

OLD SECOND BANCORP INC  
Form 10-Q  
May 15, 2013  
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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o  
**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2013  
OR  
**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0 -10537

**OLD SECOND BANCORP, INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**36-3143493**  
(I.R.S. Employer Identification Number)

**37 South River Street, Aurora, Illinois 60507**

(Address of principal executive offices) (Zip Code)

**(630) 892-0202**

(Registrant's telephone number, including area code)

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

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether 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 Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  (do not check if a smaller reporting company) Smaller reporting company

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

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of May 13, 2013, the Registrant had outstanding 13,882,910 shares of common stock, \$1.00 par value per share.

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**OLD SECOND BANCORP, INC.**

Form 10-Q Quarterly Report

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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****Old Second Bancorp, Inc. and Subsidiaries****Consolidated Balance Sheets***(In thousands, except share data)*

|   | (Unaudited)<br>March 31,<br>2013 | December 31,<br>2012 |
|---|----------------------------------|----------------------|
| <b>Assets</b>   |                                  |                      |
| Cash and due from banks                               | \$ 17,202                        | \$ 44,221            |
| Interest bearing deposits with financial institutions | 63,915                           | 84,286               |
| Cash and cash equivalents                             | 81,117                           | 128,507              |
| Securities available-for-sale                         | 575,746                          | 579,886              |
| Federal Home Loan Bank and Federal Reserve Bank stock | 11,202                           | 11,202               |
| Loans held-for-sale                                   | 6,381                            | 9,571                |
| Loans   | 1,113,302                        | 1,150,050            |
| Less: allowance for loan losses                       | 38,634                           | 38,597               |
| Net loans   | 1,074,668                        | 1,111,453            |
| Premises and equipment, net                           | 47,356                           | 47,002               |
| Other real estate owned                               | 65,663                           | 72,423               |
| Mortgage servicing rights, net                        | 4,469                            | 4,116                |
| Core deposit, net                                     | 2,751                            | 3,276                |
| Bank-owned life insurance (BOLI)                      | 54,610                           | 54,203               |
| Other assets  | 30,081                           | 24,160               |
| Total assets  | \$ 1,954,044                     | \$ 2,045,799         |
| <b>Liabilities</b>                                    |                                  |                      |
| Deposits:   |                                  |                      |
| Noninterest bearing demand                            | \$ 351,328                       | \$ 379,451           |
| Interest bearing:                                     |                                  |                      |
| Savings, NOW, and money market                        | 865,863                          | 826,976              |
| Time  | 501,065                          | 510,792              |
| Total deposits  | 1,718,256                        | 1,717,219            |
| Securities sold under repurchase agreements           | 20,802                           | 17,875               |
| 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                                     | 35,254                           | 34,275               |
| Total liabilities                                     | 1,878,190                        | 1,973,247            |
| <b>Stockholders Equity</b>                            |                                  |                      |
| Preferred stock                                       | 72,130                           | 71,869               |
| Common stock  | 18,780                           | 18,729               |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Additional paid-in capital                 |    | 66,109    |    | 66,189    |
| Retained earnings                          |    | 16,747    |    | 12,048    |
| Accumulated other comprehensive loss       |    | (2,202)   |    | (1,327)   |
| Treasury stock                             |    | (95,710)  |    | (94,956)  |
| Total stockholders' equity                 |    | 75,854    |    | 72,552    |
| Total liabilities and stockholders' equity | \$ | 1,954,044 | \$ | 2,045,799 |

|                    | March 31, 2013     |                 |    | December 31, 2012  |                 |           |
|--------------------|--------------------|-----------------|----|--------------------|-----------------|-----------|
|                    | Preferred<br>Stock | Common<br>Stock |    | Preferred<br>Stock | Common<br>Stock |           |
| Par value          | \$                 | 1               | \$ | 1                  | \$              | 1         |
| Liquidation value  |                    | 1,000           |    | n/a                |                 | 1,000     |
| Shares authorized  |                    | 300,000         |    | 60,000,000         |                 | 300,000   |
| Shares issued      |                    | 73,000          |    | 18,779,734         |                 | 73,000    |
| Shares outstanding |                    | 73,000          |    | 13,882,910         |                 | 73,000    |
| Treasury shares    |                    | -               |    | 4,896,824          |                 | -         |
|                    |                    |                 |    |                    |                 | 4,644,806 |

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Operations***(In thousands, except share data)*

|  | (Unaudited)               |             |
|--|---------------------------|-------------|
|  | <b>Three Months Ended</b> |             |
|  | <b>March 31,</b>          |             |
|  | <b>2013</b>               | <b>2012</b> |
| <b>Interest and dividend income</b>                                  |                           |             |
| Loans, including fees  | \$ 14,914                 | \$ 17,666   |
| Loans held-for-sale  | 41                        | 84          |
| Securities:  |                           |             |
| Taxable  | 2,298                     | 1,498       |
| Tax-exempt   | 119                       | 103         |
| Dividends from Federal Reserve Bank and Federal Home Loan Bank stock | 76                        | 74          |
| Interest bearing deposits with financial institutions                | 42                        | 25          |
| Total interest and dividend income                                   | 17,490                    | 19,450      |
| <b>Interest expense</b>  |                           |             |
| Savings, NOW, and money market deposits                              | 228                       | 300         |
| Time deposits  | 1,853                     | 2,605       |
| Securities sold under repurchase agreements                          | 1                         | -           |
| Other short-term borrowings  | 19                        | 3           |
| Junior subordinated debentures                                       | 1,287                     | 1,197       |
| Subordinated debt  | 196                       | 237         |
| Notes payable and other borrowings                                   | 4                         | 4           |
| Total interest expense   | 3,588                     | 4,346       |
| Net interest and dividend income                                     | 13,902                    | 15,104      |
| Provision for loan losses  | (2,500)                   | 6,084       |
| Net interest and dividend income after provision for loan losses     | 16,402                    | 9,020       |
| <b>Noninterest income</b>  |                           |             |
| Trust income   | 1,491                     | 1,651       |
| Service charges on deposits  | 1,677                     | 1,831       |
| Secondary mortgage fees  | 230                       | 296         |
| Mortgage servicing income  | 244                       | 187         |
| Net gain on sales of mortgage loans                                  | 1,976                     | 2,647       |
| Securities gains, net  | 1,453                     | 101         |
| Increase in cash surrender value of bank-owned life insurance        | 407                       | 495         |
| Debit card interchange income  | 792                       | 760         |
| Lease revenue from other real estate owned                           | 408                       | 1,179       |
| Net gain on sale of other real estate owned                          | 181                       | 23          |
| Other income   | 1,737                     | 1,294       |
| Total noninterest income   | 10,596                    | 10,464      |
| <b>Noninterest expense</b>   |                           |             |
| Salaries and employee benefits                                       | 9,032                     | 9,049       |
| Occupancy expense, net   | 1,279                     | 1,235       |
| Furniture and equipment expense                                      | 1,144                     | 1,155       |
| FDIC insurance   | 1,035                     | 1,000       |
| General bank insurance   | 849                       | 846         |
| Amortization of core deposit asset                                   | 525                       | 195         |
| Advertising expense  | 166                       | 318         |
| Debit card interchange expense                                       | 344                       | 342         |

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|  |    |            |    |            |
|--|----|------------|----|------------|
| Legal fees   |    | 323        |    | 685        |
| Other real estate expense                                  |    | 3,686      |    | 4,654      |
| Other expense  |    | 3,144      |    | 2,973      |
| Total noninterest expense                                  |    | 21,527     |    | 22,452     |
| Income (loss) before income taxes                          |    | 5,471      |    | (2,968)    |
| Income tax expense   |    | -          |    | -          |
| <b>Net income (loss)</b>                                   |    | 5,471      |    | (2,968)    |
| <b>Preferred stock dividends and accretion of discount</b> |    | 1,289      |    | 1,223      |
| <b>Net income (loss) available to common shareholders</b>  | \$ | 4,182      | \$ | (4,191)    |
| <b>Share and per share information:</b>                    |    |            |    |            |
| Ending number of shares                                    |    | 13,882,910 |    | 14,084,328 |
| Average number of shares                                   |    | 14,076,114 |    | 14,043,545 |
| Diluted average number of shares                           |    | 14,157,523 |    | 14,196,143 |
| Basic income (loss) per share                              | \$ | 0.30       | \$ | (0.30)     |
| Diluted income (loss) per share                            |    | 0.30       |    | (0.30)     |
| Dividends paid per share                                   |    | -          |    | -          |

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income (Loss)***(In thousands, except share data)*

|  | Three Months Ended<br>March 31, |            |
|--|---------------------------------|------------|
|  | 2013                            | 2012       |
| Net Income (loss)  | \$ 5,471                        | \$ (2,968) |
| Total unrealized holding (losses) gains on available-for-sale securities arising during the period | (35)                            | 1,004      |
| Related tax benefit (expense)  | 17                              | (413)      |
| Holding (losses) income after tax  | (18)                            | 591        |
| Less: Reclassification adjustment for the net gains realized during the period                     |                                 |            |
| Net realized gains   | 1,453                           | 101        |
| Income tax expense on net realized gains   | (596)                           | (41)       |
| Net realized gains after tax   | 857                             | 60         |
| Total other comprehensive (loss) income  | (875)                           | 531        |
| Comprehensive income (loss)  | \$ 4,596                        | \$ (2,437) |

See accompanying notes to consolidated financial statements.



Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(In thousands)

|   | (Unaudited)<br>Three Months Ended<br>March 31, |            |
|---|--|------------|
|   | 2013   | 2012       |
| <b>Cash flows from operating activities</b>   |  |            |
| Net income (loss)   | \$ 5,471                                       | \$ (2,968) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |  |            |
| Depreciation and amortization of leasehold improvement                                    | 746  | 801        |
| Change in market value on mortgage servicing rights                                       | 106  | 123        |
| Provision for loan losses   | (2,500)  | 6,084      |
| Gain on recapture of restricted stock   | (612)  | -          |
| Originations of loans held-for-sale   | (53,138)                                       | (64,140)   |
| Proceeds from sales of loans held-for-sale  | 57,755   | 72,729     |
| Net gain on sales of mortgage loans   | (1,976)  | (2,647)    |
| Increase in cash surrender value of bank-owned life insurance                             | (407)  | (495)      |
| Change in accrued interest receivable and other assets                                    | (5,215)  | (4,635)    |
| Change in accrued interest payable and other liabilities                                  | 634  | 3,420      |
| Net premium amortization on securities  | 414  | 403        |
| Securities gains, net   | (1,453)  | (101)      |
| Amortization of core deposit intangible   | 525  | 195        |
| Stock based compensation  | 14   | 87         |
| Net gain on sale of other real estate owned   | (181)  | (23)       |
| Provision for other real estate owned losses  | 1,987  | 2,500      |
| Net gain on disposal of fixed assets  | (5)  | -          |
| Net cash provided by operating activities   | 2,165  | 11,333     |
| <b>Cash flows from investing activities</b>   |  |            |
| Proceeds from maturities and calls including pay down of securities available-for-sale    | 18,055   | 17,254     |
| Proceeds from sales of securities available-for-sale                                      | 231,155  | 8,359      |
| Purchases of securities available-for-sale  | (240,190)                                      | (76,819)   |
| Proceeds from sales of Federal Home Loan Bank stock                                       | -  | 1,467      |
| Net change in loans   | 26,971   | 20,248     |
| Improvements in other real estate owned   | (50)   | (318)      |
| Proceeds from sales of other real estate owned  | 11,842   | 5,369      |
| Proceeds from disposition of fixed assets   | 6  | -          |
| Net purchases of premises and equipment   | (1,123)  | (154)      |
| Net cash provided by (used in) investing activities                                       | 46,666   | (24,594)   |
| <b>Cash flows from financing activities</b>   |  |            |
| Net change in deposits  | 1,037  | 23,089     |
| Net change in securities sold under repurchase agreements                                 | 2,927  | 903        |
| Net change in other short-term borrowings   | (100,000)                                      | 15,000     |
| Purchase of treasury stock  | (185)  | (63)       |
| Net cash (used in) provided by financing activities                                       | (96,221)                                       | 38,929     |
| Net change in cash and cash equivalents   | (47,390)                                       | 25,668     |
| Cash and cash equivalents at beginning of period  | 128,507  | 50,949     |
| Cash and cash equivalents at end of period  | \$ 81,117                                      | \$ 76,617  |

**Supplemental cash flow information**

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|   |    |       |    |        |
|---|----|-------|----|--------|
| Interest paid for deposits                                  | \$ | 2,124 | \$ | 3,394  |
| Interest paid for borrowings                                |    | 225   |    | 243    |
| Non-cash transfer of loans to other real estate             |    | 6,985 |    | 15,918 |
| Non-cash transfer of loans to securities available-for-sale |    | 5,329 |    | -      |
| Accretion on preferred stock warrants                       |    | 261   |    | 245    |
| Fair value difference on recapture of restricted stock      |    | 43    |    | -      |

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Changes in****Stockholders Equity**

(In thousands, except share data)

|  | Common<br>Stock | Preferred<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Total<br>Stockholders<br>Equity |
|--|-----------------|--------------------|----------------------------------|----------------------|---|-------------------|---------------------------------|
| Balance, December 31, 2011   | \$ 18,628       | \$ 70,863          | \$ 65,999                        | \$ 17,107            | \$ (3,702)                                    | \$ (94,893)       | \$ 74,002                       |
| Net loss   |                 |                    |                                  | (2,968)              |   |                   | (2,968)                         |
| Change in net unrealized gain on securities<br>available-for-sale net of \$372 tax effect  |                 |                    |                                  |                      | 531   |                   | 531                             |
| Change in restricted stock   | 101             |                    | (101)                            |                      |   |                   | -                               |
| Stock based compensation   |                 |                    | 87                               |                      |   |                   | 87                              |
| Purchase of treasury stock   |                 |                    |                                  |                      |   | (63)              | (63)                            |
| Preferred stock accretion and declared<br>dividends  |                 | 245                |                                  | (1,223)              |   |                   | (978)                           |
| Balance, March 31, 2012  | \$ 18,729       | \$ 71,108          | \$ 65,985                        | \$ 12,916            | \$ (3,171)                                    | \$ (94,956)       | \$ 70,611                       |
| Balance, December 31, 2012   | \$ 18,729       | \$ 71,869          | \$ 66,189                        | \$ 12,048            | \$ (1,327)                                    | \$ (94,956)       | \$ 72,552                       |
| Net income   |                 |                    |                                  | 5,471                |   |                   | 5,471                           |
| Change in net unrealized loss on securities<br>available-for-sale, net of \$613 tax effect |                 |                    |                                  |                      | (875)   |                   | (875)                           |
| Change in restricted stock   | 51              |                    | (51)                             |                      |   |                   | -                               |
| Recapture of restricted stock  |                 |                    | (43)                             |                      |   | (569)             | (612)                           |
| Stock based compensation   |                 |                    | 14                               |                      |   |                   | 14                              |
| Purchase of treasury stock   |                 |                    |                                  |                      |   | (185)             | (185)                           |
| Preferred stock accretion and declared<br>dividends  |                 | 261                |                                  | (772)                |   |                   | (511)                           |
| Balance, March 31, 2013  | \$ 18,780       | \$ 72,130          | \$ 66,109                        | \$ 16,747            | \$ (2,202)                                    | \$ (95,710)       | \$ 75,854                       |

See accompanying notes to consolidated financial statements.

