencies announced that the implementation of the proposed rules under Basel III was indefinitely delayed. If and when implemented in the United States, Basel III would require capital to be held in the form of tangible common equity, generally increase the required capital ratios, phase out certain kinds of intangibles treated as capital and certain types of instruments, like trust preferred securities, and change the risk weightings of assets used to determine required capital ratios. Such changes, including changes regarding interpretations and implementation, could affect us in substantial and unpredictable ways and could have a material adverse effect on us. Further, 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.

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The policies of the Federal Reserve also have a significant impact on us. Among other things, the Federal Reserve s monetary policies directly and indirectly influence the rate of interest earned on loans and paid on borrowings and interest-bearing deposits, and can also affect the value of financial instruments we hold and the ability of borrowers to repay their loans, which could have a material adverse effect on us.

The Company and its subsidiaries may not be able to realize the benefit of deferred tax assets.

The Company records deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in years in which those temporary differences are expected to be recovered or settled. The deferred tax assets can be recognized in future periods dependent upon a number of factors, including the ability to realize the asset through carrybacks or carryforwards to taxable income in prior or future years, the future reversal of existing taxable temporary differences, future taxable income, and the possible application of future tax planning strategies. The Company s fully reserved deferred tax asset may not be recoverable with resulting adverse impact on the Company s capital and potentially capital ratios.

The Company is subject to claims and litigation pertaining to fiduciary responsibility.

From time to time, customers make claims and take legal action pertaining to the Company s performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Company s performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal action are not resolved in a manner favorable to the Company, they may result in significant financial liability and/or adversely affect the market perception of the Company and its products and services as well as impact customer demand for those products and services. Any financial liability or reputational damage could have a material adverse effect on the Company s business, which, in turn, could have a material adverse impact on its financial condition and results of operations.

The Company is a defendant in a variety of litigation and other actions.

Currently, there are certain other legal proceedings pending against the Company and its subsidiaries in the ordinary course of business. While the outcome of any legal proceeding is inherently uncertain, based on information currently available, the Company s management believes that any liabilities arising from pending legal matters would have a material adverse effect on the Bank or on the consolidated financial statements of the Company. However, if actual results differ from management s expectations, it could have a material adverse effect on the Company s financial condition, results of operations, or cash flows.

Risks Associated with the Company s Common Stock

The trading volume in the Company s Common Stock is less than that of other larger financial services institutions.

Although the Company s Common Stock is listed for trading on the Nasdaq Stock Market Exchange, the trading volume in its Common Stock may be less than that of other, larger financial services companies. A public trading market having the desired characteristics of depth, liquidity, and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company s Common Stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. During any period of lower trading volume of the Company s Common Stock, significant sales of shares of the Company s Common Stock, or the

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expectation of these sales could cause the Company s Common Stock price to fall.

The Company has not established a minimum dividend payment level, and it cannot ensure its ability to pay dividends in the future.

Our July 2011 Written Agreement with the Federal Reserve includes restrictions on the Company s payment of dividends on our common stock.

In addition, the Federal Reserve has issued Federal Reserve Supervision and Regulation Letter SR-09-4, which requires bank holding companies to inform and consult with Federal Reserve supervisory staff prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid. Under this regulation, if the Company experiences losses in a series of consecutive quarters, it may be required to inform and consult with the Federal Reserve supervisory staff prior to declaring or paying any dividends. In this event, there can be no assurance that the Company s regulators will approve the payment of such dividends.

We have deferred interest payments on our junior subordinated debentures and dividends on the Series B Preferred Stock, and the failure to resume payments may adversely affect the Company and the stockholders.

In the third quarter of 2010, the Company elected to defer regularly scheduled interest payments on $58.4 million of junior subordinated debentures related to the trust preferred securities issued by its two statutory trust subsidiaries, Old Second Capital Trust I and Old Second Capital Trust II (collectively, the Trust Preferred Securities). Because of the deferral on the junior subordinated debentures, the trusts have deferred regularly scheduled dividends on the Trust Preferred Securities. The total accumulated interest on the junior subordinated debentures including compounded interest from July 1, 2010 on the deferred payments totaled $11.7 million at December 31, 2012.

The Company has also suspended quarterly cash dividends on its Series B Preferred Stock, issued to the U.S. Treasury in connection with the Company s participation in the TARP Capital Purchase Program. Dividend payments on the Series B Preferred Stock may be deferred without default, but the dividend is cumulative and therefore will continue to accrue. The dividends have been deferred since November 15, 2010, and the accumulated Series B Preferred Stock dividends totaled $9.1 million at December 31, 2012.

The Company is allowed to defer payments of interest for 20 quarterly periods on the junior subordinated debentures without default or penalty, but such amounts will continue to accrue. Also during the deferral period, the Company generally may not pay cash dividends on or repurchase its common stock or preferred stock, including the Series B Preferred Stock. In February, 2012, the Company did not pay the required dividend to Treasury for the sixth time and as a result, the Treasury has the right to appoint two representatives to the Company s board of directors. The Treasury appointed a representative to our board of directors during the fourth quarter of 2012. The terms of the Series B Preferred Stock also prevent the Company from paying cash dividends on or repurchasing its common stock while Series B Preferred Stock dividends are in arrears.

The holders of our debt have rights that are senior to those of our stockholders.

We currently have a $45.5 million credit facility with a correspondent lender, which includes $45.0 million of subordinated debt and $500,000 in term debt. As of December 31, 2012, the entire $45.5 million of principal was outstanding. The term debt and subordinated debt mature on March 31, 2018. The senior debt is secured by all of the capital stock of the Bank. At December 31, 2012, the Company continued to be out of compliance with two of the financial covenants contained within the credit

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agreement, which constitutes an event of default. In addition, as of December 31, 2012, we also had $58.4 million in junior subordinated debentures related to the Trust Preferred Securities. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us to the extent the trusts have funds available for such obligations.

The rights of the holders of our senior debt, subordinated debt and junior subordinated debentures are senior to the shares of our common stock and senior preferred stock. As a result, we must make payments on our senior debt, subordinated debt and junior subordinated debentures (and the related Trust Preferred Securities) before any dividends can be paid on our common stock or preferred stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of our senior debt, subordinated debt and junior subordinated debentures must be satisfied before any distributions can be made to our stockholders.

The holders of our senior preferred stock have rights that are senior to those of our common stockholders.

In January 2009, we issued and sold 73,000 shares of our Series B Preferred Stock, which ranks senior to our common stock in the payment of dividends and on liquidation, to the Treasury (together with the warrant to acquire 815,339 shares of our common stock) for $73.0 million. During the first quarter of 2013, Treasury sold substantially all of Series B Preferred Stock to third party investors and certain of our directors in a public auction. It is anticipated that after the close of the initial auction that Treasury will sell the remaining shares of Series B Preferred Stock in a subsequent auction , which is expected to close by the end of first quarter 2013 or early in second quarter 2013. In the event of our bankruptcy, dissolution, or liquidation, the holders of the Series B Preferred Stock will receive distributions of our available assets prior to the holders of our common stock but after the holders of our senior debt, subordinated debt and junior subordinated debentures.

Holders of our Series B Preferred Stock have certain voting rights that may adversely affect our common stock holders, and the holders of the Series B Preferred Stock may have interests different from our common shareholders.

As a consequence of our missing the sixth dividend payment on our Series B Preferred Stock, the Treasury had the right to appoint two directors to our board of directors until all accrued but unpaid dividends have been paid. The Treasury exercised its right and appointed one director to the Company s board of directors during the fourth quarter of 2012. In addition to holding a seat on our board, the holders of the Series B Preferred Stock have limited voting rights, except as required by law.

For as long as shares of the Series B Preferred Stock are outstanding, in addition to any other vote or consent of the shareholders required by law or our articles of incorporation, the vote or consent of holders of at least 66 2/3% of the shares of the Series B Preferred Stock outstanding is required for any authorization or issuance of shares ranking senior to the Series B Preferred Stock; any amendments to the rights of the Series B Preferred Stock so as to adversely affect the rights, privileges, or voting power of the Series B Preferred Stock; or initiation and completion of any merger, share exchange or similar transaction unless the shares of Series B Preferred Stock remain outstanding, or if we are not the surviving entity in such transaction, are converted into or exchanged for preference securities of the surviving entity and the shares of Series B Preferred Stock remaining outstanding or such preference securities have the rights, preferences, privileges and voting power of the Series B Preferred Stock.

The holders of our Series B Preferred Stock, including the Treasury, and the director representing the Series B Preferred Stock, may have different interests from the holders of our common stock, and could vote to block the forgoing transactions, even when considered desirable by,

or in the best interests of the holders of our common stock.

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Item 1B. Unresolved Staff Comments

None

Item 2. Properties

We conduct our business at 27 retail banking center locations. We own 25 of our banking center facilities. The two leasehold facilities are leased through March 2015 and August 2016. All of our branches have ATMs, and we have 41 additional ATMs at other locations throughout northeastern Illinois. We believe that all of our properties and equipment are well maintained, in good operating condition and adequate for all of our present and anticipated needs.

Set forth below is information relating to each of our offices as of December 31, 2012. The total net book value of our premises and equipment (including land and land improvements, buildings, furniture and equipment, and buildings and leasehold improvements) at December 31, 2012, was $47.0 million.

Principal Business Office:

37 South River Street, Aurora, Illinois

Banking Office Locations:

Cook County

195 West Joe Orr Road, Chicago Heights, Illinois

DeKalb County

1810 Dekalb Avenue, Sycamore, Illinois

1100 South County Line Road, Maple Park, Illinois

DuPage County

4080 Fox Valley Center Drive, Aurora, Illinois

3101 Ogden Road, Lisle, Illinois

Kane County

1991 West Wilson Street, Batavia, Illinois

555 Redwood Drive, Aurora, Illinois

200 West John Street, North Aurora, Illinois

1350 North Farnsworth Avenue, Aurora, Illinois

Cross Street and State Route 47, Sugar Grove, Illinois

801 South Kirk Road, Saint Charles, Illinois

1230 North Orchard Road, Aurora, Illinois

1078 East Wilson Street, Batavia, Illinois

1000 South Mclean Boulevard, Elgin, Illinois (1)

3290 U.S. Highway 20 and Nesler Road, Elgin, Illinois

749 North Main Street, Elburn, Illinois

40W422 IL Route 64, Wasco, Illinois

194 South Main Street, Burlington, Illinois

2S101 Harter Road, Kaneville, Illinois (1)

Kendall County

1200 Douglass Road, Oswego, Illinois

26 West Countryside Parkway, Yorkville, Illinois

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7050 Burroughs Avenue, Plano, Illinois

La Salle County

323 East Norris Drive, Ottawa, Illinois

Will County

850 Essington Road, Joliet, Illinois

20201 South Lagrange Road, Frankfort, Illinois

951 East Lincoln Highway, New Lennox, Illinois

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(1) Leased facility

Item 3. Legal Proceedings

On February 17, 2011, a former employee filed a purported class action complaint in the U.S. District Court for the Northern District of Illinois on behalf of participants and beneficiaries of the Old Second Bancorp, Inc. Employees 401(k) Savings Plan and Trust alleging that the Company, the Bank, the Employee Benefits Committee of Old Second Bancorp, Inc. and certain of the Company s officers and employees violated certain disclosure requirements and fiduciary duties established under Employee Retirement Income Security Act of 1974, as amended (ERISA). The complaint seeks equitable and as-of-yet unquantified monetary relief. Though the Company believes that it, its affiliates, and its officers and employees have acted, and continue to act, in compliance with ERISA law with respect to these matters, without conceding liability, the named defendants have negotiated a settlement in principle with the plaintiffs. On February 26, 2013, the plaintiffs requested the court s preliminary approval of the parties settlement agreement. The Company and its legal counsel expect that the settlement agreement will be approved, and that the plaintiffs will therefore dismiss the litigation with a release of all claims. If approved, the settlement agreement will not have a material adverse effect on the financial statements of the Bank or on the consolidated financial position of the Company because the entire settlement amount will be paid by the Company s insurers.