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**Old Second Bancorp, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

(Table amounts in thousands, except per share data, unaudited)

**Note 1 Summary of Significant Accounting Policies**

The accounting policies followed in the preparation of the interim financial statements are consistent with those used in the preparation of the annual financial information. The interim financial statements reflect all normal and recurring adjustments, which are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended March 31, 2013, are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These interim financial statements should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the Company) annual report on Form 10-K for the year ended December 31, 2012. Unless otherwise indicated, amounts in the tables contained in the notes are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2012. 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.

**Recent Accounting Pronouncements**

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02 *Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under United States generally accepted accounting practices (GAAP) to be reclassified to net income in its entirety in the same reporting period. The impact of ASU 2013-02 on the Company's consolidated financial statements is reflected in the consolidated statement of comprehensive income (loss).

**Note 2 Securities**

**Investment Portfolio Management**

Our investment portfolio serves the liquidity and income needs of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio will also serve as income producing assets. The size of the portfolio will reflect liquidity needs, loan demand and interest income objectives.

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Portfolio size and composition may be adjusted from time to time. While a significant portion of the portfolio will always consist of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. All debt securities are classified as available-for-sale and may be sold under our management and asset/liability management strategies. Securities available-for-sale are carried at fair value. Unrealized gains and losses on securities available-for-sale are reported as a separate component of equity. This balance sheet component will change as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

Non-marketable equity investments include Federal Home Loan Bank of Chicago ( FHLBC ) stock, Federal Reserve Bank of Chicago ( FRB ) stock and various other equity securities. FHLBC stock was recorded at a value of \$6.4 million at March 31, 2013, and December 31, 2012. FRB stock was recorded at \$4.8 million at March 31, 2013, and December 31, 2012. Our FHLB stock is necessary to maintain our program of access to FHLB advances.

The following table summarizes the amortized cost and fair value of the available-for-sale securities at March 31, 2013, and December 31, 2012 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive loss were as follows:

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| <b>March 31, 2013:</b>                 |                   |                              |                               |               |
| U.S. Treasury                          | \$ 1,500          | \$ 2                         | \$ -                          | \$ 1,502      |
| U.S. government agencies               | 69,189            | 129                          | (53)                          | 69,265        |
| U.S. government agency mortgage-backed | 76,500            | 804                          | (952)                         | 76,352        |
| States and political subdivisions      | 25,876            | 1,139                        | -                             | 27,015        |
| Corporate Bonds                        | 38,090            | 650                          | (161)                         | 38,579        |
| Collateralized mortgage obligations    | 131,181           | 964                          | (476)                         | 131,669       |
| Asset-backed securities                | 219,234           | 2,174                        | (671)                         | 220,737       |
| Collateralized debt obligations        | 17,919            | -                            | (7,292)                       | 10,627        |
|  | \$ 579,489        | \$ 5,862                     | \$ (9,605)                    | \$ 575,746    |
| <b>December 31, 2012:</b>              |                   |                              |                               |               |
| U.S. Treasury                          | \$ 1,500          | \$ 7                         | \$ -                          | \$ 1,507      |
| U.S. government agencies               | 49,848            | 122                          | (120)                         | 49,850        |
| U.S. government agency mortgage-backed | 127,716           | 1,605                        | (583)                         | 128,738       |
| States and political subdivisions      | 14,639            | 1,216                        | -                             | 15,855        |
| Corporate Bonds                        | 36,355            | 586                          | (55)                          | 36,886        |
| Collateralized mortgage obligations    | 168,795           | 1,895                        | (1,090)                       | 169,600       |
| Asset-backed securities                | 165,347           | 2,468                        | (322)                         | 167,493       |
| Collateralized debt obligations        | 17,941            | -                            | (7,984)                       | 9,957         |
|  | \$ 582,141        | \$ 7,899                     | \$ (10,154)                   | \$ 579,886    |

The fair value, amortized cost and weighted average yield of debt securities at March 31, 2013, by contractual maturity, were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities, collateralized debt obligations and equity securities are shown separately.



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|  | Amortized<br>Cost | Weighted<br>Average<br>Yield | Fair<br>Value |
|--|-------------------|------------------------------|---------------|
| Due in one year or less                | \$ 10,976         | 1.61%                        | \$ 10,984     |
| Due after one year through five years  | 25,685            | 1.97%                        | 26,456        |
| Due after five years through ten years | 37,930            | 3.03%                        | 38,730        |
| Due after ten years                    | 60,064            | 2.93%                        | 60,191        |
|  | 134,655           | 2.67%                        | 136,361       |
| Mortgage-backed securities             | 207,681           | 2.02%                        | 208,021       |
| Asset-back securities                  | 219,234           | 1.55%                        | 220,737       |
| Collateralized debt obligations        | 17,919            | 1.64%                        | 10,627        |
|  | \$ 579,489        | 1.98%                        | \$ 575,746    |

Securities with unrealized losses at March 31, 2013, and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands except for number of securities):

|   | Less than 12 months<br>in an unrealized loss position |                      |               | Greater than 12 months<br>in an unrealized loss position |                      |               | Total                   |                      |               |
|---|---|----------------------|---------------|--|----------------------|---------------|-------------------------|----------------------|---------------|
|   | Number of<br>Securities                               | Unrealized<br>Losses | Fair<br>Value | Number of<br>Securities                                  | Unrealized<br>Losses | Fair<br>Value | Number of<br>Securities | Unrealized<br>Losses | Fair<br>Value |
| <b>March 31, 2013</b>                     |   |                      |               |  |                      |               |                         |                      |               |
| U.S. government agencies                  | 3   | \$ 53                | \$ 12,225     | -  | \$ -                 | \$ -          | 3                       | \$ 53                | 12,225        |
| U.S. government agency<br>mortgage-backed | 9   | 952                  | 49,575        | -  | -                    | -             | 9                       | 952                  | 49,575        |
| Corporate bonds                           | 5   | 141                  | 13,657        | 1  | 20                   | 1,032         | 6                       | 161                  | 14,689        |
| Collateralized mortgage<br>obligations    | 7   | 476                  | 57,201        | -  | -                    | -             | 7                       | 476                  | 57,201        |
| Asset-backed securities                   | 7   | 671                  | 47,281        | -  | -                    | -             | 7                       | 671                  | 47,281        |
| Collateralized debt<br>obligations        | -   | -                    | -             | 2  | 7,292                | 10,627        | 2                       | 7,292                | 10,627        |
|   | 31  | \$ 2,293             | \$ 179,939    | 3  | \$ 7,312             | \$ 11,659     | 34                      | \$ 9,605             | \$ 191,598    |
| <b>December 31, 2012</b>                  |   |                      |               |  |                      |               |                         |                      |               |
| U.S. government agencies                  | 4   | \$ 120               | \$ 17,039     | -  | \$ -                 | \$ -          | 4                       | \$ 120               | \$ 17,039     |
| U.S. government agency<br>mortgage-backed | 12  | 583                  | 53,184        | -  | -                    | -             | 12                      | 583                  | 53,184        |
| Corporate bonds                           | 4   | 55                   | 9,724         | -  | -                    | -             | 4                       | 55                   | 9,724         |
| Collateralized mortgage<br>obligations    | 6   | 1,060                | 37,778        | 1  | 30                   | 2,343         | 7                       | 1,090                | 40,121        |
| Asset-backed securities                   | 6   | 322                  | 37,488        | -  | -                    | -             | 6                       | 322                  | 37,488        |
| Collateralized debt<br>obligations        | -   | -                    | -             | 2  | 7,984                | 9,957         | 2                       | 7,984                | 9,957         |
|   | 32  | \$ 2,140             | \$ 155,213    | 3  | \$ 8,014             | \$ 12,300     | 35                      | \$ 10,154            | \$ 167,513    |

Recognition of other-than-temporary impairment was not necessary in the three months ended March 31, 2013, or the year ended December 31, 2012. The changes in fair values related primarily to interest rate fluctuations and were generally not related to credit quality deterioration, although the amount of deferrals and defaults in the pooled collateralized debt obligations ( CDO ) decreased in the period from December 31, 2012 to March 31, 2013.



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Continued uncertainty in the financial markets in the periods presented has resulted in sharply reduced liquidity for certain investments, particularly the CDO securities. In the case of the CDO securities fair value measurement, management included a risk premium adjustment as of March 31, 2013, to reflect an estimated yield that a market participant would demand because of uncertainty in cash flows, based on incomplete and sporadic levels of market activity. Accordingly, management continues to designate these securities as Level 3 securities as described in Note 12 of this quarterly report as of March 31, 2013. Management does not have the intent to sell the above securities and it is more likely than not the Company will not sell the securities before recovery of its cost basis.

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Below is additional information as it relates to the CDOs, Trapeza 2007-13A, which is secured by a pool of trust preferred securities issued by trusts sponsored by multiple financial institutions.

|                          | Amortized<br>Cost | Fair<br>Value | Gross<br>Unrealized<br>Loss | S&P<br>Credit<br>Rating <sup>1</sup> | Number of<br>Banks in<br>Issuance | Issuance<br>Deferrals & Defaults<br>Amount | Collateral% | Issuance<br>Excess Subordination<br>Amount | Collateral% |
|--------------------------|-------------------|---------------|-----------------------------|--------------------------------------|-----------------------------------|--|-------------|--|-------------|
| <b>March 31, 2013</b>    |                   |               |                             |                                      |                                   |  |             |  |             |
| Class A1                 | \$ 8,981          | \$ 6,055      | \$ (2,926)                  | BB+                                  | 63                                | \$ 207,000                                 | 27.6%       | \$ 194,387                                 | 25.9%       |
| Class A2A                | 8,938             | 4,572         | (4,366)                     | B+                                   | 63                                | 207,000                                    | 27.6%       | 97,387                                     | 13.0%       |
|                          | \$ 17,919         | \$ 10,627     | \$ (7,292)                  |                                      |                                   |  |             |  |             |
| <b>December 31, 2012</b> |                   |               |                             |                                      |                                   |  |             |  |             |
| Class A1                 | \$ 9,038          | \$ 5,768      | \$ (3,270)                  | BB+                                  | 63                                | \$ 208,000                                 | 27.7%       | \$ 190,982                                 | 25.5%       |
| Class A2A                | 8,903             | 4,189         | (4,714)                     | B+                                   | 63                                | 208,000                                    | 27.7%       | 93,982                                     | 12.5%       |
|                          | \$ 17,941         | \$ 9,957      | \$ (7,984)                  |                                      |                                   |  |             |  |             |

<sup>1</sup> Moody's credit rating for class A1 and A2A were Baa2 and Ba2, respectively, as of March 31, 2013, and December 31, 2012. The Fitch ratings for class A1 and A2A were BBB and B, respectively, as of March 31, 2013, and December 31, 2012.

### **Note 3 Loans**

Major classifications of loans were as follows:

|                               | March 31, 2013 | December 31, 2012 |
|-------------------------------|----------------|-------------------|
| Commercial                    | \$ 84,332      | \$ 86,941         |
| Real estate - commercial      | 566,349        | 579,687           |
| Real estate - construction    | 40,698         | 42,167            |
| Real estate - residential     | 394,599        | 414,543           |
| Consumer                      | 2,908          | 3,101             |
| Overdraft                     | 584            | 994               |
| Lease financing receivables   | 8,574          | 6,060             |
| Other                         | 15,022         | 16,451            |
|                               | 1,113,066      | 1,149,944         |
| Net deferred loan cost (fees) | 236            | 106               |
|                               | \$ 1,113,302   | \$ 1,150,050      |

It is the policy of the Company to review each prospective credit in order to determine an adequate level of security or collateral was obtained prior to making a loan. The type of collateral, when required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to state lending laws, the Company's lending standards and credit monitoring procedures. The Bank generally makes loans solely within its market area. There are no significant concentrations of loans where the customers ability to honor loan terms is dependent upon a single economic sector although the real estate related categories listed above represent 90.0% and 90.1% of the portfolio at March 31, 2013, and December 31, 2012, respectively. The Company remains committed to overseeing and managing its loan portfolio to reduce its real estate credit concentrations in accordance with the requirements of the Consent Order the Bank entered into with the Office of the Controller of the Currency (the OCC) on May 16, 2011 (the Consent Order). Regulatory and Capital matters including the Consent Order are discussed in more detail in Note 11 of the consolidated financial statements included in this report.