In addition to the matter described above, the Company and its subsidiaries have, from time to time, collection suits in the ordinary course of business against its debtors and are defendants in legal actions arising from normal business activities. Management, after consultation with legal counsel, believes that the ultimate liabilities, if any, resulting from these actions will not have a material adverse effect on the financial position of the Bank or on the consolidated financial position of the Company.

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

Old Second Bancorp, Inc. and Subsidiaries

Corporate Information

Corporate Office

37 River Street

Aurora, Illinois 60506-4172

(630) 892-0202

www.oldsecond.com

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Market for the Company s Common Stock

The Company s common stock trades on The Nasdaq Global Select Market under the symbol OSBC . As of December 31, 2012, the Company had approximately 985 stockholders of record of its common stock. The following table sets forth the range of prices during each quarter for 2012 and 2011.

	2012			2011		
	High	**Low**	**Dividend**	**High**	**Low**	**Dividend**
First quarter	$ 1.98	$ 1.16	$ 0.00	$ 1.84	$ 0.83	$ 0.00
Second quarter	1.93	1.15	0.00	1.52	0.85	0.00
Third quarter	1.75	1.28	0.00	1.83	0.90	0.00
Fourth quarter	1.65	1.10	0.00	1.50	1.01	0.00

The Company incorporates by reference the information contained Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations under the caption Capital .

The Company also incorporates by reference the information contained under the Notes to Consolidated Financial Statements Note 19: Regulatory & Capital Matters .

The Company paid no dividends in 2011 or 2012 as set forth in the table above. The Company s shareholders are entitled to receive dividends when, as and if declared by the Board of Directors out of funds legally available therefore. The Company s ability to pay dividends to shareholders is largely dependent upon the dividends it receives from the Bank, and the Bank is subject to regulatory limitations on the amount of cash dividends it may pay. See Business Supervision and Regulation The Company Dividend Payments and Business Supervision and Regulation The Bank Dividend Payments for a more detailed description of these limitations.

As of December 31, 2012, we had $58.4 million of junior subordinated debentures held by two statutory business trusts that we control. We have the right to defer interest payments on the junior subordinated debentures, which were approximately $4.9 million in the year ended December 31, 2012, for a period of up to 20 consecutive quarters, and we elected to begin such a deferral period in August 2010. All deferred interest must be paid before we may pay dividends on our capital stock. Therefore, we will not be able to pay dividends on our common stock until all deferred interest on these debentures has been paid in full. The total amount of such deferred interest as of December 31, 2012, was $11.7 million.

Furthermore, as with the debentures discussed above, the Company is prohibited from paying dividends on its common stock unless it has fully paid all accrued dividends on its Series B Preferred Stock. In August 2010, the Company also announced the payment deferral of dividends on such preferred stock. Therefore, in addition to paying all the accrued and unpaid distributions on the debentures set forth above, the Company must also fully pay the Treasury all accrued and unpaid dividends on the Series B Preferred Stock before it may reinstate the payment of dividends on the common stock. Dividend payments on the Series B Preferred Stock may be deferred without default, but the dividend is cumulative and therefore will continue to accrue and, if the Company fails to pay dividends for an aggregate of six quarters, whether or not consecutive, the holder will have the right to appoint representatives to the Company s board of directors. A new director was appointed by the Treasury to join the board during the fourth quarter of 2012. During the first quarter of 2013, Treasury included the Company s Series B

Preferred Stock in an auction to third parties and Treasury sold substantially all of the Series B Preferred Stock to third party investors and certain of our directors. It is anticipated that after the close of the initial auction that Treasury will sell the remaining shares of Series B Preferred Stock in a subsequent auction, which is

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expected to close either at the end of first quarter or early in second quarter of 2013. For more information on the appointment of the new director please see the Company s Form 8-K dated November 20, 2012. The total amount of such deferred Series B Preferred Stock dividends as of December 31, 2012 was $9.1 million.

Form 10-K and Other Information

Transfer Agent/Stockholder Services

Inquiries related to stockholders records, stock transfers, changes of ownership, change of address and dividend payments should be sent to the transfer agent at the following address:

Old Second Bancorp, Inc.

c/o Shirley Cantrell,

Executive Administrative Department

37 River Street

Aurora, Illinois 60506-4172

(630) 906-2303

scantrell@oldsecond.com

Stockholder Return Performance Graph. The following graph indicates, for the period commencing December 31, 2007 and ending December 31, 2012, a comparison of cumulative total returns for the Company, the NASDAQ Bank Index and the S&P 500. The information assumes that $100 was invested at the closing price at December 31, 2007 in the common stock of the Company and each index and that all dividends were reinvested.

	Period Ending					
Index	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**
Old Second Bancorp, Inc.	100.00	44.96	27.12	6.72	5.14	4.82
NASDAQ Bank	100.00	78.46	65.67	74.97	67.10	79.64
S&P 500	100.00	63.00	79.68	91.68	93.61	108.59

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Stock Repurchases

There were purchases of 51,939 shares made by or on behalf of the Company of shares of its common stock during the year ended December 31, 2012 primarily for the payment of taxes relating to the vesting of stock awards.

Item 6. Selected Financial Data

Old Second Bancorp, Inc. and Subsidiaries

Financial Highlights

(In thousands, except share data)

	2012	2011	2010	2009	2008
Balance sheet items at year-end					
Total assets	$ 2,045,799	$ 1,941,418	$ 2,123,921	$ 2,596,657	$ 2,984,605
Total earning assets	1,834,995	1,751,662	1,933,296	2,359,740	2,720,142
Average assets	1,950,625	2,015,464	2,426,356	2,813,221	2,920,591
Loans, gross	1,150,050	1,368,985	1,690,129	2,062,826	2,271,114
Allowance for loan losses	38,597	51,997	76,308	64,540	41,271
Deposits	1,717,219	1,740,781	1,908,528	2,206,277	2,387,128
Securities sold under agreement to repurchase	17,875	901	2,018	18,374	46,345
Federal funds purchased					28,900
Other short-term borrowings	100,000		4,141	54,998	169,383
Junior subordinated debentures	58,378	58,378	58,378	58,378	58,378
Subordinated debt	45,000	45,000	45,000	45,000	45,000
Note payable	500	500	500	500	23,184
Stockholders equity	72,552	74,002	83,958	197,208	193,096
Results of operations for the year ended					
Interest and dividend income	75,081	85,423	106,681	132,650	157,927
Interest expense	15,735	21,473	28,068	45,513	68,413
Net interest and dividend income	59,346	63,950	78,613	87,137	89,514
Provision for loan losses	6,284	8,887	89,668	96,715	30,315
Noninterest income	42,914	36,008	44,910	43,047	35,260
Noninterest expense	96,048	97,569	100,636	144,630	80,312
(Loss) income before taxes	(72)	(6,498)	(66,781)	(111,161)	14,147
Provision (benefit) for income taxes			41,868	(45,573)	2,323
Net (loss) income	(72)	(6,498)	(108,649)	(65,588)	11,824
Preferred stock dividends and accretion	4,987	4,730	4,538	4,281	
Net (loss) income available to common stockholders	$ (5,059)	$ (11,228)	$ (113,187)	$ (69,869)	$ 11,824
Loan quality ratios					
	3.36%	3.80%	4.51%	3.13%	1.82%

Allowance for loan losses to total loans at end of year					
Provision for loan losses to total loans	0.55%	0.65%	5.31%	4.69%	1.33%
Net loans charged off to average total loans	1.56%	2.17%	4.10%	3.33%	0.41%
Nonaccrual loans to total loans at the end of year	6.74%	9.26%	12.56%	8.48%	4.69%
Nonperforming assets to total assets at end of year	7.58%	11.96%	14.50%	8.91%	4.15%
Allowance for loan losses to nonaccrual loans	49.79%	41.01%	35.96%	36.88%	38.75%
Per share data					
Basic (loss) earnings	$ (0.36)	$ (0.79)	$ (8.03)	$ (5.04)	$ 0.87
Diluted (loss) earnings	(0.36)	(0.79)	(8.03)	(5.04)	0.86
Dividends declared			0.02	0.10	0.63
Common book value per share	0.05	0.22	1.01	9.27	14.04
Weighted average diluted shares outstanding	14,207,252	14,220,822	14,104,228	13,912,916	13,689,214
Weighted average basic shares outstanding	14,074,188	14,019,920	13,918,309	13,815,965	13,584,381
Shares outstanding at year-end	14,084,328	14,034,991	13,911,475	13,823,917	13,755,884

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The following represents unaudited quarterly financial information for the periods indicated:

	2012				2011			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st
Interest income	$ 17,562	$ 18,333	$ 19,736	$ 19,450	$ 19,972	$ 21,045	$ 21,980	$ 22,426
Interest expense	3,645	3,698	4,046	4,346	4,955	5,123	5,506	5,889
Net interest income	13,917	14,635	15,690	15,104	15,017	15,922	16,474	16,537
Provision for loan losses			200	6,084	1,387	3,000	500	4,000
Securities gains (losses)	269	513	692	101	43	(63)	512	139
Income (Loss) before taxes	1,524	120	1,252	(2,968)	(3,001)	(1,390)	1,013	(3,120)
Net income (loss)	1,524	120	1,252	(2,968)	(3,001)	(1,390)	1,013	(3,120)
Basic earnings (loss) per share	0.02	(0.08)	0.00	(0.30)	(0.30)	(0.18)	(0.01)	(0.30)
Diluted earnings (loss) per share	0.02	(0.08)	0.00	(0.30)	(0.30)	(0.18)	(0.01)	(0.30)
Dividends paid per share								

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

Old Second Bancorp, Inc. and Subsidiaries

Management s Discussion and Analysis

of Financial Condition and Results of Operations

Overview

The following discussion provides additional information regarding the Company s operations for the twelve-month periods ending December 31, 2012, and 2011 and financial condition at December 31, 2012, and 2011. This discussion should be read in conjunction with Selected Consolidated Financial Data and the Company s consolidated financial statements and the accompanying notes thereto included or incorporated by reference elsewhere in this document.

The Company provides a wide range of financial services through its twenty-seven banking locations located in Cook, Kane, Kendall, DeKalb, DuPage, LaSalle and Will counties in Illinois. These banking centers offer access to a full menu of traditional retail and commercial banking services including treasury management operations as well as corporate and personal trust services. The Company focuses its business upon establishing and maintaining relationships with its clients while maintaining a commitment to providing for the financial services needs of the communities in which it operates through its retail branch network. Emphasis is placed upon relationships with individual customers as well as small to medium-sized companies throughout our market area. The Company s market area include a mix of commercial and industrial, real estate, and consumer related lending opportunities, and provide a stable core deposit base. The Company also has extensive wealth management

services, which now include a registered investment advisory platform in addition to trust administration and trust services related to personal and corporate trusts, including employee benefit plan administration services.

Although the precipitous rate of valuation decline in certain real estate assets appeared to have slowed generally in the latter part of 2010, overall economic sluggishness including continued high levels of unemployment continued to result in declines in the values of real estate and associated asset types during the reporting period that ended December 31, 2012, particularly in the Company s market area. The availability of ready local markets for real estate remained limited and continued to affect the ability of many borrowers to pay on their obligations. The Company s pre-tax losses for December 31, 2012, and 2011 were $72,000 and $6.5 million, respectively.