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Aged analysis of past due loans by class of loans were as follows:

**March 31, 2013**

|                                    | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater Past<br>Due | Total Past<br>Due | Current      | Nonaccrual | Total Loans  | Recorded<br>Investment<br>90 days or<br>Greater Past<br>Due and<br>Accruing |
|------------------------------------|------------------------|------------------------|-----------------------------------|-------------------|--------------|------------|--------------|---|
| Commercial                         | \$ 58                  | \$ -                   | \$ -                              | \$ 58             | \$ 92,638    | \$ 210     | \$ 92,906    | \$ -  |
| Real estate - commercial           |                        |                        |                                   |                   |              |            |              |   |
| Owner occupied general purpose     | 2,535                  | -                      | -                                 | 2,535             | 114,871      | 4,990      | 122,396      | -   |
| Owner occupied special purpose     | -                      | -                      | -                                 | -                 | 145,443      | 10,457     | 155,900      | -   |
| Non-owner occupied general purpose | 310                    | -                      | 165                               | 475               | 127,904      | 10,082     | 138,461      | 165   |
| Non-owner occupied special purpose | -                      | -                      | -                                 | -                 | 75,649       | 1,470      | 77,119       | -   |
| Retail properties                  | -                      | -                      | -                                 | -                 | 38,351       | 8,846      | 47,197       | -   |
| Farm                               | -                      | 52                     | -                                 | 52                | 22,807       | 2,417      | 25,276       | -   |
| Real estate - construction         |                        |                        |                                   |                   |              |            |              |   |
| Homebuilder                        | -                      | -                      | -                                 | -                 | 5,827        | 168        | 5,995        | -   |
| Land                               | -                      | -                      | -                                 | -                 | 2,712        | 254        | 2,966        | -   |
| Commercial speculative             | -                      | -                      | -                                 | -                 | 11,182       | 5,353      | 16,535       | -   |
| All other                          | 47                     | -                      | -                                 | 47                | 14,549       | 606        | 15,202       | -   |
| Real estate - residential          |                        |                        |                                   |                   |              |            |              |   |
| Investor                           | 3,905                  | -                      | -                                 | 3,905             | 127,536      | 8,524      | 139,965      | -   |
| Owner occupied                     | 3,359                  | -                      | -                                 | 3,359             | 109,617      | 7,916      | 120,892      | -   |
| Revolving and junior liens         | 508                    | 87                     | 112                               | 707               | 129,432      | 3,603      | 133,742      | 112   |
| Consumer                           | 5                      | -                      | -                                 | 5                 | 2,903        | -          | 2,908        | -   |
| All other                          | -                      | -                      | -                                 | -                 | 15,842       | -          | 15,842       | -   |
|                                    | \$ 10,727              | \$ 139                 | \$ 277                            | \$ 11,143         | \$ 1,037,263 | \$ 64,896  | \$ 1,113,302 | \$ 277  |

**December 31, 2012**

|                                    | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater Past<br>Due | Total Past<br>Due | Current   | Nonaccrual | Total Loans | Recorded<br>Investment<br>90 days or<br>Greater Past<br>Due and<br>Accruing |
|------------------------------------|------------------------|------------------------|-----------------------------------|-------------------|-----------|------------|-------------|---|
| Commercial                         | \$ 159                 | \$ -                   | \$ -                              | \$ 159            | \$ 92,080 | \$ 762     | \$ 93,001   | \$ -  |
| Real estate - commercial           |                        |                        |                                   |                   |           |            |             |   |
| Owner occupied general purpose     | 1,580                  | 50                     | -                                 | 1,630             | 119,994   | 5,487      | 127,111     | -   |
| Owner occupied special purpose     | 172                    | -                      | -                                 | 172               | 149,439   | 11,433     | 161,044     | -   |
| Non-owner occupied general purpose | -                      | 1,046                  | -                                 | 1,046             | 128,817   | 13,436     | 143,299     | -   |
| Non-owner occupied special purpose | -                      | 4,304                  | -                                 | 4,304             | 69,299    | 477        | 74,080      | -   |
| Retail properties                  | -                      | -                      | -                                 | -                 | 37,732    | 10,532     | 48,264      | -   |
| Farm                               | -                      | -                      | -                                 | -                 | 23,372    | 2,517      | 25,889      | -   |
| Real estate - construction         |                        |                        |                                   |                   |           |            |             |   |
| Homebuilder                        | -                      | -                      | -                                 | -                 | 4,469     | 1,855      | 6,324       | -   |
| Land                               | -                      | -                      | -                                 | -                 | 2,747     | 254        | 3,001       | -   |
| Commercial speculative             | -                      | -                      | -                                 | -                 | 10,755    | 6,587      | 17,342      | -   |
| All other                          | 300                    | 215                    | 68                                | 583               | 14,360    | 557        | 15,500      | 68  |

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|                            |          |          |       |           |              |           |              |       |
|----------------------------|----------|----------|-------|-----------|--------------|-----------|--------------|-------|
| Real estate - residential  |          |          |       |           |              |           |              |       |
| Investor                   | 276      | 164      | -     | 440       | 140,141      | 9,910     | 150,491      | -     |
| Owner occupied             | 3,151    | 375      | 21    | 3,547     | 110,735      | 9,918     | 124,200      | 21    |
| Revolving and junior liens | 888      | 203      | -     | 1,091     | 134,990      | 3,771     | 139,852      | -     |
| Consumer                   | 3        | -        | -     | 3         | 3,075        | 23        | 3,101        | -     |
| All other                  | -        | -        | -     | -         | 17,551       | -         | 17,551       | -     |
|                            | \$ 6,529 | \$ 6,357 | \$ 89 | \$ 12,975 | \$ 1,059,556 | \$ 77,519 | \$ 1,150,050 | \$ 89 |

The Bank had no commitments to any borrower whose loans were classified as impaired at March 31, 2013.

**Credit Quality Indicators:**

The Company categorizes loans into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, historical payment experience, and current economic trends. Each loan and loan relationship is examined. This analysis includes loans with outstanding loans or commitments greater than \$50,000 and excludes homogeneous loans such as home equity line of credit and residential mortgages. Loans with a classified risk rating are reviewed quarterly regardless of size or loan type. The Company uses the following definitions for classified risk ratings:

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**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified 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.

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as 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.

Credits that are not covered by the definitions above are pass credits, which are not considered to be adversely rated.

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Credit Quality Indicators by class of loans as were as follows:

| <b>March 31, 2013</b>              | Pass              | Special<br>Mention | Substandard 1     | Doubtful    | Total               |
|------------------------------------|-------------------|--------------------|-------------------|-------------|---------------------|
| Commercial                         | \$ 80,608         | \$ 11,551          | \$ 747            | \$ -        | \$ 92,906           |
| Real estate - commercial           |                   |                    |                   |             |                     |
| Owner occupied general purpose     | 100,321           | 11,250             | 10,825            | -           | 122,396             |
| Owner occupied special purpose     | 129,797           | 5,223              | 20,880            | -           | 155,900             |
| Non-owner occupied general purpose | 107,492           | 14,152             | 16,817            | -           | 138,461             |
| Non-owner occupied special purpose | 70,166            | 5,483              | 1,470             | -           | 77,119              |
| Retail Properties                  | 34,098            | 1,649              | 11,450            | -           | 47,197              |
| Farm                               | 21,349            | 1,510              | 2,417             | -           | 25,276              |
| Real estate - construction         |                   |                    |                   |             |                     |
| Homebuilder                        | 1,331             | 2,135              | 2,529             | -           | 5,995               |
| Land                               | 2,712             | -                  | 254               | -           | 2,966               |
| Commercial speculative             | 7,567             | -                  | 8,968             | -           | 16,535              |
| All other                          | 14,077            | 220                | 905               | -           | 15,202              |
| Real estate - residential          |                   |                    |                   |             |                     |
| Investor                           | 119,660           | 11,392             | 8,913             | -           | 139,965             |
| Owner occupied                     | 109,105           | 1,324              | 10,463            | -           | 120,892             |
| Revolving and junior liens         | 127,820           | 200                | 5,722             | -           | 133,742             |
| Consumer                           | 2,907             | -                  | 1                 | -           | 2,908               |
| All other                          | 15,842            | -                  | -                 | -           | 15,842              |
| <b>Total</b>                       | <b>\$ 944,852</b> | <b>\$ 66,089</b>   | <b>\$ 102,361</b> | <b>\$ -</b> | <b>\$ 1,113,302</b> |
| <br>                               |                   |                    |                   |             |                     |
| <b>December 31, 2012</b>           | Pass              | Special<br>Mention | Substandard 1     | Doubtful    | Total               |
| Commercial                         | \$ 88,071         | \$ 3,867           | \$ 1,063          | \$ -        | \$ 93,001           |
| Real estate - commercial           |                   |                    |                   |             |                     |
| Owner occupied general purpose     | 113,118           | 2,995              | 10,998            | -           | 127,111             |
| Owner occupied special purpose     | 134,152           | 9,036              | 17,856            | -           | 161,044             |
| Non-owner occupied general purpose | 105,192           | 14,273             | 23,834            | -           | 143,299             |
| Non-owner occupied special purpose | 68,682            | 3,911              | 1,487             | -           | 74,080              |
| Retail Properties                  | 32,715            | 1,873              | 13,676            | -           | 48,264              |
| Farm                               | 21,262            | 2,110              | 2,517             | -           | 25,889              |
| Real estate - construction         |                   |                    |                   |             |                     |
| Homebuilder                        | 1,318             | 2,196              | 2,810             | -           | 6,324               |
| Land                               | 2,747             | -                  | 254               | -           | 3,001               |
| Commercial speculative             | 7,122             | -                  | 10,220            | -           | 17,342              |
| All other                          | 14,607            | 37                 | 856               | -           | 15,500              |
| Real estate - residential          |                   |                    |                   |             |                     |
| Investor                           | 123,876           | 14,608             | 12,007            | -           | 150,491             |
| Owner occupied                     | 110,858           | 396                | 12,946            | -           | 124,200             |
| Revolving and junior liens         | 133,992           | 166                | 5,694             | -           | 139,852             |
| Consumer                           | 3,075             | -                  | 26                | -           | 3,101               |
| All other                          | 17,331            | 220                | -                 | -           | 17,551              |
| <b>Total</b>                       | <b>\$ 978,118</b> | <b>\$ 55,688</b>   | <b>\$ 116,244</b> | <b>\$ -</b> | <b>\$ 1,150,050</b> |

1 The substandard credit quality indicator includes both potential problem loans that are currently performing and nonperforming loans





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Impaired loans by class of loan were as follows:

|   | As of March 31, 2013   |                                |                      | Quarter Ended<br>March 31, 2013   |                                  |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>With no related allowance recorded</b>       |                        |                                |                      |                                   |                                  |
| Commercial                                      | \$ 142                 | \$ 190                         | \$ -                 | \$ 169                            | \$ -                             |
| Commercial real estate                          |                        |                                |                      |                                   |                                  |
| Owner occupied general purpose                  | 4,193                  | 4,631                          | -                    | 4,333                             | 1                                |
| Owner occupied special purpose                  | 4,530                  | 5,657                          | -                    | 5,855                             | -                                |
| Non-owner occupied general purpose              | 11,237                 | 12,697                         | -                    | 12,797                            | 44                               |
| Non-owner occupied special purpose              | 467                    | 630                            | -                    | 472                               | -                                |
| Retail properties                               | 5,282                  | 8,348                          | -                    | 7,031                             | -                                |
| Farm  | 2,417                  | 2,417                          | -                    | 2,467                             | -                                |
| Construction                                    |                        |                                |                      |                                   |                                  |
| Homebuilder                                     | 3,597                  | 4,033                          | -                    | 3,876                             | 31                               |
| Land  | -                      | -                              | -                    | 127                               | -                                |
| Commercial speculative                          | 1,988                  | 97                             | -                    | 2,126                             | -                                |
| All other                                       | 53                     | 2,781                          | -                    | 66                                | -                                |
| Residential                                     |                        |                                |                      |                                   |                                  |
| Investor  | 7,707                  | 9,839                          | -                    | 6,437                             | -                                |
| Owner occupied                                  | 9,460                  | 10,766                         | -                    | 9,425                             | 57                               |
| Revolving and junior liens                      | 1,232                  | 1,468                          | -                    | 1,300                             | 1                                |
| Consumer  | -                      | -                              | -                    | 11                                | -                                |
| Total impaired loans with no recorded allowance | 52,305                 | 63,554                         | -                    | 56,492                            | 134                              |
| <b>With an allowance recorded</b>               |                        |                                |                      |                                   |                                  |
| Commercial                                      | 68                     | 74                             | 68                   | 317                               | -                                |
| Commercial real estate                          |                        |                                |                      |                                   |                                  |
| Owner occupied general purpose                  | 897                    | 937                            | 236                  | 956                               | -                                |
| Owner occupied special purpose                  | 5,927                  | 8,264                          | 735                  | 5,090                             | -                                |
| Non-owner occupied general purpose              | 2,519                  | 4,124                          | 115                  | 2,649                             | -                                |
| Non-owner occupied special purpose              | 1,003                  | 1,003                          | 101                  | 501                               | -                                |
| Retail properties                               | 3,564                  | 7,133                          | 813                  | 2,658                             | -                                |
| Farm  | -                      | -                              | -                    | -                                 | -                                |
| Construction                                    |                        |                                |                      |                                   |                                  |
| Homebuilder                                     | -                      | -                              | -                    | 13                                | -                                |
| Land  | 254                    | 308                            | 15                   | 127                               | -                                |
| Commercial speculative                          | 3,365                  | 5,661                          | 677                  | 3,844                             | -                                |
| All other                                       | 553                    | 776                            | 347                  | 516                               | -                                |
| Residential                                     |                        |                                |                      |                                   |                                  |
| Investor  | 817                    | 1,195                          | 202                  | 2,779                             | -                                |
| Owner occupied                                  | 3,945                  | 4,648                          | 765                  | 4,927                             | 6                                |
| Revolving and junior liens                      | 2,432                  | 2,536                          | 964                  | 2,448                             | -                                |
| Consumer  | -                      | -                              | -                    | -                                 | -                                |
|   | 25,344                 | 36,659                         | 5,038                | 26,825                            | 6                                |

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Total impaired loans with a  
recorded allowance

|                      |           |            |          |           |        |
|----------------------|-----------|------------|----------|-----------|--------|
| Total impaired loans | \$ 77,649 | \$ 100,213 | \$ 5,038 | \$ 83,317 | \$ 140 |
|----------------------|-----------|------------|----------|-----------|--------|