The Company recorded income tax expense totaling $41.9 million in 2010 as it established a valuation reserve on substantially all of its deferred tax assets. In 2011 and 2012, management determined that realization of the deferred tax asset was not more likely than not and maintained a full valuation

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allowance on net deferred tax assets. Considerations in making this tax valuation estimate included forecasts of future income, available tax planning strategies, and assessments of the current and future economic and business conditions. In each subsequent accounting period, the Company s management has reevaluated current conditions to consider support for a change in the valuation allowance against its deferred tax assets. Any such subsequent reduction in the estimated valuation allowance would lower the amount of income tax expense recognized in the Company s consolidated statements of operations in future periods. A discussion related to realizability of tax benefits and related items is included in our results of operations that follows as well as in Notes 1 and 11 of the consolidated financial statements included in this annual report.

In 2012, the Bank continued to reposition its balance sheet to reduce asset quality risk, maintain its capital ratios, and liquidity and improve asset quality. The Company deferred dividends and distributions related to its capital instruments and continued to take steps to cut operating expenses. The deferral of interest payments and dividends related to capital instruments are discussed in Notes 10 and 15 to the financial statements in this report. Management has emphasized continuing its open dialogue with customers, employees, stakeholders and regulators. A discussion of regulatory matters including the compliance of the Bank with the Consent Order is detailed in the Supervisory and Regulation section of Item 1 at this Form 10-K and in Note 15 to the consolidated financial statements included in this report. The Bank continued to work to address key asset quality and liquidity issues throughout 2012. At the same time, the Bank expanded upon its core competencies by broadening the platform of services offered in the wealth management unit by adding investment advisory/management services and continued with a high level of profit contribution from the mortgage origination unit despite difficulties in the larger economy and underlying real estate markets.

The Company s primary deposit products are checking, NOW, money market, savings, and certificate of deposit accounts, and the Company s primary lending products are commercial mortgages, construction lending, commercial loans, residential mortgages and consumer loans. Major portions of the Company s loans are secured by various forms of collateral including real estate, business assets, and consumer property while borrower cash flow is the primary source of repayment at the time of loan origination.

For 2012, the Company recorded a net loss of $72,000, or $0.36 per diluted share, which compares with net loss of $6.5 million or $0.79 diluted loss per share in 2011. The basic loss per share was $0.36 in 2012 and $0.79 in 2011. The Company recorded a $6.3 million provision for loan losses in 2012, compared to $8.9 million in 2011 a decrease of $2.6 million. The Company did not record a provision in the third or fourth quarter of 2012. Net charge-offs were $19.7 million during 2012, including $1.7 million in the fourth quarter. Net charge-offs were $33.2 million in 2011, which included $9.2 million in the fourth quarter. The net loss available to common stockholders was $5.1 million and $11.2 million for the years ended December 31, 2012, and December 31, 2011.

Net interest and dividend income decreased $4.6 million, or 7.2%, from $64.0 million for the year ended 2011 to $59.3 million for the year ended 2012. Average earning assets decreased $80.7 million, or 4.4%, from $1.82 billion in 2011 to $1.74 billion in 2012, as management continued to focus on asset quality and capital management. Average loans, including loans held for sale during the year, decreased $264.9 million, in part, from a continued low level of qualified borrower demand within the Company s market areas, combined with charge-off activity. Average interest bearing liabilities decreased $87.6 million, or 5.6%, from $1.56 billion in 2011 to $1.47 billion in 2012, as the need for funding decreased with the reduction in assets.

Application of critical accounting policies

The Company s consolidated financial statements are prepared in accordance with United States generally accepted accounting principles and follow general practices within the banking industry. Application of

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these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the consolidated financial statements.

Significant accounting policies are presented in Note 1 of the financial statements included in this annual report. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Management has determined that the Company s accounting policies with respect to the allowance for loan losses is an accounting area requiring subjective or complex judgments very important to the Company s financial position and results of operations. Therefore, the allowance policy is one of the Company s most critical accounting policies. The allowance for loan losses represents management s estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the amount of estimated losses on pools of homogeneous loans are based on historical loss experience, consideration of current economic trends and conditions, as well as estimated collateral valuations, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheets. The allowance for loan losses is a valuation allowance for loan losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using an assessment of various risk factors including, but not limited to, past loan loss experience, known and inherent risks in the portfolio, information about specific borrower situations, estimated collateral values, volume trends in delinquencies, nonaccruals, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for losses inherent in the loan portfolio. A loan is considered impaired when it is probable that not all contractual principal or interest due will be received according to the original terms of the loan agreement. Management defines the measured value of an impaired loan based upon the present value of the future cash flows, discounted at the loan s original effective interest rate, or the fair value of underlying collateral, if the loan is collateral dependent. Impaired loans at December 31, 2012, and 2011, were $89.0 million and $138.6 million, respectively. In addition, a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Provision for Loan Losses section that follows.

The Company recognizes expense for federal and state income taxes currently payable as well as deferred federal and state taxes, estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the consolidated balance sheets, as well as loss carryforwards and tax credit carryforwards. The Company maintained net deferred tax assets for deductible temporary differences, the largest of which related to the allowance for loan losses. For income tax return purposes as it relates to lending activities, only net charge-offs are deductible, not the provision for loan losses. Realization of deferred tax assets is dependent upon generating sufficient taxable income in either the carryforward or carryback periods to cover net operating losses generated by the reversal of temporary differences. A valuation allowance is provided by way of a charge to income tax expense if it is determined that it is not more likely than not that some or all of the deferred tax asset will be realized. That determination is highly subjective and dependent upon judgment concerning management s evaluation of both positive and negative evidence, including the forecasts of future income, applicable tax planning strategies, and assessments of current and future economic and business conditions. Management considered both positive and negative evidence regarding the ultimate realizability of the Company s deferred tax assets. Examples of positive evidence may include the existence, if any, of taxes paid in available carry-back years and the likelihood that taxable income will be

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generated in future periods. Examples of negative evidence included a cumulative loss and negative general business and economic trends. Management determined that realization of the deferred tax asset was not   more likely than not   as required by accounting principles and established a valuation allowance to reflect this judgment. Management believed internal projections and positive evidence was not sufficient under generally accepted accounting principles to overcome the negative evidence present at December 31 in both 2011 and 2012. This was based, in part, upon the lack of certainty of future projections to support the deferred tax assets from an accounting standpoint and based upon that guidance a valuation reserve was needed. This determination was based, largely, on the negative evidence of a cumulative loss caused primarily by the loan loss provisions made during the last four years. In addition, general uncertainty surrounding future economic and business conditions increased the likelihood of volatility in future earnings. Accrual of income taxes payable and valuation allowances against deferred tax assets are estimates subject to change based upon the outcome of future events.

Future issuances or sales of common stock or other equity securities could also result in an   ownership change   as defined for U.S. federal income tax purposes. If an ownership change were to occur, the Company could realize a loss of a portion of our U.S. federal and state deferred tax assets, including certain built-in losses that have not been recognized for tax purposes, as a result of the operation of Section 382 of the Internal Revenue Code of 1986, as amended. The amount of the permanent loss would be determined by the annual limitation period and the carryforward period (generally up to 20 years for federal net operating losses) and any resulting loss could have a material adverse effect on the results of operations and financial condition.

Income tax returns are also subject to audit by the Internal Revenue Service (IRS) and state taxing authorities. Income tax expense for current and prior periods is subject to adjustment based upon the outcome of such audits. The Company believes it has adequately accrued for all probable income taxes payable. Starting January 4, 2012, the Company was under examination with the IRS for the Company s Federal income tax filing for the year 2010. Starting February 21, 2013, the Company was under examination with the IRS for the Company s Federal income tax filing for the year 2011. Also, the Company was under examination by the State of Illinois for the tax years 2008 and 2009. Years that remain subject to examination are years 2010 and 2011 for Illinois.

Another of the Company s critical accounting policies relates to the fair value measurement of various nonfinancial and financial instruments including investment securities, valuation of OREO, derivative instruments and the expanded fair value measurement disclosures that are related to Accounting Standards Codification (ASC) 820-10 in detail in Notes 1 and 17 to the consolidated financial statements included in this annual report.

Results of operations

Net interest income

Net interest and dividend income decreased $4.6 million from $64.0 million for the year ended December 31, 2011, to $59.3 million for the year ended December 31, 2012. Average earning assets decreased $80.7 million, or 4.4%, during 2012 to $1.74 billion as of December 31, 2012, as management continued to emphasize asset quality and funded new loan originations continued to be limited. The $264.9 million decrease in year to date average loans and loans held-for-sale was primarily due to the ongoing decreased demand from qualified borrowers in the Bank s market area, charge-off activity, and movement of loan assets to OREO, as well as maturities and payments on performing loans. To utilize available liquid funds, management continued to increase securities available-for-sale in the fourth quarter of 2012 to 28.3% of total assets up from 21.7% at September 30, 2012, and 15.8% at the end of 2011. At the same time, management reduced deposits that had previously provided funding for those assets by emphasizing relationship banking rather than single service customers. As a result, average interest bearing liabilities

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decreased $87.6 million, or 5.6%, during 2012 to $1.47 billion as of December 31, 2012. The net interest margin (tax-equivalent basis), expressed as a percentage of average earning assets, decreased slightly from 3.54% in 2011 to 3.43% in 2012. The average tax-equivalent yield on earning assets decreased from 4.66% in 2011 to 4.28%, or 38 basis points, in 2012.

The Company s net interest income can be significantly influenced by a variety of factors, including overall economic conditions, credit risk, the amount of nonearning assets including nonperforming loans and OREO, the amounts of and rates at which assets and liabilities reprice, variances in prepayment of loans and securities, early withdrawal of deposits, exercise of call options on borrowings or securities, a general rise or decline in interest rates, changes in the slope of the yield-curve, and balance sheet growth or contraction. The Company s asset and liability committee (ALCO) seeks to manage interest rate risk under a variety of rate environments by structuring the Company s balance sheet and off-balance sheet positions, and this process is discussed in more detail in the interest rate risk section.

Provision for loan losses

In 2012, the Company recorded a $6.3 million provision for loan losses, all of which was made in the first half of the year, as no provision was made in the third and fourth quarters. In 2011, the provision for loan losses was $8.9 million, which included a provision of $1.4 million in the fourth quarter. Provisions for loan losses are made to provide for probable and estimable losses inherent in the loan portfolio. Nonperforming loans decreased to $82.6 million at December 31, 2012, from $138.9 million at December 31, 2011. Charge-offs, net of recoveries, totaled $19.7 million in 2012 and improved from $33.2 million in 2011. The distribution of the Company s net charge-off activity for the periods indicated is detailed in the first table below and the distribution of the Company s remaining nonperforming loans and related specific allocations at December 31, 2012, are included in the following tables.