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Impaired loans by class of loans were as follows:

|   | As of December 31, 2012 |                                |                      | Quarter Ended<br>March 31, 2012   |                                  |
|---|-------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|   | Recorded<br>Investment  | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>With no related allowance recorded</b>       |                         |                                |                      |                                   |                                  |
| Commercial                                      | \$ 196                  | \$ 229                         | \$ -                 | \$ 511                            | \$ -                             |
| Commercial real estate                          |                         |                                |                      |                                   |                                  |
| Owner occupied general purpose                  | 4,473                   | 5,021                          | -                    | 4,540                             | -                                |
| Owner occupied special purpose                  | 7,180                   | 8,486                          | -                    | 11,905                            | -                                |
| Non-owner occupied general purpose              | 14,356                  | 17,381                         | -                    | 9,980                             | 45                               |
| Non-owner occupied special purpose              | 477                     | 634                            | -                    | 794                               | -                                |
| Retail properties                               | 8,780                   | 15,323                         | -                    | 8,126                             | -                                |
| Farm  | 2,517                   | 2,517                          | -                    | 709                               | -                                |
| Construction                                    |                         |                                |                      |                                   |                                  |
| Homebuilder                                     | 4,155                   | 4,729                          | -                    | 9,464                             | 27                               |
| Land  | 254                     | 308                            | -                    | 1,305                             | -                                |
| Commercial speculative                          | 2,265                   | 3,451                          | -                    | 7,783                             | -                                |
| All other                                       | 78                      | 168                            | -                    | 3,218                             | -                                |
| Residential                                     |                         |                                |                      |                                   |                                  |
| Investor  | 5,168                   | 6,979                          | -                    | 3,417                             | 2                                |
| Owner occupied                                  | 9,389                   | 11,002                         | -                    | 12,523                            | 22                               |
| Revolving and junior liens                      | 1,368                   | 1,689                          | -                    | 1,549                             | -                                |
| Consumer  | 23                      | 23                             | -                    | -                                 | -                                |
| Total impaired loans with no recorded allowance | 60,679                  | 77,940                         | -                    | 75,824                            | 96                               |
| <b>With an allowance recorded</b>               |                         |                                |                      |                                   |                                  |
| Commercial                                      | 566                     | 619                            | 458                  | 650                               | -                                |
| Commercial real estate                          |                         |                                |                      |                                   |                                  |
| Owner occupied general purpose                  | 1,014                   | 1,057                          | 230                  | 5,078                             | -                                |
| Owner occupied special purpose                  | 4,253                   | 6,200                          | 712                  | 4,171                             | -                                |
| Non-owner occupied general purpose              | 2,779                   | 3,906                          | 204                  | 11,456                            | -                                |
| Non-owner occupied special purpose              | -                       | -                              | -                    | 429                               | -                                |
| Retail properties                               | 1,752                   | 1,812                          | 1,102                | 5,656                             | -                                |
| Farm  | -                       | -                              | -                    | 592                               | -                                |
| Construction                                    |                         |                                |                      |                                   |                                  |
| Homebuilder                                     | 26                      | 75                             | 3                    | 1,916                             | -                                |
| Land  | -                       | -                              | -                    | 352                               | -                                |
| Commercial speculative                          | 4,322                   | 6,613                          | 757                  | 4,661                             | -                                |
| All other                                       | 479                     | 649                            | 353                  | 241                               | -                                |
| Residential                                     |                         |                                |                      |                                   |                                  |
| Investor  | 4,742                   | 5,954                          | 477                  | 12,060                            | -                                |
| Owner occupied                                  | 5,909                   | 6,923                          | 1,089                | 6,803                             | 1                                |
| Revolving and junior liens                      | 2,464                   | 2,625                          | 874                  | 1,288                             | -                                |
| Consumer  | -                       | -                              | -                    | -                                 | -                                |
| Total impaired loans with a recorded allowance  | 28,306                  | 36,433                         | 6,259                | 55,353                            | 1                                |

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|                      |           |            |          |            |       |
|----------------------|-----------|------------|----------|------------|-------|
| Total impaired loans | \$ 88,985 | \$ 114,373 | \$ 6,259 | \$ 131,177 | \$ 97 |
|----------------------|-----------|------------|----------|------------|-------|

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Troubled debt restructurings ( TDR ) are loans for which the contractual terms have been modified and both of these conditions exist: (1) there is a concession to the borrower and (2) the borrower is experiencing financial difficulties. Loans are restructured on a case-by-case basis during the loan collection process with modifications generally initiated at the request of the borrower. These modifications may include reduction in interest rates, extension of term, deferrals of principal, and other modifications. The Bank does participate in the U.S. Department of the Treasury s (the Treasury ) Home Affordable Modification Program ( HAMP ) which gives qualifying homeowners an opportunity to refinance into more affordable monthly payments.

The specific allocation of the allowance for loan losses on TDRs is determined either by discounting the modified cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance (i.e. specific reserve) as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. The allowance for loan losses also includes an allowance based on a loss migration analysis for each loan category for loans that are not individually evaluated for specific impairment. All loans charged-off, including TDRs charged-off, are factored into this calculation by portfolio segment.

TDR s that were modified during the period are summarized as follows:

|                                     |      |                   |   | TDR Modifications<br>Three months ending 3/31/13 |     |
|-------------------------------------|------|-------------------|---|--|-----|
|                                     |      | # of<br>contracts | Pre-modification<br>recorded investment | Post-modification<br>recorded investment         |     |
| <b>Troubled debt restructurings</b> |      |                   |   |  |     |
| Real estate - residential           |      |                   |   |  |     |
| Owner occupied                      |      |                   |   |  |     |
| Deferral <sup>1</sup>               |      |                   |   |  |     |
|                                     | 1    |                   | \$ 137                                  | \$   | 137 |
|                                     | \$ 1 |                   | \$ 137                                  | \$   | 137 |

|                                     |      |                   |   | TDR Modifications<br>Three months ending 3/31/12 |     |
|-------------------------------------|------|-------------------|---|--|-----|
|                                     |      | # of<br>contracts | Pre-modification<br>recorded investment | Post-modification<br>recorded investment         |     |
| <b>Troubled debt restructurings</b> |      |                   |   |  |     |
| Real estate - construction          |      |                   |   |  |     |
| Commercial speculative              |      |                   |   |  |     |
| Interest <sup>2</sup>               |      |                   |   |  |     |
|                                     | 1    |                   | \$ 430                                  | \$   | 460 |
| Real estate - residential           |      |                   |   |  |     |
| Owner occupied                      |      |                   |   |  |     |
| Deferral                            |      |                   |   |  |     |
|                                     | 1    |                   | 108                                     |  | 108 |
|                                     | \$ 2 |                   | \$ 538                                  | \$   | 568 |

<sup>1</sup> Deferral: Refers to the deferral of principal

2 Interest: Interest rate concession below normal market

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TDR s are classified as being in default on a case-by-case basis. The following table presents TDR s that defaulted during the periods shown and were restructured within the 12 month period prior to default. There was no TDR default activity for the three months ending March 31, 2012.

Troubled debt restructurings that  
Subsequently Defaulted

|                                    | # of contracts | TDR Default Activity<br>Three Months ending 3/31/13 |  | # of contracts | TDR Default Activity<br>Three Months ending 3/31/12 |  |   |
|------------------------------------|----------------|---|--|----------------|---|--|---|
|                                    |                |   | Pre-modification outstanding recorded investment |                |   | Pre-modification outstanding recorded investment |   |
| Real estate - residential Investor | 1              | \$  |  | 155            | -   | \$   | - |
|                                    | 1              | \$  |  | 155            | -   | \$   | - |

**Note 4 Allowance for Loan Losses**

Changes in the allowance for loan losses by segment of loans based on method of impairment for the three months ended March 31, 2013, were as follows:

|   | Commercial | Real Estate Commercial <sup>1</sup> | Real Estate Construction | Real Estate Residential | Consumer | Unallocated | Total        |
|---|------------|-------------------------------------|--------------------------|-------------------------|----------|-------------|--------------|
| <b>Allowance for loan losses:</b>                     |            |                                     |                          |                         |          |             |              |
| Beginning balance                                     | \$ 4,517   | \$ 20,100                           | \$ 3,837                 | \$ 4,535                | \$ 1,178 | \$ 4,430    | \$ 38,597    |
| Charge-offs   | 254        | 508                                 | 4                        | 585                     | 172      | -           | 1,523        |
| Recoveries  | 19         | 2,724                               | 770                      | 404                     | 143      | -           | 4,060        |
| Provision   | (509)      | (3,051)                             | (874)                    | (383)                   | 65       | 2,252       | (2,500)      |
| Ending balance  | \$ 3,773   | \$ 19,265                           | \$ 3,729                 | \$ 3,971                | \$ 1,214 | \$ 6,682    | \$ 38,634    |
| Ending balance: Individually evaluated for impairment | \$ 68      | \$ 2,000                            | \$ 1,039                 | \$ 1,931                | \$ -     | \$ -        | \$ 5,038     |
| Ending balance: Collectively evaluated for impairment | \$ 3,705   | \$ 17,265                           | \$ 2,690                 | \$ 2,040                | \$ 1,214 | \$ 6,682    | \$ 33,596    |
| <b>Financing receivables:</b>                         |            |                                     |                          |                         |          |             |              |
| Ending balance  | \$ 92,906  | \$ 566,349                          | \$ 40,698                | \$ 394,599              | \$ 2,908 | \$ 15,842   | \$ 1,113,302 |
| Ending balance: Individually evaluated for impairment | \$ 210     | \$ 42,036                           | \$ 9,810                 | \$ 25,593               | \$ -     | \$ -        | \$ 77,649    |
| Ending balance: Collectively evaluated for impairment | \$ 92,696  | \$ 524,313                          | \$ 30,888                | \$ 369,006              | \$ 2,908 | \$ 15,842   | \$ 1,035,653 |

<sup>1</sup> As of March 31, 2013, this segment consisted of performing loans that included a higher risk pool of loans rated as substandard that totaled \$21.8 million. The amount of general allocation that was estimated for that portion of these performing substandard rated loans was \$3.1 million at March 31, 2013.

The Company's allowance for loan loss is calculated in accordance with GAAP and relevant supervisory guidance. All management estimates were made in light of observable trends within loan portfolio segments, market conditions and established credit review administration practices.



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Changes in the allowance for loan losses by segment of loans based on method of impairment for the quarter ended March 31, 2012, were as follows:

|   | Commercial | Real Estate Commercial | Real Estate Construction | Real Estate Residential | Consumer | Unallocated | Total        |
|---|------------|------------------------|--------------------------|-------------------------|----------|-------------|--------------|
| <b>Allowance for loan losses:</b>                     |            |                        |                          |                         |          |             |              |
| Beginning balance                                     | \$ 5,070   | \$ 30,770              | \$ 7,937                 | \$ 6,335                | \$ 884   | \$ 1,001    | \$ 51,997    |
| Charge-offs   | 10         | 8,280                  | 1,402                    | 2,291                   | 139      | -           | 12,122       |
| Recoveries  | 6          | 189                    | 1,169                    | 165                     | 122      | -           | 1,651        |
| Provision   | 262        | 5,959                  | (740)                    | 584                     | 52       | (33)        | 6,084        |
| Ending balance  | \$ 5,328   | \$ 28,638              | \$ 6,964                 | \$ 4,793                | \$ 919   | \$ 968      | \$ 47,610    |
| Ending balance: Individually evaluated for impairment |            |                        |                          |                         |          |             |              |
|   | \$ 389     | \$ 4,568               | \$ 1,908                 | \$ 2,782                | \$ -     | \$ -        | \$ 9,647     |
| Ending balance: Collectively evaluated for impairment |            |                        |                          |                         |          |             |              |
|   | \$ 4,939   | \$ 24,070              | \$ 5,056                 | \$ 2,011                | \$ 919   | \$ 968      | \$ 37,963    |
| <b>Financing receivables:</b>                         |            |                        |                          |                         |          |             |              |
| Ending balance  | \$ 105,147 | \$ 676,297             | \$ 60,285                | \$ 464,596              | \$ 3,544 | \$ 12,479   | \$ 1,322,348 |
| Ending balance: Individually evaluated for impairment | \$ 1,157   | \$ 61,580              | \$ 24,072                | \$ 36,919               | \$ -     | \$ -        | \$ 123,728   |
| Ending balance: Collectively evaluated for impairment | \$ 103,990 | \$ 614,717             | \$ 36,213                | \$ 427,677              | \$ 3,544 | \$ 12,479   | \$ 1,198,620 |

1 As of March 31, 2012, this segment consisted of performing loans that included a higher risk pool of loans rated as substandard that totaled \$43.3 million. The amount of general allocation that was estimated for that portion of these performing substandard rated loans was \$5.0 million at March 31, 2012.