Loan Charge-offs, Net

(in thousands)

	Three Months Ended December 31,		Year to Date December 31,	
	2012	**2011**	**2012**	**2011**
Real estate-construction				
Homebuilder	$ 426	$ 542	$ 1,194	$ 2,720
Land	14	96	(709)	3,100
Commercial speculative	180	2,405	848	3,083
All other	51	110	216	265
Total real estate-construction	671	3,153	1,549	9,168
Real estate-residential				
Investor	987	2,090	4,221	3,641
Owner occupied	342	237	1,782	3,767
Revolving and junior liens	530	296	1,820	1,014
Total real estate-residential	1,859	2,623	7,823	8,422
Real estate-commercial, nonfarm				
Owner general purpose	46	326	1,146	3,551
Owner special purpose	131	223	1,420	258
Non-owner general purpose	(1,608)	1,182	2,884	4,829
Non-owner special purpose		317	77	1,973

Retail properties	367	1,666	4,405	5,018
Total real estate-commercial, nonfarm	(1,064)	3,714	9,932	15,629
Real estate-commercial, farm				
Commercial	151	48	229	193
Other	43	(295)	151	(214)
	$ 1,660	$ 9,243	$ 19,684	$ 33,198

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The distribution of the Company s nonperforming loans as of December 31, 2012, is included in the chart below (in thousands):

Nonperforming loans
as of December 31, 2012

	Nonaccrual Total	90 Days or More Past Due (Accruing)	Substandard Restructured Loans (Accruing)	Total Non performing Loans	% Non Performing Loans	Specific Allocation
Real estate-construction	$ 9,253	$ 68	$ 556	$ 9,877	12.0%	$ 1,113
Real estate-residential:						
Investor	9,910			9,910	12.0%	477
Owner occupied	9,918	21	671	10,610	12.8%	1,089
Revolving and junior liens	3,771		61	3,832	4.6%	874
Real estate-commercial, nonfarm	41,365		3,699	45,064	54.6%	2,248
Real estate-commercial, farm	2,517			2,517	3.1%	
Commercial	762			762	0.9%	458
Other	23			23	0.0%	
	$ 77,519	$ 89	$ 4,987	$ 82,595	100.0%	$ 6,259

Classified loans decreased $116.2 million, or 50.0%, from December 31, 2011. For purposes of this table, classified loans are defined as loans rated substandard or worse, which closely reflects our regulator s definition. The components of the classified loans were as follows (in thousands):

	Classified Loans	
	12/31/2012	12/31/2011
Commercial	$ 1,063	$ 2,380
Real estate - commercial	70,368	134,015
Real estate - construction	14,140	38,481
Real estate - residential	30,647	57,550
Consumer	26	13
	$ 116,244	$ 232,439

Commercial Real Estate

Commercial Real Estate Nonfarm (CRE) loans remained the largest component of nonperforming loans at $45.1 million, or 54.6% of total nonperforming loans. The dollar volume of nonperforming CRE loans is down from $64.0 million at December 31, 2011. These decreases resulted from loans moving to OREO during these periods, loans paying off and loans upgraded as a result of improved performance. The class components of the CRE segment at December 31, 2012, were as follows (in thousands):

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CRE	Nonaccrual Total	90 Days or More Past Due (Accruing)	Restructured Loans (Accruing)	Total Non performing Loans	% Non performing CRE Loans	Specific Allocation
Owner occupied general purpose	$ 5,487	$	$	$ 5,487	12.2%	$ 230
Owner occupied special purpose	11,433			11,433	25.4%	712
Non-owner occupied general purpose	13,436		3,699	17,135	38.0%	204
Non-owner occupied special purpose	477			477	1.1%	
Retail properties	10,532			10,532	23.3%	1,102
	$ 41,365	$	$ 3,699	$ 45,064	100.0%	$ 2,248

Non-owner occupied, general purpose loans include credits that are collateralized by office, warehouse, and industrial properties and represented 25.9% of total CRE loans, and 38.0% of nonperforming CRE loans at the end of the fourth quarter of 2012. Year to date 2012 charge-offs in this category were $4.9 million, with most of the charge-offs coming from fully allocated credits, and management estimated that $204,000 of specific allocation was sufficient coverage for the remaining loss exposure at December 31, 2012. However, there can be no guarantee that actual losses in this category, and all other categories discussed in this section, will not exceed the amount specifically reserved for the category.

The owner occupied special purpose category had loans totaling $161.0 million, representing 29.1% of all CRE loans. With $11.4 million of these loans nonperforming at December 31, 2012, these loans accounted for 25.4% of total nonperforming CRE. Owner occupied special purpose credits include loans collateralized by property types such as car washes, golf courses, restaurants, and medical office buildings. Charge-offs in the year ended 2012 totaled $2.7 million in this loan category, and management estimated that the specific allocation of $712,000 was sufficient coverage for the remaining loss exposure at December 31, 2012.

Portfolio loans secured by retail property, primarily retail strip malls, continue to experience financial stress as vacancies and lower rents needed to secure tenants hampered successful retail mall performance. This class accounted for 8.7% of all CRE loans and 23.3% of all nonperforming CRE loans at December 31, 2012. For the year ended 2012 charge-offs in the retail segment totaled $4.6 million in this loan category and management estimated that the specific allocation of $1.1 million was sufficient coverage for the remaining loss exposure at December 31, 2012.

As of December 31, 2012, owner occupied general purpose loans comprised 22.9% of CRE, and 12.2% of nonperforming CRE loans. Charge-offs totaled $1.3 million in the year ending 2012, and management estimated that specific allocations of $230,000 was sufficient coverage for the remaining loss exposure at December 31, 2012.

Non-owner occupied special purpose loans represented 13.4% of the CRE portfolio, and 1.1% of nonperforming CRE loans at December 31, 2012. For the year ended December 31, 2012 there were charge-offs of $124,000. Management has reviewed all nonperforming loans and concluded no additional inherent losses are apparent which would require a specific reserve at December 31, 2012.

In addition to the specific allocations detailed above, management estimates include a higher risk commercial real estate pool loss factor for certain CRE loans. These loans typically have a deficiency in cash flow coverage from the property securing the credit, but other supporting factors such as liquidity, guarantor capacity, sufficient global cash flow coverage or cooperation from the borrower is evident to support the credit. These deficiencies in cash flow coverage are typically attributable to vacancies that are expected to be temporary or reduced operating income from the owner-occupant due to continued economic stress in our market areas. The pool also includes cases where the property

securing the credit

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has adequate cash flow coverage, but the borrower has other economic stress indicators to warrant heightened risk treatment. Due to a 3.3% decrease in the management factor in this pool and $45.5 million decrease in the higher risk CRE loans from December 31, 2011, management estimated a decrease of reserves of $5.8 million in the year ending December 31, 2012.

Office space absorption in our markets, especially in the local tollway corridor, has improved as space in greater Chicago is filled forcing tenants to locations in our markets. Healthcare relocations and expansions were evident in the market over the last year and the Company was successful in winning a few healthcare related expansion projects. The current office vacancy rate in the tollway corridor is the lowest seen in five years and medical office space is in expansion mode as smaller practices consolidate into larger medial groups. Similarly, the Company s industrial property borrowers (both owner and non-owner occupied) have not encountered high vacancies over the past twelve months.

Construction and Development

At December 31, 2012, nonperforming construction and development (C & D) loans totaled $9.9 million, or 12.0% of total nonperforming loans. This is a decrease of $23.9 million from $33.8 million at December 31, 2011. Of the $42.2 million of total C & D loans in the portfolio, 23.4% were nonperforming as of December 31, 2012, as compared to 47.3% at December 31, 2011. Total C & D charge-offs for the year ending 2012 were $5.0 million, as compared to $10.4 million in the year ending 2011. Following all charge-off activity, management estimated that specific allocations of $1.1 million were sufficient coverage for the remaining loss exposure in this segment at December 31, 2012. The majority of the Bank s C & D loans are located in suburban Chicago markets, predominantly in the far western and southwestern suburbs. The Bank s loan exposure to credits secured by homebuilder inventory is down 66.6% from a year ago.

Management closely monitors the performing loans that have been rated as special mention or substandard but that are still accruing interest. While some additional adverse migration is still possible, management believes that the remaining performing C & D borrowers have demonstrated sufficient operating strength through an extended period of weak construction to avoid classification as an impaired credit at December 31, 2012. As a result, management believes future losses in the construction segment will generally continue to trend downward. In addition to reviewing the operating performance of the borrowers when reviewing allowance estimates, management also continues to update underlying collateral valuation estimates to reflect the aggregate estimated credit exposure.

The C & D portfolio no longer dominates the Company s CRE portfolio and in fact now represents one of the lowest dollar and volume concentrations in the Company s loan portfolio. Additionally, overall repayment performance in this segment was substantially improved over the course of 2012.

Residential Real Estate

Nonperforming 1-4 family owner occupied residential mortgages totaled $10.6 million, or 12.8% of the nonperforming loan total as of December 31, 2012. This segment totaled $20.3 million at December 31, 2011 a decrease of 47.8%. While Kendall, Kane, and Will counties experienced high rates of foreclosure in both 2012 and 2011, the Bank has recently experienced somewhat improved nonperforming totals. The majority of all residential mortgage loans originated today are sold on the secondary market. Of the nonperforming loans in this category, $671,000, or 6.3%, are to homeowners enrolled in the Bank s foreclosure avoidance program and were classified as restructured at December 31, 2012. The typical concessions granted in these cases were small and temporary rate reductions and a reduced monthly payment with the

expectation that these borrowers will resume normal performance on their obligations when their earnings situation improves. The usual profile of these borrowers includes a decrease in

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household income resulting from a change or loss of employment. The remaining nonperforming loans in the 1-4 family residential category are in nonaccrual status and most cases are in various stages of foreclosure. Management believes that deterioration in the segment relates primarily to the high rate of unemployment in our market areas, which is offset by some reductions from loans moved to OREO or upgraded as borrowers regain employment. In addition, a significant portion of these nonperforming loans were supported by private mortgage insurance and at December 31, 2012, management estimated that a specific allocation of $1.1 million was adequate loss coverage following $2.1 million of charge-offs that occurred during the year ending 2012 and allowing for recurring problems and delays in collecting on private mortgage insurance. At December 31, 2012, there were loans of $21,000 that were greater than 90 days past due and were still accruing interest in this portion of the portfolio. Additionally, at December 31, 2012, loans 30 to 89 days past due and still accruing totaled $3.5 million, which was an improvement from $4.0 million at December 31, 2011.

Nonperforming residential investor loans at December 31, 2012, consisted of multi-family ($6.1 million) and 1-4 family properties ($3.8 million) for a total of $9.9 million, or 12.0% of the total nonperforming loans. This represented a decrease from $15.3 million at December 31, 2011. Following the charge-offs for year ended 2012 of $4.4 million, management estimated that a total specific allocation of $477,000 would provide sufficient loss reserves at December 31, 2012, for the remaining risk in this category. The multi-family and rental market segment is showing improved credit metrics as higher occupancy rates have driven stronger net operating income.

Management has seen improvements in the residential real estate markets in our market areas. With the exception of more remote rural and smaller suburban communities, residential property sales are returning to more normal levels.

Other

The remaining nonperforming credits included $762,000 in commercial loans, $3.8 million in consumer home equity and second mortgage loans, $2.5 million in farmland and agricultural loans and $23,000 in other loans. These loan categories have shown stable credit characteristics and losses have been minimal during this economic cycle. At December 31, 2012, management estimated that a total specific allocation of $458,000 on the commercial portfolio would be sufficient loss coverage for the remaining risk in those nonperforming credits and that $874,000 was sufficient loss coverage for the consumer home equity. These estimated amounts were following charge-offs during the year ending 2012 of $344,000 in commercial loans, and $2.0 million in consumer home equity loans.

Management has seen non-real estate commercial borrowers receiving benefit from economic recovery as their customer demand is up. To date, there has been a curtailment in borrowing as our significant commercial borrowers have accumulated cash reserves.

Other Troubled Loans

Loans that were classified as performing but 30 to 89 days past due and still accruing interest increased to $12.9 million at December 31, 2012, from $12.1 million at December 31, 2011. At December 31, 2012, loans 30 to 89 days past due consisted of $3.5 million in 1-4 family owner occupied mortgages, $7.1 million in commercial real estate credits, $440,000 in residential investor credits, $515,000 in construction and development, $159,000 in commercial loans, $3,000 in consumer loans and $1.1 million in home equity loans. TDRs accruing interest were $5.0 million at December 31, 2012.

Allowance for Loan Losses (ALLL)

The bank s ALLL methodology reasonably estimates loan and lease losses as of the financial statement

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date(s) and incorporates management s current judgments about the credit quality of the loan portfolio through a disciplined and consistently applied process. The methodology is done according to U.S. generally accepted accounting practices including, but not limited to, guidance included in Accounting Standards Codification (ASC) 310 and ASC 450, formally known as FAS 114 and FAS 5, respectively. Its analysis is prepared in accordance with guidelines established by generally accepted accounting principles, the SEC, the FFIEC, the AICPA Audit and Accounting Guide for Banks and Savings Institutions, and banking industry practices overall. This methodology is periodically reviewed by the bank s independent accountants and banking regulators.

The coverage ratio of the allowance for loan losses to nonperforming loans was 46.7% as of December 31, 2012, which reflects an increase from 37.4% as of December 31, 2011. A decrease of $56.3 million, or 40.6%, in nonperforming loans in 2012 drove the overall coverage ratio change. Management updated the estimated specific allocations in the fourth quarter after receiving more recent appraisal collateral valuations or information on cash flow trends related to the impaired credits. The estimated general allocations decreased by $6.6 million from December 31, 2011, as the overall loan balances subject to general factors decreased at December 31, 2012. Management determined the estimated amount to include in the allowance for loan losses based upon a number of factors, including loan growth or contraction, the quality and composition of the loan portfolio and loan loss experience. The latter item was also weighted more heavily based upon recent loss experience. The C & D portfolio has had diminished adverse migration and the remaining credits are exhibiting more stable credit characteristics leading to reduced general allocations at year end 2012. Management estimates adequate reserves have been established for the remaining risk of loss in the C & D portfolio.

Management regularly reviews the performance of the higher risk pool within CRE loans, and adjusts the population and the related loss factors taking into account adverse market trends including collateral valuation as well as its assessments of the credits in that pool. Those assessments capture management s estimate of the potential for adverse migration to an impaired status as well as its estimation of what the potential valuation impact from that migration would be if it were to occur. The amount of assets subject to this pool factor decreased by $45.5 million, or 66.7%, at December 31, 2012, as compared to December 31, 2011. Also, compared to December 31, 2011, management decreased the loss factor assigned to this pool by 3.3% based on risk characteristics of the remaining credits. Management has also observed that many stresses in those credits were generally attributable to cyclical economic events that are showing some signs of stabilization. Those signs included a reduction in loan migration to watch status, as well as some stabilization in values of certain properties.

Management conducts a full annual review of all Home Equity Lines of Credit (HELOC) by looking at credit scores and collateral values. When we are notified of a foreclosure on a first mortgage, our HELOC loan is moved to nonaccrual and a decision is made if the loan is collectible. We actively charge off loan balances in the absence of sufficient equity unless the borrower reaffirms or notifies us on an intention to reaffirm.

The above changes in estimates were made by management to be consistent with observable trends within loan portfolio segments and in conjunction with market conditions and credit review administration activities. Several environmental factors are also evaluated on an ongoing basis and are included in the assessment of the adequacy of the allowance for loan losses. When measured as a percentage of loans outstanding, the total allowance for loan losses decreased from 3.8% of total loans as of December 31, 2011, to 3.4% of total loans at December 31, 2012. In management s judgment, an adequate allowance for estimated losses has been established for inherent losses at December 31, 2012; however, there can be no assurance that actual losses will not exceed the estimated amounts in the future.

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The allowance for loan losses consists of three components: (i) specific allocations established for losses resulting from an analysis developed through reviews of individual impaired loans for which the recorded investment in the loan exceeds the measured value of the loan; (ii) reserves based on historical loss experience for each loan category; and (iii) reserves based on general current economic conditions as well as specific economic and other factors believed to be relevant to the Company s loan portfolio. The components of the allowance for loan losses represent an estimation performed pursuant to ASC Topic 450, Contingencies , and ASC Topic 310, Receivables including Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures . See Note 1 on Summary of Significant Accounting Policies for further detail.

The analysis of these factors involves a high degree of judgment by management. Because of the imprecision surrounding these factors, the Company estimates a range of inherent losses and maintains a general allowance that is not allocated to a specific category. Changes in the allowance for loan losses are detailed in Note 5 on the consolidated financial statements of this report.

Noninterest income

Noninterest income increased in the year ending December 31, 2012, by $6.9 million, or 19.2%, to $42.9 million as compared to $36.0 million for the year 2011. Most of the increase is from mortgage banking income including net gain on sales of mortgage loans, secondary market fees, and servicing income, which was $11.7 million in 2012, or an increase of $5.5 million, or 89.7%, from 2011 levels reflecting increases in sales of loans to investors.

Trust income decreased by $776,000, in 2012 from $6.8 million recorded in 2011 to $6.0 million in 2012. The 2012 decrease in annual revenue was largely caused by three key client departures early in 2012 along with lower levels of new business development throughout the year. Discretionary assets under management were $653.3 million and $741.7 million at December 31, 2012 and 2011, respectively. Substantially all of the 2011 decrease in discretionary assets in the trust department was attributable to the number of closed accounts and customers transfer of assets to other financial advisors.

Interchange income from debit card usage continued to increase in 2012 as customers continued to respond favorably to rewards programs and consumer card activity remained strong although recently announced and pending legislative changes may adversely affect this revenue source in the future. Interchange income from debit card usage was $3.5 million and $3.0 million in 2012 and 2011, respectively.

The lease revenue received from OREO properties decreased $138,000 in the year ended December 31, 2012, to $3.5 million as compared to $3.6 million in the prior year, as several properties that generated substantial rental income were sold during 2012. The Bank had a total net gain on sale of OREO properties of $2.2 million for the year, which was an $887,000 increase from 2011. The net gains resulted from management s successful efforts to dispose of OREO and focus on the reduction of nonperforming assets.

Net realized gains on securities sales (up $944,000 year over year) also contributed to improved noninterest income for 2012 over 2011.

Noninterest expense

Noninterest expense totaled $96.0 million in the year ended December 31, 2012, a decrease of $1.5 million, or 1.6%, from $97.6 million in the year ended December 31, 2011. Salaries and benefits expense was $35.0 million during the year ended December 31, 2012, which was a $974,000 increase from the prior year. This category totaled $34.0 million during the twelve months ended December 31, 2011. The

increase in salaries and benefits expense for the year resulted primarily from an increase in salary expense as we hired loan officers and accrued incentive compensation. The number of full time equivalent employees was 481 and 492 at December 31 2012, and 2011, respectively.

Net occupancy expense of $4.8 million decreased $271,000 or 5.3%, during 2012 compared with the $5.1 million recorded in 2011. Furniture and fixture expenses decreased by $987,000 to $4.6 million in the year ended December 31, 2012.

FDIC costs decreased $823,000, or 17.0%, for the year ended December 31, 2012, respectively, as compared to the same period of the prior year. The methodology for the assessment calculation changed effective with the second quarter of 2011. The revised assessment approach applies to an adjusted average asset base rather than insured deposits. The Bank s reduced asset base contributed to the lower Bank assessment. In addition, the reduction in assets inherent in management s balance sheet strategy has also resulted in lower FDIC premiums.

OREO expenses were flat in the year ended December 31, 2012 compared to the same period in 2011. There were decreases for the year to date period in insurance, taxes and general OREO expense. Professional and valuation expense increases offset these other decreases.

Other noninterest expenses decreased $420,000, or 3.3%, from approximately $12.8 million in the year ended December 31, 2011 to approximately $12.4 million in the same period of 2012. Other expense decreases resulted primarily from the reduction of consulting and management fees, and collection expense.

Income taxes

The Company did not record an income tax benefit for the year ended December 31, 2012, despite a $72,000 pre-tax loss during that period, due to the establishment of a valuation allowance against the Company s deferred tax assets which was first established as of December 31, 2010. Under generally accepted accounting principles, income tax benefits and the related tax assets are only allowed to be recognized if they will more likely than not be fully realized. As a result, at December 31, 2012, the net amount of the Company s deferred tax assets related to operations has been reduced to zero. The Company s effective tax rate for the year ending December 31, 2012, and 2011 was 0%.

The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgments concerning management s evaluation of both positive and negative evidence, including forecasts of future income, available tax planning strategies, and assessments of the current and future economic and business conditions. Management considered both positive and negative evidence regarding the ultimate realizability of the deferred tax assets, which is largely dependent upon the ability to derive benefits based upon future taxable income. Management determined that realization of the deferred tax asset was not more likely than not as required by accounting principles and established a valuation allowance at December 31, 2010, to reflect this judgment. A deferred tax asset related to accumulated other comprehensive loss resulting from the net unrealized loss on available-for-sale securities decreased to $928,000 at December 31, 2012, from $2.6 million at December 31, 2011. An increase in rates will generally cause a decrease in the fair value of individual securities and result in changes in unrealized loss on available-for-sale securities, while a decrease in rates generally causes an increase in fair value at a point in time. In addition to the impact of rate changes upon pricing, uncertainty in the financial markets can cause reduced liquidity for certain investments and those changes are discussed in detail in Note 3 to the consolidated financial statements. Management has both the ability and intent to retain an investment in available-for-sale securities.

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On September 12, 2012, the Company and the Bank, as rights agent, entered into the Amended and Restated Rights Plan and Tax Benefits Preservation Plan (the Rights Plan). The Rights Plan amends the Rights Agreement, dated September 17, 2002. The purpose of the Rights Plan is to protect the Company s deferred tax asset against an unsolicited ownership change, which could significantly limit the Company s ability to utilize its deferred tax assets. The Rights Plan will terminate if it is not ratified by the Company s stockholders at the Company s 2013 annual meeting. For a description of the Rights Plan, please refer to the Company s Form 8-A, filed September 13, 2012.

Financial condition

General

Total assets increased $104.4 million, or 5.4%, from December 31, 2011, to close at $2.05 billion as of December 31, 2012. Loans decreased by $218.9 million, or 16.0%, to $1.15 billion over the course of 2012 as management continued to emphasize balance sheet stabilization and credit quality and demand from qualified borrowers remained slow. At the same time, loan charge-off activity reduced balances and collateral that previously secured loans moved to OREO. OREO assets decreased $20.9 million, or 22.4%**,** for the year ended December 31, 2012, compared to December 31, 2011, as sale activity and valuation writedowns exceeded new properties added. Offsetting these reductions, available-for-sale securities increased by $272.3 million, or 88.5%, for the year ended December 31, 2012, reflecting continued movement by management to emphasize securities investments in the absence of qualified loan demand. Management continued to increase available-for-sale securities in the fourth quarter consistent with the Company s past practice of utilizing available liquid funds supplemented by short term borrowings from Federal Home Loan Bank of Chicago (FHLBC). For the year ended December 31, 2012, large dollar purchases were made in collateralized mortgage backed securities and asset-backed securities (many backed by student loan assets) totaling $203.5 million, and $184.0 million, respectively. At the same time, net cash equivalents increased despite general balance sheet stabilization. At December 31, 2012, the largest changes by loan type included decreases in commercial real estate, real estate construction, and residential real estate loans of $124.8 million, $29.3 million and $62.7 million, or 17.7%, 41.0%, and 13.1%, respectively.

Investments

As shown below, net investments purchases during 2012 changed the composition of our securities portfolio as total loans continued to decline (dollars in millions).