**Note 5 Other Real Estate Owned**

Details related to the activity in the other real estate owned ( OREO ) portfolio, net of valuation reserve, for the periods presented are itemized in the following table:

|                                | Three Months Ended |            |
|--------------------------------|--------------------|------------|
|                                | 2013               | 2012       |
| Balance at beginning of period | \$ 72,423          | \$ 93,290  |
| Property additions             | 6,985              | 15,918     |
| Development improvements       | 50                 | 318        |
| Less:                          |                    |            |
| Property disposals             | 11,661             | 5,346      |
| Period valuation adjustments   | 2,134              | 2,500      |
| Balance at end of period       | \$ 65,663          | \$ 101,680 |



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Activity in the valuation allowance was as follows:

|                                 | Three Months Ended |           |
|---------------------------------|--------------------|-----------|
|                                 | March 31,          |           |
|                                 | 2013               | 2012      |
| Balance at beginning of period  | \$ 31,454          | \$ 23,462 |
| Provision for unrealized losses | 1,987              | 2,500     |
| Reductions taken on sales       | (2,622)            | (1,968)   |
| Other adjustments               | 147                | -         |
| Balance at end of period        | \$ 30,966          | \$ 23,994 |

Expenses related to foreclosed assets, net of lease revenue includes:

|                                 | Three Months Ended |          |
|---------------------------------|--------------------|----------|
|                                 | March 31,          |          |
|                                 | 2013               | 2012     |
| Gain on sales, net              | \$ (181)           | \$ (23)  |
| Provision for unrealized losses | 1,987              | 2,500    |
| Operating expenses              | 1,699              | 2,154    |
| Less:                           |                    |          |
| Lease revenue                   | 408                | 1,179    |
|                                 | \$ 3,097           | \$ 3,452 |

**Note 6 Deposits**

Major classifications of deposits were as follows:

|  | March 31, 2013 |           | December 31, 2012 |           |
|--|----------------|-----------|-------------------|-----------|
| Noninterest bearing demand                     | \$             | 351,328   | \$                | 379,451   |
| Savings  |                | 230,771   |                   | 216,305   |
| NOW accounts                                   |                | 303,385   |                   | 286,860   |
| Money market accounts                          |                | 331,707   |                   | 323,811   |
| Certificates of deposit of less than \$100,000 |                | 312,193   |                   | 318,844   |
| Certificates of deposit of \$100,000 or more   |                | 188,872   |                   | 191,948   |
|  | \$             | 1,718,256 | \$                | 1,717,219 |

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The following table is a summary of borrowings as of March 31, 2013, and December 31, 2012. Junior subordinated debentures are discussed in detail in Note 8:

|   | March 31, 2013 | December 31, 2012 |
|---|----------------|-------------------|
| Securities sold under repurchase agreements | \$ 20,802      | \$ 17,875         |
| FHLB advances                               | -              | 100,000           |
| Junior subordinated debentures              | 58,378         | 58,378            |
| Subordinated debt                           | 45,000         | 45,000            |
| Notes payable and other borrowings          | 500            | 500               |
|   | \$ 124,680     | \$ 221,753        |

The Company enters into deposit sweep transactions where the transaction amounts are secured by pledged securities. These transactions consistently mature within 1 to 90 days from the transaction date. All sweep repurchase agreements are treated as financings secured by U. S. government agencies and collateralized mortgage-backed securities with a carrying amount of \$31.7 and \$26.0 million at March 31, 2013, and December 31, 2012, respectively.

The Company's borrowings at the FHLBC require the Bank to be a member and invest in the stock of the FHLBC and are generally limited to the lower of 35% of total assets or 60% of the book value of certain mortgage loans. At March 31, 2013, there were no advances on the FHLBC stock of \$6.4 million and collateralized securities and loans valued at \$109.4 million. As of December 31, 2012, there were advances totaling \$100.0 million on FHLBC stock of \$6.4 million and collateralized loan balances of \$129.5 million. All \$100.0 million was paid off during the month of January 2013. On January 30, 2013, an advance of \$40.0 million was taken on FHLBC stock, which matured and was paid off on March 20, 2013. The Company has also established borrowing capacity at the FRB that was not used at either March 31, 2013, or December 31, 2012. The Company currently has \$34.7 million of borrowing capacity at the FRB at the current secondary rate of 1.25%.

One of the Company's most significant borrowing relationships continued to be the \$45.5 million credit facility with Bank of America. That credit facility was originally comprised of a \$30.5 million senior debt facility, which included a \$30.0 million revolving line now matured and \$500,000 in term debt (together, the Senior Debt), as well as \$45.0 million of subordinated debt (the Subordinated Debt). The Subordinated Debt and the term debt portion of the Senior Debt mature on March 31, 2018. The interest rate on the Senior Debt resets quarterly and at the Company's option, based on the Lender's prime rate or three-month LIBOR plus 90 basis points. The interest rate on term debt portion of the Subordinated Debt resets quarterly, and is equal to three-month LIBOR plus 150 basis points. The Company had no principal outstanding balance on the Bank of America senior line of credit when it matured but did have \$500,000 in principal outstanding in term debt and \$45.0 million in principal outstanding in Subordinated Debt at both December 31, 2012 and March 31, 2013. The term debt is secured by all of the outstanding capital stock of the Bank. The Company has made all required interest payments on the outstanding principal amounts on a timely basis.

The credit facility agreement contains usual and customary provisions regarding acceleration of the term debt portion of the Senior Debt upon the occurrence of an event of default by the Company under the agreement, as described therein. The agreement also contains certain customary representations and warranties as well as financial covenants. At March 31, 2013, the Company was out of compliance with one of the financial covenants. Previously, the Company was out of compliance with two of the financial covenants. The agreement provides that upon an event of default as the result of the Company's failure to comply with a financial covenant, the lender may (i) terminate all commitments to extend further credit, (ii) increase the interest rate on the revolving line and the term debt by 200 basis points, (iii) declare the Senior Debt immediately due and

payable and (iv) exercise all of its rights and remedies

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at law, in equity and/or pursuant to any or all collateral documents, including foreclosing on the collateral. The total outstanding principal amount of the Senior Debt is the \$500,000 in term debt with interest payable at the default rate mentioned above. Because the Subordinated Debt is treated as Tier 2 capital for regulatory capital purposes, the agreement does not provide the lender with any rights of acceleration or other remedies with regard to the Subordinated Debt upon an event of default caused by the Company's failure to comply with a financial covenant.

**Note 8 Junior Subordinated Debentures**

The Company completed the sale of \$27.5 million of cumulative trust preferred securities by its unconsolidated subsidiary, Old Second Capital Trust I in June 2003. An additional \$4.1 million of cumulative trust preferred securities was sold in July 2003. The costs associated with the issuance of the cumulative trust preferred securities are being amortized over 30 years. The trust preferred securities may remain outstanding for a 30-year term but, subject to regulatory approval, can be called in whole or in part by the Company. The stated call period commenced on June 30, 2008 and a call can be exercised by the Company from time to time hereafter. When not in deferral, cash distributions on the securities are payable quarterly at an annual rate of 7.80%. The Company issued a new \$32.6 million subordinated debenture to the trust in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

The Company issued an additional \$25.0 million of cumulative trust preferred securities through a private placement completed by an additional unconsolidated subsidiary, Old Second Capital Trust II, in April 2007. Although nominal in amount, the costs associated with that issuance are being amortized over 30 years. These trust preferred securities also mature in 30 years, but subject to the aforementioned regulatory approval, can be called in whole or in part on a quarterly basis commencing June 15, 2017. The quarterly cash distributions on the securities are fixed at 6.77% through June 15, 2017 and float at 150 basis points over three-month LIBOR thereafter. The Company issued a new \$25.8 million subordinated debenture to the Old Second Capital Trust II in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

Under the terms of the subordinated debentures issued to each of Old Second Capital Trust I and II, the Company is allowed to defer payments of interest for 20 quarterly periods 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 Fixed Rate Cumulative Perpetual Preferred Stock (the Series B Preferred Stock) as discussed in Note 15. In August of 2010, the Company elected to defer regularly scheduled interest payments on the \$58.4 million of junior subordinated debentures. Because of the deferral on the subordinated debentures, the trusts will defer regularly scheduled dividends on the trust preferred securities. Both of the debentures issued by the Company are recorded on the Consolidated Balance Sheets as junior subordinated debentures and the related interest expense for each issuance is included in the Consolidated Statements of Operations. The total accumulated unpaid interest on the junior subordinated debentures including compounded interest from July 1, 2010 on the deferred payments totals \$13.0 million at March 31, 2013.

**Note 9 - Long-Term Incentive Plan**

The Long-Term Incentive Plan (the Incentive Plan) authorizes the issuance of up to 1,908,332 shares of the Company's common stock, including the granting of qualified stock options, non-qualified stock options, restricted stock, restricted stock units, and stock appreciation rights. Total shares issuable under the plan were 200,868 at March 31, 2013. Stock based awards may be granted to selected directors and officers or employees at the discretion of the board of directors. There were no stock options granted in the first quarter of 2013 or 2012. All stock options are granted for a term of ten years.



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Total compensation cost that has been charged for those plans was \$14,000 in the first quarter of 2013 and \$87,000 in the first quarter of 2012.

There were no stock options exercised during the first quarter of 2013 or 2012. There is no unrecognized compensation cost related to nonvested stock options as all stock options of the Company's common stock have vested as of March 31, 2012.

A summary of stock option activity in the Incentive Plan as of each quarter is as follows:

|                               | Shares  | Weighted<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (years) | Aggregate<br>Intrinsic<br>Value |
|-------------------------------|---------|--|--|---------------------------------|
| <b>March 31, 2013</b>         |         |  |  |                                 |
| Beginning outstanding         | 409,500 | \$ 28.75                                 |  |                                 |
| Canceled                      | -       | -  |  |                                 |
| Ending outstanding            | 409,500 | \$ 28.75                                 | 2.8  | \$ -                            |
| Exercisable at end of quarter | 409,500 | \$ 28.75                                 | 2.8  | \$ -                            |

Generally, restricted stock and restricted stock units vest three years from the grant date, but the Company's Board of Directors have discretionary authority to change some terms including the amount of time until vest date. Awards under the Incentive Plan become fully vested upon a merger or change in control of the Company.

Under the Incentive Plan, restricted stock was granted beginning in 2005 and the grant of restricted units began in February 2009. Both of these restricted awards have voting and dividend rights and are subject to forfeiture until certain restrictions have lapsed including employment for a specific period. Further, in first quarter 2013 after completion on Treasury's auction of the Old Second Bancorp Series B Preferred Stock at a discount, 45,000 unvested restricted stock shares previously awarded were recaptured in addition to 133,943 restricted stock shares that were fully vested. These recaptures provided an income statement benefit of \$612,000 included in other noninterest income. There were no restricted awards issued during the first quarter of 2013 and 60,000 restricted awards were issued during the first quarter of 2012. Compensation expense is recognized over the vesting period of the restricted award based on the market value of the award at issue date.



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A summary of changes in the Company's nonvested restricted awards from December 31, 2012 is as follows:

|                                   | March 31, 2013                          |    |   |
|-----------------------------------|---|----|---|
|                                   | Restricted<br>Stock Shares<br>and Units | \$ | Weighted<br>Average<br>Grant Date<br>Fair Value |
| Nonvested at January 1            | 327,920                                 | \$ | 2.21  |
| Granted                           | -                                       |    | -   |
| Vested                            | (191,920)                               |    | 2.63  |
| Forfeited                         | (11,000)                                |    | 2.47  |
| Recaptured after Series B auction | (45,000)                                |    | 1.25  |
| Nonvested at March 31             | 80,000                                  | \$ | 1.73  |

Total unrecognized compensation cost of restricted awards is \$31,000 as of March 31, 2013, and is expected to be recognized over a weighted-average period of 0.81 years. Total unrecognized compensation cost of restricted awards was \$294,000 as of March 31, 2012, which was expected to be recognized over a weighted-average period of 1.29 years.

### **Note 10 Earnings (Loss) Per Share**

Earnings (loss) per share is included below as of March 31 (in thousands except for share data):

|  | Three Months Ended |            |
|--|--------------------|------------|
|  | 2013               | 2012       |
| Basic earnings (loss) per share:                                     |                    |            |
| Weighted-average common shares outstanding                           | 14,076,114         | 14,043,545 |
| Weighted-average common shares less stock based awards               | 13,947,454         | 13,855,339 |
| Weighted-average common shares stock based awards                    | 210,069            | 340,804    |
| Net earnings (loss)  | \$ 5,471           | \$ (2,968) |
| Dividend and accretion on preferred shares                           | 1,289              | 1,223      |
| Net earnings (loss) available to common stockholders                 | 4,182              | (4,191)    |
| Undistributed earnings (loss)  | 4,182              | (4,191)    |
| Basic earnings (loss) per share common undistributed earnings (loss) | 0.30               | (0.30)     |
| Basic earnings (loss) per share of common stock                      | \$ 0.30            | \$ (0.30)  |
| Diluted earnings (loss) per share:                                   |                    |            |
| Weighted-average common shares outstanding                           | 14,076,114         | 14,043,545 |
| Dilutive effect of nonvested restricted awards                       | 81,409             | 152,598    |
| Diluted average common shares outstanding                            | 14,157,523         | 14,196,143 |
| Net earnings (loss) available to common stockholders                 | \$ 4,182           | \$ (4,191) |
| Diluted earnings (loss) per share                                    | \$ 0.30            | \$ (0.30)  |

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|  |           |           |
|--|-----------|-----------|
| Number of antidilutive options excluded<br>from the diluted earnings per share calculation | 1,224,839 | 1,313,839 |
|--|-----------|-----------|

The above loss per share calculation did not include 815,339 common stock warrants that were outstanding as of March 31, 2013, and March 31, 2012 because they were anti-dilutive.

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**Note 11 - Regulatory & Capital Matters**

On May 16, 2011, the Bank, the wholly-owned banking subsidiary of the Company, entered into 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.

Both capital ratio objectives in the OCC agreement have been exceeded since June 30, 2011. At March 31, 2013, the Bank's Tier 1 leverage ratio was 9.94%, up 27 basis points from December 31, 2012, and 119 basis points above the objective the Bank had agreed with the OCC to maintain of 8.75%. The Bank's total capital ratio was 15.79%, up 93 basis points from December 31, 2012, and 454 basis points above the objective of 11.25%.

On July 22, 2011, the Company entered into a Written Agreement with the FRB (the "Written Agreement"). Pursuant to the Written Agreement, the Company has agreed to take certain actions and operate in compliance with the Written Agreement's provisions during its term.

Under the terms of the Written Agreement, the Company is required to, among other things: (i) serve as a source of strength to the Bank, including ensuring that the Bank complies with the Consent Order; (ii) refrain from declaring or paying any dividend, or taking dividends or other payments representing a reduction in the Bank's capital, each without the prior written consent of the FRB and the Director of the Division of Banking Supervision and Regulation of the Board of Governors of the Federal Reserve System (the "Director"); (iii) refrain, along with its nonbank subsidiaries, from making any distributions on subordinated debentures or trust preferred securities without the prior written consent of the FRB and the Director; (iv) refrain, along with its nonbank subsidiaries, from incurring, increasing or guaranteeing any debt, and from purchasing or redeeming any shares of its capital stock, each without the prior written consent of the FRB; (v) provide the FRB with a written plan to maintain sufficient capital at the Company on a consolidated basis; (vi) provide the FRB with a projection of the Company's planned sources and uses of cash; (vii) comply with certain regulatory notice provisions pertaining to the appointment of any new director or senior executive officer, or the changing of responsibilities of any senior executive officer; and (viii) comply with certain regulatory restrictions on indemnification and severance payments. The Company is also required to submit certain reports to the FRB with respect to the foregoing requirements.

Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve Capital guidelines. The general bank and holding company capital adequacy guidelines are described in the accompanying table, as are the capital ratios of the Company and the Bank, as of March 31, 2013, and December 31, 2012. These ratios are calculated on a consistent basis with the ratios disclosed in the most recent filings with the regulatory agencies.

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At March 31, 2013, the Company, on a consolidated basis, exceeded the minimum thresholds to be considered adequately capitalized under regulatory defined capital ratios. The Company and the

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Bank are subject to regulatory capital requirements administered by federal banking agencies. Generally, if adequately capitalized, regulatory approval is not required to accept brokered deposits, however, the Bank is limited in the amount of brokered deposits that it can hold pursuant to the Consent Order.

Capital levels and industry defined regulatory minimum required levels:

|  | Actual     |        | Minimum Required<br>for Capital<br>Adequacy Purposes |       | Minimum Required<br>to be Well<br>Capitalized 1 |       |
|--|------------|--------|--|-------|---|-------|
|  | Amount     | Ratio  | Amount   | Ratio | Amount  | Ratio |
| <b>March 31, 2013</b>                  |            |        |  |       |   |       |
| Total capital to risk weighted assets  |            |        |  |       |   |       |
| Consolidated                           | \$ 193,639 | 14.33% | \$ 108,103   | 8.00% | N/A   | N/A   |
| Old Second Bank                        | 212,983    | 15.79  | 107,908  | 8.00  | 134,885   | 10.00 |
| Tier 1 capital to risk weighted assets |            |        |  |       |   |       |
| Consolidated                           | 100,877    | 7.46   | 54,090   | 4.00  | N/A   | N/A   |
| Old Second Bank                        | 195,854    | 14.52  | 53,954   | 4.00  | 80,931  | 6.00  |
| Tier 1 capital to average assets       |            |        |  |       |   |       |
| Consolidated                           | 100,877    | 5.11   | 78,964   | 4.00  | N/A   | N/A   |
| Old Second Bank                        | 195,854    | 9.94   | 78,814   | 4.00  | 98,518  | 5.00  |
| <b>December 31, 2012</b>               |            |        |  |       |   |       |
| Total capital to risk weighted assets  |            |        |  |       |   |       |
| Consolidated                           | \$ 189,465 | 13.62% | \$ 111,286   | 8.00% | N/A   | N/A   |
| Old Second Bank                        | 206,496    | 14.86  | 111,169  | 8.00  | 138,961   | 10.00 |
| Tier 1 capital to risk weighted assets |            |        |  |       |   |       |
| Consolidated                           | 94,816     | 6.81   | 55,692   | 4.00  | N/A   | N/A   |
| Old Second Bank                        | 188,873    | 13.59  | 55,592   | 4.00  | 83,388  | 6.00  |
| Tier 1 capital to average assets       |            |        |  |       |   |       |
| Consolidated                           | 94,816     | 4.85   | 78,199   | 4.00  | N/A   | N/A   |
| Old Second Bank                        | 188,873    | 9.67   | 78,127   | 4.00  | 97,659  | 5.00  |

1 The Bank exceeded the general minimum regulatory requirements to be considered well capitalized and is in full compliance with heightened capital ratios, that it has agreed to maintain with the OCC, contained within the Consent Order.

The Company's credit facility with Bank of America includes \$45.0 million in subordinated debt. That debt obligation continues to qualify as Tier 2 regulatory capital. In addition, the trust preferred securities continue to qualify as Tier 1 regulatory capital, and the Company treats the maximum amount of this security type allowable under regulatory guidelines as Tier 1 capital. As of March 31, 2013, trust preferred proceeds of \$26.0 million qualified as Tier 1 regulatory capital and \$30.6 million qualified as Tier 2 regulatory capital. 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.

**Dividend Restrictions and Deferrals**

In addition to the above requirements, banking regulations and capital guidelines generally limit the amount of dividends that may be paid by a Bank without prior regulatory approval. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's profits, combined with the retained profit of the previous two years, subject to the capital requirements described above. As a result of the December 31, 2012, operating loss, funds were not available for the payment of dividends by the Bank to the Company and this restriction continued at March 31, 2013.

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As discussed in Note 8, as of March 31, 2013, the Company had \$58.4 million of junior subordinated debentures held by two statutory business trusts that it controls. The Company has the right to defer interest payments on the debentures for a period of up to 20 consecutive quarters, and elected to begin such a deferral in August 2010. However, all deferred interest must be paid before the Company may pay dividends on its capital stock. Therefore, the Company will not be able to pay dividends on its common stock until all deferred interest on these debentures has been paid in full. The total amount of such deferred and unpaid interest as of March 31, 2013, was \$13.0 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 the Series B Preferred Stock. In August 2010, it also began to defer the payment 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 all accrued and unpaid dividends on the Series B Preferred Stock before it may reinstate the payment of dividends on the common stock. The total amount of deferred Series B Preferred Stock dividends as of March 31, 2013, was \$10.2 million. Agreements with the OCC and the FRB contain restrictions on dividend payments.

Further detail on the subordinated debentures, the Series B Preferred Stock and the deferral of interest and dividends thereon is described in Notes 8 and 15.

During the fourth quarter 2012, the U.S. Treasury ( Treasury ) announced the continuation of individual auctions of the preferred stock that was issued through the Troubled Asset Relief Program and Capital Purchase Program (the CPP ). At this time, the Company was informed that the Series B Stock would be auctioned. Auctions were held and transactions were settled in first quarter 2013 reflecting Treasury's efforts to conclude the CPP. The auctions were successful for Treasury as all of the Series B Stock held by Treasury was sold to third parties, including certain of our directors. At December 31, 2012, Old Second Bancorp carried \$71.9 million of Series B Stock in Total Stockholders Equity. At March 31, 2013, the Company carried \$72.1 million of Series B Stock.

As a result of the completed auctions, the Company's Board elected to stop accruing the dividend on the Series B Stock. Previously, the Company had declared and accrued the dividend on the Series B Stock quarterly throughout the deferral period. Given the discount reflected in the results of the auction, the Board believes that the Company will likely be able to repurchase the Series B Stock in the future at a price less than the face amount of the Series B Stock plus accrued and unpaid dividends. Therefore, under GAAP, the Company did not fully accrue the dividend on the Series B Stock in the first quarter and does not anticipate accruing for it through the second quarter. The Company will continue to evaluate whether declaring dividends on the Series B Stock is appropriate in future periods. Pursuant to the terms of the Series B Stock, the dividends paid on the Series B Stock will increase from 5% to 9% in 2014.

**Note 12 Fair Value Option and Fair Value Measurements**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy established by the Company also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs that may be used to measure fair value are:

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Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Company has the ability to access as of the measurement date.

Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.



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Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Transfers between levels are deemed to have occurred at the end of the reporting period. For the quarters ended March 31, 2013, and 2012 there were no significant transfers between levels.

Securities available-for-sale are valued primarily by a third party pricing agent and both the market and income valuation approaches are implemented. The Company uses the following methods and significant assumptions to estimate fair value:

- Government-sponsored agency debt securities are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.
- Other government-sponsored agency securities, mortgage-backed securities and some of the actively traded real estate mortgage investment conduits and collateralized mortgage obligations are primarily priced using available market information including benchmark yields, prepayment speeds, spreads, volatility of similar securities and trade date.
- Other inactive government-sponsored agency securities are primarily priced using consensus pricing and dealer quotes.
- State and political subdivisions are largely grouped by characteristics (i.e., geographical data and source of revenue in trade dissemination systems). Because some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities and could be valued with Level 3 measurements.
- CDOs are collateralized by trust preferred security issuances of other financial institutions. CDOs are valued utilizing a discounted cash flow analysis. To reflect an appropriate fair value measurement, management included a risk premium adjustment to provide an estimate of the amount that a market participant would demand because of uncertainty in cash flows in the discounted cash flow analysis. Changes in unobservable inputs such as future cash flows, prepayment speeds and market rates which may result in a significantly higher or lower fair value measurement. Due to the significant amount of unobservable inputs for the security and limited market activity, these securities are considered Level 3 valuations.
- Asset-backed securities are priced using a single expected cash flow stream model using trades, covers, bids, offers and price for similar bonds as well as prepayment and default projections based on historical statistics of the underlying collateral and current market data.
- Residential mortgage loans eligible for sale in the secondary market are carried at fair market value. The fair value of loans held for sale is determined using quoted secondary market prices.
- Lending related commitments to fund certain residential mortgage loans (interest rate locks) to be sold in the secondary market and forward commitments for the future delivery of mortgage loans to third party investors as well as forward commitments for future delivery of mortgage-backed securities are considered derivatives. Fair values are estimated based on observable changes in mortgage interest rates including mortgage-backed securities prices from the date of the commitment and do not typically involve significant judgments by management.
- The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income to derive the resultant value. The Company is able to compare the valuation model inputs, such as the discount rate, prepayment speeds, weighted average delinquency and foreclosure/bankruptcy rates to widely available published industry data for reasonableness.

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- Interest rate swap positions, both assets and liabilities, are based on a valuation pricing models using an income approach based upon readily observable market parameters such as interest rate yield curves.
- Both the credit valuation reserve on current interest rate swap positions and on receivables related to unwound customer interest rate swap positions was determined based upon management's estimate of the amount of credit risk exposure, including available collateral protection and/or by

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utilizing an estimate related to a probability of default as indicated in the Bank credit policy. Such adjustments would result in a Level 3 classification.

- The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.
- Nonrecurring adjustments to certain commercial and residential real estate properties classified as OREO are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

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**Assets and Liabilities Measured at Fair Value on a Recurring Basis:**

The tables below present the balance of assets and liabilities at March 31, 2013, and December 31, 2012, respectively, which are measured by the Company at fair value on a recurring basis:

|   | March 31, 2013 |            |            | Total      |
|---|----------------|------------|------------|------------|
|   | Level 1        | Level 2    | Level 3    |            |
| <b>Assets:</b>  |                |            |            |            |
| Securities available-for-sale   |                |            |            |            |
| U.S. Treasury   | \$ 1,502       | \$ -       | \$ -       | \$ 1,502   |
| U.S. government agencies  | -              | 69,265     | -          | 69,265     |
| U.S. government agency mortgage-backed States and political subdivisions  | -              | 76,352     | -          | 76,352     |
| Corporate Bonds   | -              | 26,883     | 132        | 27,015     |
| Collateralized mortgage obligations                                       | -              | 38,579     | -          | 38,579     |
| Asset-backed securities   | -              | 131,669    | -          | 131,669    |
| Collateralized debt obligations   | -              | 114,709    | 106,028    | 220,737    |
| Loans held-for-sale   | -              | -          | 10,627     | 10,627     |
| Mortgage servicing rights   | -              | 6,381      | -          | 6,381      |
| Other assets (Interest rate swap agreements net of swap credit valuation) | -              | -          | 4,469      | 4,469      |
| Other assets (Forward MBS)  | -              | 1,197      | (33)       | 1,164      |
| Total   | \$ 1,502       | \$ 465,527 | \$ 121,223 | \$ 588,252 |

|   |      |          |      |          |
|---|------|----------|------|----------|
| <b>Liabilities:</b>   |      |          |      |          |
| Other liabilities (Interest rate swap agreements)               | \$ - | \$ 1,197 | \$ - | \$ 1,197 |
| Other liabilities (Interest rate lock commitments to borrowers) | -    | -        | -    | -        |
| Total   | \$ - | \$ 1,197 | \$ - | \$ 1,197 |

|   | December 31, 2012 |            |           | Total      |
|---|-------------------|------------|-----------|------------|
|   | Level 1           | Level 2    | Level 3   |            |
| <b>Assets:</b>  |                   |            |           |            |
| Securities available-for-sale   |                   |            |           |            |
| U.S. Treasury   | \$ 1,507          | \$ -       | \$ -      | \$ 1,507   |
| U.S. government agencies  | -                 | 49,850     | -         | 49,850     |
| U.S. government agency mortgage-backed States and political subdivisions  | -                 | 128,738    | -         | 128,738    |
| Corporate Bonds   | -                 | 15,723     | 132       | 15,855     |
| Collateralized mortgage obligations                                       | -                 | 36,886     | -         | 36,886     |
| Asset-backed securities   | -                 | 169,600    | -         | 169,600    |
| Collateralized debt obligations   | -                 | 167,493    | -         | 167,493    |
| Loans held-for-sale   | -                 | -          | 9,957     | 9,957      |
| Mortgage servicing rights   | -                 | 9,571      | -         | 9,571      |
| Other assets (Interest rate swap agreements net of swap credit valuation) | -                 | -          | 4,116     | 4,116      |
| Other assets (Forward MBS)  | -                 | 1,349      | (47)      | 1,302      |
| Total   | \$ 1,507          | \$ 579,777 | \$ 14,158 | \$ 595,442 |

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Liabilities:

|   |    |   |    |       |    |   |    |       |
|---|----|---|----|-------|----|---|----|-------|
| Other liabilities (Interest rate swap agreements)               | \$ | - | \$ | 1,349 | \$ | - | \$ | 1,349 |
| Other liabilities (Interest rate lock commitments to borrowers) |    | - |    | 5     |    | - |    | 5     |
| Total   | \$ | - | \$ | 1,354 | \$ | - | \$ | 1,354 |