	12/31/2011	% of Total	6/30/2012	% of Total	12/31/2012	% of Total
U.S. government agencies	$ 43.4	14.1%	$ 44.6	11.2%	$ 49.9	8.6%
U.S. government agency mortgage-backed	154.0	50.1%	95.2	23.9%	128.7	22.2%
Collateralized mortgage obligations	25.1	8.2%	62.4	15.6%	169.6	29.2%
Asset-backed securities	28.3	9.2%	136.7	34.3%	167.5	28.9%
Other (Treasury, State and political, Corporate, and CDO)	56.8	18.4%	60.0	15.0%	64.2	11.1%
Total securities available-for-sale	307.6	100.0%	398.9	100.0%	579.9	100.0%
Total loans	1,369.0		1,238.1		1,150.1	
Total loans and securities available-for-sale	$ 1,676.6		$ 1,637.0		$ 1,730.0	

Securities available-for-sale increased $272.3 million during 2012, from $307.6 million as of December 31, 2011, to $579.9 million as of December 31, 2012. Collateralized debt obligations (CDO) remain unchanged at $10.0 million as of December 31, 2012.

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Loans

Total loans were $1.15 billion as of December 31, 2012, a decrease of $218.9 million, or 16.0%, from $1.37 billion as of December 31, 2011. The lack of demand from qualified borrowers through the year hindered growth in the loan portfolio. As discussed in the Loan Loss Provision section above, management continued to emphasize loan portfolio quality in 2012 and, as a result, $19.7 million of net loan charge-offs were recorded in 2012 down from $33.2 million in 2011.

The quality of the loan portfolio is in large part a reflection of the economic health of the communities in which the Company operates. The local economies have been affected by the overall decline in economic conditions that has been experienced nationwide. The adverse economic conditions continue to affect our business regions in particular and financial markets generally. Real estate related activity, including valuations and transactions, while improved from past severe conditions continues to experience distress. Because the Company is located in a growth corridor with significant open space and undeveloped real estate, real estate lending (including commercial, residential, and construction) has been and continues to be a sizeable portion of the portfolio. These categories comprised 90.1% of the portfolio as of December 31, 2012 compared to 91.5% of the portfolio as of December 31, 2011. The commercial loan sector also decreased $11.2 million, or 11.4%, to $86.9 million at December 31, 2012, from $98.1 million at December 31, 2011. The Company remains committed to overseeing and managing its loan portfolio to attempt to avoid unnecessarily high credit concentrations in accordance with the Consent Order as well as general interagency guidance on risk management. Consistent with those commitments, management updated its asset diversification plan and policy and anticipates that the percentage of real estate lending to the overall portfolio will decrease in the future. Consumer loans, overdrafts, and lease financing receivables also increased $3.8 million or 60.4% in the aggregate, to $10.2 million at December 31, 2012, from $6.3 million at December 31, 2011.

The allowance for loan losses was $38.6 million and $52.0 million at year end 2012 and 2011, respectively. One measure of the adequacy of the allowance for loan losses is the ratio of the allowance to total loans. The allowance for loan losses as a percentage of total loans was 3.4% as of December 31, 2012, compared to 3.8% as of December 31, 2011. In management s judgment, an adequate allowance for estimated losses has been established; however, there can be no assurance that losses will not exceed the estimated amounts in the future.

Management, along with many other financial institutions, remains cautious about the current economic environment and outlook including the continued elevated levels of unemployment. Furthermore, the sustained slowdown in the real estate market could continue to adversely affect collateral values. These events adversely affect cash flows generally for both commercial and individual borrowers, and as a result, the Company could continue to experience elevated levels of problem assets, delinquencies, and losses on loans in future periods.

Other Real Estate Owned

OREO net of valuation reserve totaled $72.4 million at December 31, 2012, or a decrease of $20.9 million from December 31, 2011, whereas the year ended December 31, 2011 had an overall increase of $17.7 million. Disposition activity for the year was $36.9 million which included strong fourth quarter dispositions of $16.3 million. Most notably the fourth quarter included disposition of a property carried at $6.5 million. Additions and improvements to OREO were $32.8 million for the year ended December 31, 2012 compared to $74.9 million for the year ended December 31, 2011. Fourth quarter 2012 additions of $5.2 million are net of an OREO participant reclass processed in December 2012. Additionally, valuation write downs were $16.8 million for the year ended 2012. In the year ended 2012, management successfully converted collateral securing problem loans to properties ready for disposition, spent as needed on development improvements, transacted asset dispositions and recorded valuation adjustments as shown below in thousands. As a result, holdings in all categories of vacant land suitable

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for farming, lots suitable for development, commercial, multi-family properties and single family residence properties declined during the year ended December 31, 2012. Overall, a net gain on sale of $1.8 million was realized in fourth quarter 2012 representing the majority of the $2.2 million net gain on sale for the year ended December 31, 2012.

	Three Months Ended December 31,		Year to Date December 31,	
	2012	2011	2012	2011
Beginning balance	$ 88,093	$ 100,554	$ 93,290	$ 75,613
Property additions	5,177	11,560	32,121	71,915
Development improvements	55	423	701	2,984
Less:				
Property disposals	16,337	13,059	36,854	41,813
Period valuation adjustments	4,565	6,188	16,835	15,409
Other real estate owned	$ 72,423	$ 93,290	$ 72,423	$ 93,290

4th quarter Property additions of $11.1 million and full year additions of $38.0 million reduced to $5.2 million and $32.1 million above by participant reclass.

The OREO valuation reserve increased to $31.5 million, which is 30.3% of gross OREO at December 31, 2012. The valuation reserve represented 20.1% of gross OREO at December 31, 2011. In management s judgment, an adequate property valuation allowance has been established; however, there can be no assurance that actual valuation losses will not exceed the estimated amounts in the future.

Funding / Borrowings

Total deposits decreased $23.6 million, or 1.4%, during the year ended December 31, 2012, to close at $1.72 billion. The deposit segment that declined in this period was time certificates of deposits, which declined $106.7 million, or 17.3%. The Bank also decreased the level of brokered certificates of deposit in the same period from $930,000 at December 31, 2011 to zero at December 31, 2012. At the same time, noninterest bearing demand deposits increased by $17.5 million, or 4.8%, interest bearing savings, NOW and money market deposits increased by $19.4 million, $10.9 million and $35.3 million or 9.9%, 4.0%, and 12.2%, respectively. The decrease in time deposits occurred primarily due to management s pricing strategy discouraging customers with a single service relationship at the Bank. Market interest rates decreased generally and the average cost of interest bearing deposits decreased from 1.11% in the year ended December 31, 2011, to 0.73%, or 38 basis points, in the same period of 2012. Similarly, the average total cost of interest bearing liabilities decreased 30 basis points from 1.37% in the year ended December 31, 2011 to 1.07% in the same period of 2012.

The Company entered into a $75.5 million credit facility with Bank of America in the first quarter of 2008. The $75.5 million credit facility obtained in 2008 was comprised of a $30.5 million senior debt facility, which included the $30.0 million revolving line that matured on March 31, 2010, $500,000 in term debt as well as $45.0 million of subordinated debt. The Company had no principal outstanding on the revolving line when it matured, $500,000 in principal outstanding in term debt, and $45.0 million in outstanding subordinated debt. The term debt is secured by all of the outstanding capital stock of the Bank. The Company was out of compliance with two of the financial covenants of this credit facility at December 31, 2012 and December 31, 2011.

Other major borrowing category changes from December 31, 2011 included an increase of $100.0 million, or 100.0%, in other short-term borrowings. At December 31, 2012, the Bank maintained several different sources of liquidity including $80.7 million in overnight cash invested with the Federal Reserve Bank (FRB), $69.5 million in available borrowing capacity with the Federal Home Loan Bank of

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Chicago (FHLBC) and FRB of Chicago, as well as additional unencumbered securities with a market value of $388.8 million that could be pledged to increase borrowing capacity. In addition, the Bank has a preestablished program to review the loan portfolio for credits that strengthen borrowing capacity at both the FRB of Chicago and FHLBC through the delivery of files that meet their respective eligibility requirements.

Capital

Total stockholders equity decreased $1.4 million, or 2.0%, to $72.6 million at year end 2012, from $74.0 million as of December 31, 2011. This decrease was primarily attributable to the net loss from operations in the year 2012. A net loss available to common shareholders of $5.1 million which included preferred dividends and accretion of $5.0 million decreased retained earnings to $12.0 million as of December 31, 2012. In the same year, a $2.4 million decrease in the securities unrealized loss position net of tax decreased the accumulated other comprehensive loss to $1.3 million from $3.7 million at December 31, 2011. In 2011, retained earnings decreased by a net loss available to common stockholders of $11.2 million, which decreased retained earnings to $17.1 million as of December 31, 2011.

As discussed in Note 20 of the consolidated financial statements, the United States Treasury completed its investment in the Company in January 2009, as part of the CPP, and those proceeds continue to qualify as Tier 1 capital at December 31, 2012. The Series B Preferred Stock and warrants to purchase common stock of the Company that were issued increased stockholders equity by $68.2 million and $4.8 million, respectively, at December 31, 2009 and remained in place through 2011 and 2012 to December 31, 2012. The fair value ascribed to the warrants is included as part of additional paid-in capital.

As of December 31, 2012, the Company s regulatory ratios of total capital to risk weighted assets and Tier 1 capital to risk weighted assets increased to 13.62%, and 6.81%, while the Tier 1 leverage decreased to 4.85%, compared to 12.38%, 6.21%, and 4.98%, respectively, at December 31, 2011. The Company, on a consolidated basis, exceeded the minimum ratios to be deemed adequately capitalized under regulatory defined capital ratios at December 31, 2012. The same capital ratios at the Bank were 14.86%, 13.59%, and 9.67%, respectively, at December 31, 2012, compared to 12.97%, 11.70%, and 9.34%, at December 31, 2011. The Bank s ratios exceeded the heightened capital ratios agreed to in the Consent Order entered into with the OCC in May 2011.

As discussed in the section entitled Supervision and Regulation , in July 2011, the Company entered into the Written Agreement with the Reserve Bank designed to maintain the financial soundness of the Company. The Written Agreement also calls for the Company to serve as a source of strength for the Bank, including ensuring that the Bank complies with the Consent Order.

In 2012, the federal bank regulatory agencies issued joint proposed rules that would implement an international capital accord called Basel III , developed by the Basel Committee on Banking Supervision, a committee of central banks and bank supervisors. The proposed rules would apply to all depository organizations in the United States and most of their parent companies and would increase minimum capital ratios, add a new minimum common equity ratio, add a new capital conservation buffer, and would change the risk weightings of certain assets for the purposes of calculating certain capital ratios. The proposed changes were scheduled to be phased in from 2013 through 2019. This implementation has been delayed. No new implementation dates have been announced.

In addition to the above regulatory ratios, as expected due to net losses in 2012, the Company s non-GAAP tangible common equity to tangible assets and the Tier 1 common equity to risk weighted assets decreased to (0.13)% and (0.12)%, respectively, at December 31, 2012, compared to (0.08)% and (0.05)%, respectively, at December 31, 2011.

The Company completed the sale of $32.6 million of cumulative trust preferred securities by its subsidiary, Old Second Capital Trust I in July 2003 and the payment of regularly scheduled dividends are in deferral. These trust preferred securities remain outstanding for a 30-year term, but subject to regulatory approval, they can be called in whole or in part at the Company s discretion after an initial five-year period, which has since passed. The Company does not currently intend on seeking regulatory approval to call these securities. Dividends are payable quarterly at an annual rate of 7.80% and are included in interest expense in the consolidated financial statements even when deferred. Likewise, the Company issued an additional $25.0 million of cumulative trust preferred securities through a private placement completed by a second unconsolidated subsidiary, Old Second Capital Trust II in April 2007. These trust preferred securities also mature in 30 years, but subject to the aforementioned regulatory approval, can be called in whole or in part in 2017. When not in deferral the quarterly cash distributions on the securities are fixed at 6.766% through June 15, 2017 and float at 150 basis points over the three-month LIBOR rate thereafter. As of December 31, 2012, trust preferred proceeds of $24.6 million qualified as Tier 1 regulatory capital and $32.0 million qualified as Tier 2 regulatory capital. As of December 31, 2011, trust preferred proceeds of $25.9 million qualified as Tier 1 regulatory capital and $30.7 million qualified as Tier 2 regulatory capital. Additionally, the $45.0 million in subordinated debt that was obtained to finance the February 2008 acquisition qualified as Tier 2 regulatory capital as of December 31, 2012 and December 31, 2011.

As announced and implemented in the third quarter of 2010, the Company elected to defer regularly scheduled interest payments on $58.4 million of junior subordinated debentures related to the trust preferred securities issued by its two statutory trust subsidiaries, Old Second Capital Trust I and Old Second Capital Trust II (collectively the Trust Preferred Securities). Because of the deferral on the subordinated debentures, the trusts will defer regularly scheduled dividends on their Trust Preferred Securities. The total accumulated interest on the Trust Preferred Securities including compounded interest from July 1, 2010, on the deferred payments totaled $11.7 million at December 31, 2012. Under the terms of the junior subordinated debentures, the Company is allowed to defer payments of interest for 20 quarterly periods on the Trust Preferred Securities without default or penalty, but such amounts will continue to accrue. Also during the deferral period, the Company generally may not pay cash dividends on or repurchase its common stock or preferred stock, including the Series B Preferred Stock.

Under the terms of the Series B Preferred Stock, the Company is required to pay dividends on a quarterly basis at a rate of 5% per year for the first five years, after which the dividend rate automatically increases to 9%. Dividend payments on the Series B Preferred Stock may be deferred without default, but the dividend is cumulative and therefore will continue to accrue, and, if the Company fails to pay dividends for an aggregate of six quarters, whether or not consecutive, the holder will have the right to appoint representatives to the Company s board of directors. A new director was appointed by the U.S. Treasury to join the board during the fourth quarter of 2012. For more information on the appointment please see the Company s Form 8-K dated November 20, 2012.

The Company has suspended quarterly cash dividends on its Series B Preferred Stock, issued to the Treasury in connection with the Company s participation in the CPP as well as suspending dividends on its outstanding common stock. The dividend payments on the Series B Preferred Stock have been deferred since November 15, 2010, and while in deferral these dividends are compounded quarterly. The accumulated Series B Preferred Stock dividends declared and accrued totaled $9.1 million at December 31, 2012, and are reflected as a reduction to capital even though not paid.

During the fourth quarter of 2012, the U.S. Department of the Treasury announced continuation of individual auctions of its CPP preferred stock and subordinated debt positions, and included Old Second in the auction. The sale of these securities at auction is part of Treasury s efforts to conclude the CPP. At December 31, 2012, Old Second Bancorp carried $71.9 million of this preferred stock in Total Stockholders Equity. During the first quarter of 2013, Treasury included the Company s Series B

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Preferred Stock in an auction to third parties and sold substantially all of the Series B Preferred Stock to third party investors and certain directors. It is anticipated that after the close of the initial auction that Treasury will sell the remaining shares of Series B Preferred Stock in a subsequent auction, which is expected to close either at the end of first quarter or early in the second quarter of 2013.

The Company was limited in its ability to repurchase common shares because of restrictions imposed by Treasury as a result of the Company s participation in the CPP, which such restrictions are no longer in place, and such repurchases were limited to amounts associated with the tax liability incurred with the vesting of stock awards under the preexisting equity incentive plan. The Company repurchased 51,939 shares in 2012, resulting in an increase in treasury stock to 4,644,806 shares as of December 31, 2012. The repurchase of these shares increased treasury stock by $63,000 or 0.07% to $95.0 million at December 31, 2012. The Company had repurchased 37,804 shares in 2011, resulting in an increase in treasury stock to 4,592,867 shares as of December 31, 2011. The repurchase of these shares increased treasury stock by $49,000, or 0.05%, to $94.9 million at December 31, 2011. Treasury stock repurchased decreases stockholders equity, but also increases earnings per share by reducing the number of shares outstanding. No options were exercised in the years ended December 31, 2012 and 2011. Return on average equity was (0.10%) and (8.15%) in 2012 and 2011, respectively.

Bank regulatory agencies have adopted capital standards by which all banks and bank holding companies are evaluated. Those agencies define the basis for these calculations including the prescribed methodology for the calculation of the amount of risk-weighted assets. The risk based capital guidelines were designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks. In addition to the regulatory capital ratios disclosed above, information regarding capital levels and minimum required levels can be found in Note 15 of the consolidated financial statements.

Contractual Obligations, Commitments, Contingent Liabilities, and Off-balance sheet arrangements

The Company has various financial obligations that may require future cash payments. The following table presents, as of December 31, 2012, significant fixed and determinable contractual obligations (all dollars in thousands) to third parties by payment date:

	Within One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$ 1,206,427	$	$	$	$ 1,206,427
Certificates of deposit	244,695	234,434	31,663		510,792
Securities sold under repurchase agreements	17,875				17,875
Other short-term borrowings	100,000				100,000
Junior subordinated debentures				58,378	58,378
Subordinated debt				45,000	45,000
Notes payable and other borrowings				500	500
Purchase obligations	811	413			1,224
Automatic teller machines (ATM s) leases	31	23			54
Operating leases	94	185	58		337
Nonqualified voluntary deferred compensation plan	63	42	390	1,042	1,537
Total	$ 1,569,996	$ 235,097	$ 32,111	$ 104,920	$ 1,942,124

Purchase obligations represent obligations under agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price

provisions; and the approximate timing of the transaction. The purchase obligation amounts presented above primarily relate to certain contractual payments for services provided for information technology, capital expenditures, and the outsourcing of certain operational activities. We routinely enter into contracts for services. These

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contracts may require payment for services to be provided in the future and may also contain penalty clauses for early termination. We have made an effort to estimate such payments, where applicable. Additionally, where necessary, we have made reasonable estimates as to certain purchase obligations as of December 31, 2012. Management has used the information available to make the estimations necessary to value the related purchase obligations.

We also enter into derivative contracts, which include contracts under which we are required to either receive cash from, or pay cash to, counterparties depending on changes in interest rates. Derivative contracts are carried at fair value on the consolidated balance sheet as disclosed in Note 18 of the Notes to the Consolidated Financial Statements provided in Part II, Item 8, Financial Statements and Supplementary Data . Because the fair value of derivative contracts changes daily as market interest rates change, the derivative assets and liabilities recorded on the balance sheet at December 31, 2012 do not necessarily represent the amounts that may ultimately be paid. As a result, these assets and liabilities are not included in the table of contractual obligations presented above.

Assets under management are held in the investment advisory company. In addition, assets under management and assets under custody are held in fiduciary or custodial capacity for our clients. In accordance with U. S. Generally Accepted Accounting Principles, these assets are not included on our balance sheet.

We are also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our clients. These financial instruments include commitments to extend credit including performance, standby and commercial letters of credit. Further discussion of these commitments is included in Note 14 of the Notes to Consolidated Financial Statements provided in Part II, Item 8, Financial Statements and Supplementary Data .

The following table details the amounts and expected maturities of significant commitments to extend credit as of December 31, 2012:

	Within One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Commitment to extend credit:					
Commercial secured by real estate	$ 13,072	$ 3,820	$ 5,696	$ 719	$ 23,307
Revolving open end residential	13,504	27,000	20,284	51,189	111,977
Other	101,966	16,370			118,336
Financial standby letters of credit (borrowers)	3,378	5			3,383
Performance standby letters of credit (borrowers)	5,545	302			5,847
Commercial letters of credit (borrowers)	51				51
Performance standby letters of credit (others)	1,365				1,365
Total	$ 138,881	$ 47,497	$ 25,980	$ 51,908	$ 264,266

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Liquidity and market risk

Liquidity is the Company s ability to fund operations, to meet depositor withdrawals, to provide for customer s credit needs, and to meet maturing obligations and existing commitments. The liquidity of the Company principally depends on cash flows from net operating activities, including pledging requirements, investment in, and maturity of assets, changes in balances of deposits and borrowings, and its ability to borrow funds. The Company continually monitors its cash position and borrowing capacity as well as performs monthly stress tests of contingency funding as part of its liquidity management

process. In the first quarter of 2011, management expanded the methodology for stress testing of liquidity for contingency funding purposes to include tests that outline scenarios for specifically identified liquidity risk events, which are then aggregated into a Bank-wide assessment of liquidity risk stress levels. The outcomes of these tests are reviewed by management and the Company s Board of Directors monthly.

Net cash inflows from operating activities were $43.3 million during 2012, compared with $29.3 million in 2011. Proceeds from sales of loans held-for-sale, net of funds used to originate loans held-for-sale, was a source of inflow for 2012 and 2011. Interest received, net of interest paid, combined with changes in provision for loan losses, and other assets and liabilities were a source of inflow for 2012 and 2011. The Company did not record an income tax benefit for the year ended December 31, 2012, despite a $72,000 pre-tax loss during the year, due to the establishment of a valuation allowance against the Company s deferred tax assets established as of December 31, 2010. Management of investing and financing activities, as well as market conditions, determines the level and the stability of net interest cash flows. Management s policy is to mitigate the impact of changes in market interest rates to the extent possible as part of the balance sheet management process.

Net cash outflows from investing activities were $59.1 million in 2012, compared to net cash inflow of $95.9 million in 2011. Consistent with management s deleveraging strategy in 2012, securities transactions accounted for a net outflow of $264.8 million, net principal received on loans accounted for net inflows of $167.5 million, and proceeds from the sales of OREO assets accounted for inflows of $39.1 million. In 2011, securities transactions accounted for a net outflow of $159.9 million, and net principal disbursed on loans accounted for net inflows of $216.5 million whereas proceeds from the sale of OREO assets accounted for inflows of $43.1 million.

Net cash inflows from financing activities in 2012, were $93.3 million compared with net cash outflows of $173.1 million in 2011. Significant cash inflows from financing activity in 2012 included an increase in securities sold under repurchase agreements of $17.0 million and an increase in other short term borrowings of $100.0 million, offset by decreases in deposits of $23.6 million. Significant cash outflows from financing activities in 2011 included reductions of $167.7 million in deposits and $4.1 million in other short-term borrowings. Net reductions in securities sold under repurchase agreements were $1.1 million during 2011.

Interest rate risk

As part of its normal operations, the Company is subject to interest-rate risk on the assets it invests in (primarily loans and securities) and the liabilities it funds (primarily customer deposits and borrowed funds), as well as its ability to manage such risk. Fluctuations in interest rates may result in changes in the fair market values of the Company s financial instruments, cash flows, and net interest income. Like most financial institutions, the Company has an exposure to changes in both short-term and long-term interest rates.

The Company manages various market risks in its normal course of operations, including credit, liquidity risk, and interest-rate risk. Other types of market risk, such as foreign currency exchange risk and commodity price risk, do not arise in the normal course of the Company s business activities and operations. In addition, since the Company does not hold a trading portfolio, it is not exposed to significant market risk from trading activities. The changes in the Company s interest rate risk exposures at December 31, 2012, and December 31, 2011, are outlined in the table below.