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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs are summarized as follows:

|   | Three months ended March 31, 2013  |              |   |                                 |                                    |
|---|------------------------------------|--------------|---|---------------------------------|------------------------------------|
|   | Securities available-for-sale      |              |   |                                 |                                    |
|   | Collateralized<br>Debt Obligations | Asset-Backed | States and<br>Political<br>Subdivisions | Mortgage<br>Servicing<br>Rights | Interest Rate<br>Swap<br>Valuation |
| Beginning balance January 1, 2013               | \$ 9,957                           | \$ -         | \$ 132                                  | \$ 4,116                        | \$ (47)                            |
| Transfers into Level 3                          | -                                  | 106,028      | -                                       | -                               | -                                  |
| Total gains or losses                           |                                    |              |   |                                 |                                    |
| Included in earnings (or changes in net assets) | 42                                 | -            | -                                       | (106)                           | 14                                 |
| Included in other comprehensive income          | 692                                | -            | -                                       | -                               | -                                  |
| Purchases, issuances, sales, and settlements    |                                    |              |   |                                 |                                    |
| Issuances                                       | -                                  | -            | -                                       | 459                             | -                                  |
| Settlements                                     | (64)                               | -            | -                                       | -                               | -                                  |
| Ending balance March 31, 2013                   | \$ 10,627                          | \$ 106,028   | \$ 132                                  | \$ 4,469                        | \$ (33)                            |

|   | Three months ended March 31, 2012  |   |                                 |                                    |  |
|---|------------------------------------|---|---------------------------------|------------------------------------|--|
|   | Securities available-for-sale      |   |                                 |                                    |  |
|   | Collateralized<br>Debt Obligations | States and<br>Political<br>Subdivisions | Mortgage<br>Servicing<br>Rights | Interest Rate<br>Swap<br>Valuation |  |
| Beginning balance January 1, 2012               | \$ 9,974                           | \$ 138                                  | \$ 3,487                        | \$ (80)                            |  |
| Transfers into Level 3                          | -                                  | -                                       | -                               | -                                  |  |
| Transfers out of Level 3                        | -                                  | -                                       | -                               | -                                  |  |
| Total gains or losses                           |                                    |   |                                 |                                    |  |
| Included in earnings (or changes in net assets) | 38                                 | -                                       | (123)                           | 2                                  |  |
| Included in other comprehensive income          | (283)                              | -                                       | -                               | -                                  |  |
| Purchases, issuances, sales, and settlements    |                                    |   |                                 |                                    |  |
| Issuances                                       | -                                  | -                                       | 442                             | -                                  |  |
| Settlements                                     | (27)                               | -                                       | -                               | -                                  |  |
| Ending balance March 31, 2012                   | \$ 9,702                           | \$ 138                                  | \$ 3,806                        | \$ (78)                            |  |

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The following table and commentary presents quantitative (dollars in thousands) and qualitative information about Level 3 fair value measurements as of March 31, 2013:

| <b>Measured at fair value on a recurring basis:</b> | Fair Value | Valuation Methodology                       | Unobservable Inputs    | Range of Input        | Weighted Average of Inputs |
|---|------------|---|------------------------|-----------------------|----------------------------|
| Collateralized Debt Obligations                     | \$ 10,627  | Discounted Cash Flow                        | Discount Rate          | Libor<br>+ 5.75-6.75% | 6.2%                       |
|   |            |   | Prepayment %           | 0%-100%               | 18.3%                      |
|   |            |   | Default range          | 3.5%-55.6%            | 16.2%                      |
| Mortgage Servicing rights                           | 4,469      | Discounted Cash Flow                        | Discount Rate          | 10.5%                 | 10.5%                      |
|   |            |   | Prepayment Speed       | 14.4%                 | 14.4%                      |
| Interest Rate Swap Valuation                        | (33)       | Management estimate of credit risk exposure | Probability of Default | 2-31%                 | 20.3%                      |
| Asset-backed securities                             | 106,028    | Discounted Cash Flow                        | Credit Risk Premium    | 1-3%                  | 2%                         |
|   |            |   | Liquidity Risk Premium | 0-2%                  | 1%                         |

The following table and commentary presents quantitative (dollars in thousands) and qualitative information about Level 3 fair value measurements as of December 31, 2012:

| <b>Measured at fair value on a recurring basis:</b> | Fair Value | Valuation Methodology                       | Unobservable Inputs    | Range of Input | Weighted Average of Inputs |
|---|------------|---|------------------------|----------------|----------------------------|
| Collateralized Debt Obligations                     | \$ 9,957   | Discounted Cash Flow                        | Discount Rate          | Libor + 6%-7%  | 6.4%                       |
|   |            |   | Prepayment %           | 0%-76%         | 16.4%                      |
|   |            |   | Default range          | 3.1%-100%      | 19.1%                      |
| Mortgage Servicing rights                           | 4,116      | Discounted Cash Flow                        | Discount Rate          | 10.5%          | 10.5%                      |
|   |            |   | Prepayment Speed       | 15.8%          | 15.8%                      |
| Interest Rate Swap Valuation                        | (47)       | Management estimate of credit risk exposure | Probability of Default | 2%-31%         | 17.9%                      |

The \$132,000 on the state and political subdivisions line at March 31, 2013 under Level 3 represents a security from a small, local municipality. Given the small dollar amount and size of the municipality involved, this is categorized under Level 3 based on the payment stream received by the Company from the municipality. That payment stream is otherwise an unobservable input.

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:**

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The Company may be required, from time to time, to measure certain other assets at fair value on a nonrecurring basis in accordance with GAAP. These assets consist of impaired loans and other real estate owned. For assets measured at fair value on a nonrecurring basis on hand at March 31, 2013, and December 31, 2012, respectively, the following tables provide the level of valuation assumptions used to determine each valuation and the carrying value of the related assets:

|   | March 31, 2013 |         |         |    |    |    |        |
|---|----------------|---------|---------|----|----|----|--------|
|   | Level 1        | Level 2 | Level 3 | \$ | \$ | \$ | Total  |
| Impaired loans <sup>1</sup>               | -              | -       | 19,954  | \$ | -  | \$ | 19,954 |
| Other real estate owned, net <sup>2</sup> | -              | -       | 65,663  | -  | -  | -  | 65,663 |
| <b>Total</b>                              | -              | -       | 85,617  | \$ | -  | \$ | 85,617 |



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1 Represents carrying value and related write-downs of loans for which adjustments are substantially based on the appraised value of collateral for collateral-dependent loans, had a carrying amount of \$25.0 million, with a valuation allowance of \$5.0 million, resulting in a decrease of specific allocations within the provision for loan losses of \$1.2 million for the quarter ending March 31, 2013. The carrying value of loans fully charged off is zero.

2 OREO is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of \$65.7 million, which is made up of the outstanding balance of \$99.1 million, net of a valuation allowance of \$31.0 million and participations of \$2.6 million, at March 31, 2013, resulting in a charge to expense of \$2.0 million for the quarter ended March 31, 2013.

|   | December 31, 2012 |         |           | Total     |
|---|-------------------|---------|-----------|-----------|
|   | Level 1           | Level 2 | Level 3   |           |
| Impaired loans <sup>1</sup>               | \$ -              | \$ -    | \$ 21,543 | \$ 21,543 |
| Other real estate owned, net <sup>2</sup> | -                 | -       | 72,423    | 72,423    |
| Total                                     | \$ -              | \$ -    | \$ 93,966 | \$ 93,966 |

1 Represents carrying value and related write-downs of loans for which adjustments are substantially based on the appraised value of collateral for collateral-dependent loans, had a carrying amount of \$27.8 million, with a valuation allowance of \$6.3 million, resulting in a decrease of specific allocations within the provision for loan losses of \$6.8 million for the year ending December 31, 2012. The carrying value of loans fully charged off is zero.

2 OREO is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of \$72.4 million, which is made up of the outstanding balance of \$109.7 million, net of a valuation allowance of \$31.4 million and participations of \$5.9 million, at December 31, 2012, resulting in a charge to expense of \$16.4 million for the year ended December 31, 2012.

The Company also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include other real estate owned and impaired loans. The Company has estimated the fair values of these assets based primarily on Level 3 inputs. Other real estate and impaired loans are generally valued using the fair value of collateral provided by third party appraisals. These valuations include assumptions related to cash flow projections, discount rates, and recent comparable sales. The numerical range of unobservable inputs for these valuation assumptions are not meaningful.

**Note 13 Financial Instruments with Off-Balance Sheet Risk and Derivative Transactions**

To meet the financing needs of its customers, the Bank, as a subsidiary of the Company, is a party to various financial instruments with off-balance-sheet risk in the normal course of business. These off-balance-sheet financial instruments include commitments to originate and sell loans as well as financial standby, performance standby and commercial letters of credit. The instruments involve, to varying degrees, elements

of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Bank's credit exposure for loan commitments and letters of credit are represented by the dollar amount of those instruments. Management generally uses the same credit policies and collateral requirements in making commitments and conditional obligations as it does for on-balance-sheet instruments.

**Interest Rate Swaps**

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The Company also has interest rate derivative positions to assist with risk management that are not designated as hedging instruments. These derivative positions relate to transactions in which the Bank enters an interest rate swap with a client while at the same time entering into an offsetting interest rate swap with another financial institution. Due to financial covenant violations relating to nonperforming loans, the Bank had \$7.0 million in investment securities pledged to support interest rate swap activity with three correspondent financial institutions at March 31, 2013. The Bank had \$7.4 million in investment securities pledge to support interest rate swap activity with two correspondent financial institutions at December 31, 2012. In connection with each transaction, the Bank agreed to pay interest to the client on a notional amount at a variable interest rate and receive interest from the client on the same notional amount at a fixed interest rate. At the same time, the Bank agreed to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the client to effectively convert a variable rate loan to a fixed rate loan and is part of the Company's interest rate risk management strategy. Because the Bank acts as an intermediary for the client, changes in the fair value of the underlying derivative contracts offset each other and do not generally affect the results of operations. Fair value measurements include an assessment of credit risk related to the client's ability to perform on their contract position, however, and valuation estimates related to that exposure are discussed in Note 12 above. At March 31, 2013, the notional amount of non-hedging interest rate swaps was \$91.9 million with a weighted average maturity of 1.49 years. At December 31, 2012, the notional amount of non-hedging interest rate swaps was \$82.1 million with a weighted average maturity of 1.3 years. The Bank offsets derivative assets and liabilities that are subject to a master netting arrangement.

The Bank also grants mortgage loan interest rate lock commitments to borrowers, subject to normal loan underwriting standards. The interest rate risk associated with these loan interest rate lock commitments is managed by entering into contracts for future deliveries of loans as well as selling forward mortgage-backed securities contracts. Loan interest rate lock commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments to originate residential mortgage loans held-for-sale and forward commitments to sell residential mortgage loans or forward mortgage-backed securities contracts are considered derivative instruments and changes in the fair value are recorded to mortgage banking income. Fair values are estimated based on observable changes in mortgage interest rates including mortgage-backed securities prices from the date of the commitment.

The following table presents derivatives not designated as hedging instruments as of March 31, 2013, and periodic changes in the values of the interest rate swaps are reported in other noninterest income. Periodic changes in the value of the forward contracts related to mortgage loan origination are reported in the net gain on sales of mortgage loans.

|  | Asset Derivatives              |                        |            | Liability Derivatives  |            |
|--|--------------------------------|------------------------|------------|------------------------|------------|
|  | Notional or Contractual Amount | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Interest rate swap contracts net of credit valuation | \$ 91,879                      | Other Assets           | \$ 1,164   | Other Liabilities      | \$ 1,197   |
| Commitments <sup>1</sup>                             | 233,514                        | Other Assets           | 492        | N/A                    | -          |
| Forward contracts <sup>2</sup>                       | 27,000                         | N/A                    | -          | Other Liabilities      | -          |
| Total  |                                |                        | \$ 1,656   |                        | \$ 1,197   |

<sup>1</sup>Includes unused loan commitments and interest rate lock commitments.

<sup>2</sup>Includes forward MBS contracts and forward loan contracts.



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The following table presents derivatives not designated as hedging instruments as of December 31, 2012.

|  | Notional or Contractual Amount | Asset Derivatives      |            | Liability Derivatives  |            |
|--|--------------------------------|------------------------|------------|------------------------|------------|
|  |                                | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Interest rate swap contracts net of credit valuation | \$ 82,097                      | Other Assets           | \$ 1,302   | Other Liabilities      | \$ 1,349   |
| Commitments <sup>1</sup>                             | 226,135                        | Other Assets           | 567        | N/A                    | -          |
| Forward contracts <sup>2</sup>                       | 28,000                         | N/A                    | -          | Other Liabilities      | 5          |
| Total  |                                |                        | \$ 1,869   |                        | \$ 1,354   |

<sup>1</sup>Includes unused loan commitments and interest rate lock commitments.

<sup>2</sup>Includes forward MBS contracts.

The Bank also issues letters of credit, which are conditional commitments that guarantee the performance of a customer to a third party. The credit risk involved and collateral obtained in issuing letters of credit are essentially the same as that involved in extending loan commitments to our customers.

In addition to customer related commitments, the Company is responsible for letters of credit commitments that relate to properties held in OREO. The following table represents the Company's contractual commitments due to letters of credit as of March 31, 2013, and December 31, 2012.

The following table is a summary of financial instrument commitments (in thousands):

|  | March 31, 2013 |          |       | December 31, 2012 |          |       |
|--|----------------|----------|-------|-------------------|----------|-------|
|  | Fixed          | Variable | Total | Fixed             | Variable | Total |
|  |                |          |       |                   |          |       |

**Note 14 Fair Values of Financial Instruments**

The estimated fair values approximate carrying amount for all items except those described in the following table. Investment security fair values are based upon market prices or dealer quotes, and if no such information is available, on the rate and term of the security. The fair value of the collateralized debt obligations included in investment securities includes a risk premium adjustment to provide an estimate of the amount that a market participant would demand because of uncertainty in cash flows and the methods for determining fair value of securities is discussed in detail in Note 12. It is not practicable to determine the fair value of Federal Home Loan Bank Chicago stock due to restrictions on

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transferability. Fair values of loans were estimated for portfolios of loans with similar financial characteristics, such as type and fixed or variable interest rate terms. Cash flows were discounted using current rates at which similar loans would be made to borrowers with similar ratings and for similar maturities. The fair value of time deposits is estimated using discounted future cash flows at current rates offered for deposits of similar remaining maturities. The fair values of borrowings were estimated based on interest rates available to the Company for debt with similar terms and remaining maturities. The fair value of off-balance sheet items is not considered material.