Like most financial institutions, the Company s net income can be significantly influenced by a variety of external factors, including: overall economic conditions, policies and actions of regulatory authorities, the amounts of and rates at which assets and liabilities reprice, variances in

prepayment of loans and securities other than those that are assumed, early withdrawal of deposits, exercise of call options on borrowings or securities, competition, a general rise or decline in interest rates, changes in the slope of the yield-curve, changes in historical relationships between indices (such as LIBOR and prime), and

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balance sheet growth or contraction. The Company s ALCO seeks to manage interest rate risk under a variety of rate environments by structuring the Company s balance sheet and off-balance sheet positions, which includes interest rate swap derivatives as discussed in Note 18 of the financial statements included in this annual report. The risk is monitored and managed within approved policy limits.

The Company utilizes simulation analysis to quantify the impact of various rate scenarios on net interest income. Specific cash flows, repricing characteristics, and embedded options of the assets and liabilities held by the Company are incorporated into the simulation model. Earnings at risk is calculated by comparing the net interest income of a stable interest rate environment to the net interest income of a different interest rate environment in order to determine the percentage change. Due to the significant declines in interest rates that have occurred during the first half of 2012, it is no longer possible to calculate valid interest rate scenarios that represent declines of 0.5% or more. Consequently, net interest income sensitivity is currently only calculated for interest rate increases. Compared to December 31, 2011, the Company would have less earnings gains (in dollars) if interest rates should rise. This decline in rising-rate benefit reflects the Company s decision to extend some loan and investment maturities to help support margin, while still maintaining a position to benefit from rising rates when that event occurs. Federal Funds rates and the Bank s prime rate were stable throughout the year at 0.25% and 3.25%, respectively.

The following table summarizes the effect on annual income before income taxes based upon an immediate increase or decrease in interest rates of 0.5%, 1%, and 2% and no change in the slope of the yield curve. The -2% -1% and -0.5% sections of the table do not show model changes for those magnitudes of decrease due to the low interest rate environment over the relevant time periods:

Analysis of Net Interest Income Sensitivity

	Immediate Changes in Rates					
	-2.0%	**-1.0%**	**-0.5%**	**0.5%**	**1.0%**	**2.0%**
December 31, 2012						
Dollar change	N/A	N/A	N/A	$ 538	$ 1,164	$ 2,511
Percent change	N/A	N/A	N/A	+1.1%	+2.3%	+4.9%
December 31, 2011						
Dollar change	N/A	N/A	$ (1,172)	$ 1,196	$ 2,327	$ 4,628
Percent change	N/A	N/A	-2.0%	+2.1%	+4.0%	+8.0%

The amounts and assumptions used in the simulation model should not be viewed as indicative of expected actual results. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies. The above results do not take into account any management action to mitigate potential risk.

Effects of Inflation

In management s opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not change at the same rate or in the same magnitude as the inflation rate. Rather, interest rate volatility is based on changes in the expected rate of inflation, as well as on changes in monetary and fiscal policies. A financial institution s ability to be relatively unaffected by changes in interest rates is a good indicator of its

capability to perform in today s volatile economic environment. The Company seeks to insulate itself from interest rate volatility by ensuring that rate sensitive assets and rate sensitive liabilities respond to changes in interest rates in a similar time frame and to a similar degree.

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Item 8. Financial Statements and Supplementary Data

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31, 2012 and 2011

(In thousands, except share data)

	2012	2011
Assets		
Cash and due from banks	$ 44,221	$ 2,692
Interest bearing deposits with financial institutions	84,286	48,257
Cash and cash equivalents	128,507	50,949
Securities available-for-sale	579,886	307,564
Federal Home Loan Bank and Federal Reserve Bank stock	11,202	14,050
Loans held-for-sale	9,571	12,806
Loans	1,150,050	1,368,985
Less: allowance for loan losses	38,597	51,997
Net loans	1,111,453	1,316,988
Premises and equipment, net	47,002	50,477
Other real estate owned	72,423	93,290
Mortgage servicing rights, net	4,116	3,487
Core deposit, net	3,276	4,678
Bank-owned life insurance (BOLI)	54,203	52,595
Other assets	24,160	34,534
Total assets	$ 2,045,799	$ 1,941,418
Liabilities		
Deposits:		
Noninterest bearing demand	$ 379,451	$ 361,963
Interest bearing:		
Savings, NOW, and money market	826,976	761,335
Time	510,792	617,483
Total deposits	1,717,219	1,740,781
Securities sold under repurchase agreements	17,875	901
Other short-term borrowings	100,000	
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
Other liabilities	34,275	21,856
Total liabilities	1,973,247	1,867,416
Stockholders Equity		
Preferred stock	71,869	70,863
Common stock	18,729	18,628
Additional paid-in capital	66,189	65,999
Retained earnings	12,048	17,107
Accumulated other comprehensive loss	(1,327)	(3,702)
Treasury stock	(94,956)	(94,893)

Total stockholders equity		72,552		74,002
Total liabilities and stockholders equity	$	2,045,799	$	1,941,418

	December 31, 2012		December 31, 2011	
	Preferred Stock	**Common Stock**	**Preferred Stock**	**Common Stock**
Par value	$ 1	$ 1	$ 1	$ 1
Liquidation value	1,000	n/a	1,000	n/a
Shares authorized	300,000	60,000,000	300,000	60,000,000
Shares issued	73,000	18,729,134	73,000	18,627,858
Shares outstanding	73,000	14,084,328	73,000	14,034,991
Treasury shares		4,644,806		4,592,867

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Operations

Years Ended December 31, 2012 and 2011

(In thousands, except share data)

	2012	2011
Interest and dividend income		
Loans, including fees	$ 66,769	$ 80,084
Loans held-for-sale	260	342
Securities:		
Taxable	7,212	3,989
Tax-exempt	416	487
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	305	290
Federal funds sold		1
Interest bearing deposits	119	230
Total interest and dividend income	75,081	85,423
Interest expense		
Savings, NOW and money market deposits	1,062	1,579
Time deposits	8,809	14,478
Securities sold under repurchase agreements	2	1
Other short-term borrowings	17	
Junior subordinated debentures	4,925	4,577
Subordinated debt	903	822
Notes payable and other borrowings	17	16
Total interest expense	15,735	21,473
Net interest and dividend income	59,346	63,950
Provision for loan losses	6,284	8,887
Net interest and dividend income after provision for loan losses	53,062	55,063
Noninterest income		
Trust income	6,041	6,817
Service charges on deposits	7,682	8,135
Secondary mortgage fees	1,307	1,055
Mortgage servicing loss, net of changes in fair value	(289)	(341)
Net gain on sales of mortgage loans	10,688	5,458
Securities gains, net	1,575	631
Increase in cash surrender value of bank-owned life insurance	1,608	1,629
Debit card interchange income	3,547	3,004
Lease revenue from other real estate owned	3,497	3,635
Net gain on sale of other real estate owned	2,198	1,311
Other income	5,060	4,674
Total noninterest income	42,914	36,008
Noninterest expense		
Salaries and employee benefits	34,989	34,015
Occupancy expense, net	4,841	5,112
Furniture and equipment expense	4,614	5,601
FDIC insurance	4,031	4,854
General bank insurance	3,384	3,320
Amortization of core deposit asset	1,402	847
Advertising expense	1,309	1,106
Debit card interchange expense	1,548	1,424

Legal fees		3,176		4,118
Other real estate expense		24,358		24,356
Other expense		12,396		12,816
Total noninterest expense		96,048		97,569
Loss before income taxes		(72)		(6,498)
Provision for income taxes				
Net loss		(72)		(6,498)
Preferred stock dividends and accretion of discount		4,987		4,730
Net loss available to common stockholders	$	(5,059)	$	(11,228)
Basic loss per share	$	(0.36)	$	(0.79)
Diluted loss per share		(0.36)		(0.79)
Dividends declared per share				

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

(In thousands, except share data)

	Twelve Months Ended December 31, 2012	Twelve Months Ended December 31, 2011
Net loss	$ (72)	$ (6,498)
Total unrealized holding gains (losses) on available-for-sale securities arising during the period	5,614	(469)
Related tax (expense) benefit	(2,305)	270
Holding gains (losses) income after tax	3,309	(199)
Less: Reclassification adjustment for the net gains and losses realized during the period		
Net realized gains	1,575	631
Income tax expense on net realized gains	(641)	(258)
Net realized gains after tax	934	373
Total other comprehensive income (loss)	2,375	(572)
Comprehensive income (loss)	$ 2,303	$ (7,070)

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31, 2012 and 2011

(In thousands)

	2012	2011
Cash flows from operating activities		
Net loss	$ (72)	$ (6,498)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization of leasehold improvement	3,074	4,076
Change in market value of mortgage servicing rights	1,575	1,571
Provision for loan losses	6,284	8,887
Originations of loans held-for-sale	(291,559)	(228,960)
Proceeds from sales of loans held-for-sale	303,561	231,420
Net gain on sales of mortgage loans	(10,688)	(5,458)
Change in current income taxes receivable	815	5,750
Increase in cash surrender value of bank-owned life insurance	(1,608)	(1,629)
Change in accrued interest receivable and other assets	8,381	7,400
Change in accrued interest payable and other liabilities	8,119	(2,797)
Net premium amortization on securities	943	156
Securities gains, net	(1,575)	(631)
Amortization of core deposit intangible	1,402	847
Stock based compensation	291	951
Net gain on sale of other real estate owned	(2,198)	(1,311)
Provision for other real estate owned losses	16,385	15,114
Net gain on disposal of fixed assets	(609)	
Loss on transfer of premises to other real estate owned	782	415
Net cash provided by operating activities	43,303	29,303
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	79,642	56,044
Proceeds from sales of securities available-for-sale	223,860	26,281
Purchases of securities available-for-sale	(571,153)	(241,867)
Proceeds from sales of Federal Home Loan Bank stock	2,848	
Purchases of Fedral Reserve Bank stock		(359)
Net change in loans	167,490	216,503
Improvements in other real estate owned	(701)	(2,984)
Proceeds from sales of other real estate owned	39,052	43,124
Proceeds from disposition of fixed assets	917	
Net purchases of premises and equipment	(1,049)	(800)
Net cash (used in) provided by investing activities	(59,094)	95,942
Cash flows from financing activities		
Net change in deposits	(23,562)	(167,747)
Net change in securities sold under repurchase agreements	16,974	(1,117)
Net change in other short-term borrowings	100,000	(4,141)
Purchase of treasury stock	(63)	(49)
Net cash provided by (used in) financing activities	93,349	(173,054)
Net change in cash and cash equivalents	77,558	(47,809)
Cash and cash equivalents at beginning of period	50,949	98,758

Cash and cash equivalents at end of period	$	128,507	$	50,949
Supplemental cash flow information				
Income taxes received	$	(815)	$	(5,746)
Interest paid for deposits		10,592		16,751
Interest paid for borrowings		930		838
Non-cash transfer of loans to other real estate owned		31,761		71,443
Non-cash transfer of premises to other real estate owned		360		472
Change in dividends declared not paid		3,981		3,788
Accretion on preferred stock warrants		1,006		942

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity

Years ended December 31, 2012 and 2011

(In thousands, except share data)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Balance, December 31, 2010	$ 18,467	$ 69,921	$ 65,209	$ 28,335	$ (3,130)	$ (94,844)	$ 83,958
Net loss				(6,498)			(6,498)
Net unrealized loss on securities available-for-sale net of $528 tax effect					(572)		(572)
Change in restricted stock	161		(161)				
Stock based compensation			951				951
Purchase of treasury stock						(49)	(49)
Preferred dividends declared and accrued (5% per preferred share)		942		(4,730)			(3,788)
Balance, December 31, 2011	$ 18,628	$ 70,863	$ 65,999	$ 17,107	$ (3,702)	$	