The carrying amount and estimated fair values of financial instruments were as follows:

|   | Carrying<br>Amount | Fair<br>Value | March 31, 2013 |           |           |
|---|--------------------|---------------|----------------|-----------|-----------|
|   |                    |               | Level 1        | Level 2   | Level 3   |
| <b>Financial assets:</b>                              |                    |               |                |           |           |
| Cash, due from banks and federal funds sold           | \$ 17,202          | \$ 17,202     | \$ 17,202      | \$ -      | \$ -      |
| Interest bearing deposits with financial institutions | 63,915             | 63,915        | 63,915         | -         | -         |
| Securities available-for-sale                         | 575,746            | 575,746       | 1,502          | 457,457   | 116,787   |
| FHLBC and FRB Stock                                   | 11,202             | 11,202        | -              | 11,202    | -         |
| Bank-owned life insurance                             | 54,610             | 54,610        | -              | 54,610    | -         |
| Loans held for sale                                   | 6,381              | 6,381         | -              | 6,381     | -         |
| Loans, net  | 1,074,668          | 1,084,532     | -              | -         | 1,084,532 |
| Accrued interest receivable                           | 5,373              | 5,373         | -              | 5,373     | -         |
| <b>Financial liabilities:</b>                         |                    |               |                |           |           |
| Noninterest bearing deposits                          | \$ 351,328         | \$ 351,328    | \$ 351,328     | \$ -      | \$ -      |
| Interest bearing deposits                             | 1,366,928          | 1,372,966     | -              | 1,372,966 | -         |
| Securities sold under repurchase agreements           | 20,802             | 20,802        | -              | 20,802    | -         |
| Junior subordinated debentures                        | 58,378             | 50,550        | 30,211         | 20,339    | -         |
| Subordinated debenture                                | 45,000             | 35,991        | -              | 35,991    | -         |
| Note payable and other borrowings                     | 500                | 450           | -              | 450       | -         |
| Borrowing interest payable                            | 13,027             | 13,027        | 7,717          | 5,310     | -         |
| Deposit interest payable                              | 958                | 958           | -              | 958       | -         |

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|   | Carrying<br>Amount | Fair<br>Value | December 31, 2012 |           |           |
|---|--------------------|---------------|-------------------|-----------|-----------|
|   |                    |               | Level 1           | Level 2   | Level 3   |
| <b>Financial assets:</b>                              |                    |               |                   |           |           |
| Cash, due from banks and federal funds sold           | \$ 44,221          | \$ 44,221     | \$ 44,221         | \$ -      | \$ -      |
| Interest bearing deposits with financial institutions | 84,286             | 84,286        | 84,286            | -         | -         |
| Securities available-for-sale                         | 579,886            | 579,886       | 1,507             | 568,290   | 10,089    |
| FHLBC and FRB Stock                                   | 11,202             | 11,202        | -                 | 11,202    | -         |
| Bank-owned life insurance                             | 54,203             | 54,203        | -                 | 54,203    | -         |
| Loans held for sale                                   | 9,571              | 9,571         | -                 | 9,571     | -         |
| Loans, net  | 1,111,453          | 1,118,711     | -                 | -         | 1,118,711 |
| Accrued interest receivable                           | 5,252              | 5,252         | -                 | 5,252     | -         |
| <b>Financial liabilities:</b>                         |                    |               |                   |           |           |
| Noninterest bearing deposits                          | \$ 379,451         | \$ 379,451    | \$ 379,451        | \$ -      | \$ -      |
| Interest bearing deposits                             | 1,337,768          | 1,347,603     | -                 | 1,347,603 | -         |
| Securities sold under repurchase agreements           | 17,875             | 17,875        | -                 | 17,875    | -         |
| Other short-term borrowings                           | 100,000            | 100,000       | -                 | 100,000   | -         |
| Junior subordinated debentures                        | 58,378             | 38,308        | 22,725            | 15,583    | -         |
| Subordinated debenture                                | 45,000             | 28,206        | -                 | 28,206    | -         |
| Note payable and other borrowings                     | 500                | 302           | -                 | 302       | -         |
| Borrowing interest payable                            | 11,740             | 11,740        | 6,946             | 4,794     | -         |
| Deposit interest payable                              | 1,006              | 1,006         | -                 | 1,006     | -         |

**Note 15 Preferred Stock**

The Series B Preferred Stock was issued as part of the CPP as implemented by the Treasury. The Series B Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends on the liquidation preference amount on a quarterly basis at a rate of 5% per annum for the first five years, and 9% per annum thereafter. Concurrent with issuing the Series B Preferred Stock, the Company issued to the Treasury a ten year warrant to purchase 815,339 shares of the Company's common stock at an exercise price of \$13.43 per share.

Subsequent to the Company's receipt of the \$73.0 million in proceeds from the Treasury in the first quarter of 2009, the proceeds were allocated between the Series B Preferred Stock and warrants that were issued. The warrants were classified as equity, and the allocation was based on their relative fair values in accordance with accounting guidance. The fair value was determined for both the Series B Preferred Stock and the warrants as part of the allocation process in the amounts of \$68.2 million and \$4.8 million, respectively.

As discussed in Note 11, in August 2010, the Company suspended quarterly cash dividends on its outstanding Series B Preferred Stock. Further, as discussed in Note 8, the Company has elected to defer interest payments on certain of its subordinated debentures. In quarters prior to First Quarter, 2013, during the period in which preferred stock dividends were deferred such dividends continued to accrue. However, 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. The terms of the Series B Preferred Stock also prevent the Company from paying cash dividends or generally repurchasing its common stock while Series B Preferred Stock dividends are in arrears. The total amount of unpaid and deferred Series B Preferred Stock dividends as of March 31, 2013, was \$10.2 million.



During the fourth quarter 2012, the U.S. Treasury ( Treasury ) announced the continuation of individual auctions of the preferred stock that was issued through the Troubled Asset Relief Program and Capital Purchase Program (the CPP ). At this time, the Company was informed that the Series B Stock

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would be auctioned. Auctions were held and transactions were settled in first quarter 2013 reflecting Treasury's efforts to conclude the Troubled Asset Relief Program Capital Purchase Program. The auctions were successful for Treasury as all of the Series B Stock held by Treasury was sold to third parties, including certain of our directors. At December 31, 2012, Old Second Bancorp carried \$71.9 million of Series B Stock in Total Stockholders Equity. At March 31, 2013, the Company carried \$72.1 million of Series B Stock.

As a result of the completed auctions, the Company's Board elected to stop accruing the dividend on the Series B Stock in First Quarter, 2013. Previously, the Company had declared and accrued the dividend on the Series B Stock quarterly throughout the deferral period. Given the discount reflected in the results of the auction, the Board believes that the Company will likely be able to repurchase the Series B Stock in the future at a price less than the face amount of the Series B Stock plus accrued and unpaid dividends. Therefore, under GAAP, the Company did not fully accrue the dividend on the Series B Stock in the first quarter and does not anticipate accruing for it through the second quarter. The Company will continue to evaluate whether declaring dividends on the Series B Stock is appropriate in future periods. Pursuant to the terms of the Series B Stock, the dividends paid on the Series B Stock will increase from 5% to 9% in 2014.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Overview**

Old Second Bancorp, Inc. (the Company) is a financial services company with its main headquarters located in Aurora, Illinois. The Company is the holding company of Old Second National Bank (the Bank), a national banking organization headquartered in Aurora, Illinois and provides commercial and retail banking services, as well as a full complement of trust and wealth management services. The Company has offices located in Cook, Kane, Kendall, DeKalb, DuPage, LaSalle and Will counties in Illinois. The following management's discussion and analysis is presented to provide information concerning our financial condition as of March 31, 2013, as compared to December 31, 2012, and the results of operations for the three months ended March 31, 2013, and 2012. This discussion and analysis should be read in conjunction with our consolidated financial statements and the financial and statistical data appearing elsewhere in this report and our 2012 Form 10-K.

The ongoing weakness in the financial system and economy, particularly as it relates to credit costs associated with the real estate markets in the Company's market areas, continues to directly affect borrowers' ability to repay their loans. This has resulted in a continued elevated, but improving level of nonperforming loans. Overall economic weakness is reflected in the Company's operating results, and management remains vigilant in analyzing the loan portfolio quality, estimating loan loss provision and making decisions to charge-off loans. The Company recorded a \$2.5 million loan loss reserve release and net income of \$5.5 million prior to preferred stock dividends and accretion in the first three months of 2013. This compared to a \$6.1 million provision for loan losses and a net loss of \$3.0 million prior to preferred stock dividends and accretion for the same period in 2012.

**Results of Operations**

Earnings per share for the first quarter of 2013 was \$.30 per diluted share on \$5.5 million of net income. This compares to net loss of \$.30 per diluted share, on a loss of \$3.0 million for the first quarter of 2012. The Company recorded a \$2.5 million release from the loan loss reserve while net recoveries totaled \$2.5 million in the first quarter of 2013. This compared to a provision for loan losses of \$6.1 million and net charge-offs totaling \$10.5 million in the first quarter of 2012. The net income available to common stockholders was \$4.2 million for the first quarter of 2013 after preferred stock dividends and accretion of \$1.3 million. This compared to net loss available to common stockholders of \$4.2 million for the first quarter of 2012 after Series B Preferred Stock dividends and accretion of \$1.2 million.

**Net Interest Income**

Net interest and dividend income decreased \$1.2 million, from \$15.1 million for the quarter ended March 31, 2012, to \$13.9 million for the quarter ended March 31, 2013. Average earning assets increased \$29.6 million, or 1.7%, from \$1.75 billion in the first quarter of 2012, to \$1.78 billion in the first quarter of 2013, as management continued to emphasize asset quality and new loan originations continued to be limited. Average loans, including loans held for sale, decreased \$214.0 million from the first quarter of 2012 to the first quarter of 2013. This decline was primarily due to the generally slow demand from qualified borrowers in the Bank's market areas, charge-off activity, maturities, and payments on performing loans. To utilize available liquid funds, management increased securities available-for-sale in the first quarter of 2013 to 29.5% of total assets up from 18.1% at March 31, 2012, and 28.3% at the end of 2012. At the same time, the Company continued to reduce deposits that had previously provided asset funding by emphasizing relationship banking rather than single service customers. During the first

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quarter of 2013, average interest bearing liabilities increased \$23.7 million, or 1.6%, from March 31, 2012. The net interest margin (tax-equivalent basis), expressed as a percentage of average earning assets, decreased from 3.48% in the first quarter of 2012 to 3.18% in the first quarter of 2013. The average tax-equivalent yield on earning assets decreased from 4.41% in the first quarter of 2012 to 3.94%, or 47 basis points, in the first quarter of 2013. At the same time, however, the cost of funds on interest bearing liabilities decreased from 1.17% to 0.95%, or 22 basis points, helping to offset

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the decrease in asset yields. The growth of lower yielding securities in the current environment of low interest rates was the main cause of decreased net interest income.

Management, in order to evaluate and measure performance, uses certain non-GAAP performance measures and ratios. This includes tax-equivalent net interest income (including its individual components) and net interest margin (including its individual components) to total average interest earning assets. Management believes that these measures and ratios provide users of the financial information with a more accurate view of the performance of the interest earning assets and interest bearing liabilities and of the Company's operating efficiency for comparison purposes. Other financial holding companies may define or calculate these measures and ratios differently. See the tables and notes below for supplemental data and the corresponding reconciliations to GAAP financial measures for the three-month periods ended March 31, 2013, and 2012.

The following tables set forth certain information relating to the Company's average consolidated balance sheets and reflect the yield on average earning assets and cost of average liabilities for the periods indicated. Dividing the related interest by the average balance of assets or liabilities derives rates. Average balances are derived from daily balances. For purposes of discussion, net interest income and net interest income to total earning assets on the following tables 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.

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ANALYSIS OF AVERAGE BALANCES,  
TAX EQUIVALENT INTEREST AND RATES

Three Months ended March 31, 2013, and 2012

(Dollar amounts in thousands - unaudited)

|   | 2013               |           |       | 2012               |           |       |
|---|--------------------|-----------|-------|--------------------|-----------|-------|
|   | Average<br>Balance | Interest  | Rate  | Average<br>Balance | Interest  | Rate  |
| <b>Assets</b>   |                    |           |       |                    |           |       |
| Interest bearing deposits                                       | \$ 68,995          | \$ 42     | 0.24% | \$ 44,018          | \$ 25     | 0.22% |
| Securities:   |                    |           |       |                    |           |       |
| Taxable   | 548,231            | 2,298     | 1.68  | 326,886            | 1,498     | 1.83  |
| Non-taxable (tax equivalent)                                    | 10,002             | 183       | 7.32  | 10,579             | 159       | 6.01  |
| Total securities  | 558,233            | 2,481     | 1.78  | 337,465            | 1,657     | 1.96  |
| Dividends from FRB and FHLB<br>stock                            | 11,202             | 76        | 2.71  | 13,325             | 74        | 2.22  |
| Loans and loans held-for-sale 1                                 | 1,143,666          | 14,971    | 5.24  | 1,357,670          | 17,774    | 5.18  |
| Total interest earning assets                                   | 1,782,096          | 17,570    | 3.94  | 1,752,478          | 19,530    | 4.41  |
| Cash and due from banks   | 29,913             | -         | -     | 16,409             | -         | -     |
| Allowance for loan losses                                       | (38,994)           | -         | -     | (51,362)           | -         | -     |
| Other noninterest bearing assets                                | 203,417            | -         | -     | 239,989            | -         | -     |
| Total assets  | \$ 1,976,432       |           |       | \$ 1,957,514       |           |       |
| <b>Liabilities and Stockholders</b>                             |                    |           |       |                    |           |       |
| <b>Equity</b>   |                    |           |       |                    |           |       |
| NOW accounts  | \$ 291,051         | \$ 64     | 0.09% | \$ 277,077         | \$ 72     | 0.10% |
| Money market accounts   | 329,377            | 123       | 0.15  | 300,762            | 166       | 0.22  |
| Savings accounts  | 221,889            | 41        | 0.07  | 205,165            | 62        | 0.12  |
| Time deposits   | 505,685            | 1,853     | 1.49  | 593,561            | 2,605     | 1.77  |
| Interest bearing deposits                                       | 1,348,002          | 2,081     | 0.63  | 1,376,565          | 2,905     | 0.85  |
| Securities sold under repurchase<br>agreements                  | 20,264             | 1         | 0.02  | 1,675              | -         | -     |
| Other short-term borrowings                                     | 43,833             | 19        | 0.17  | 10,165             | 3         | 0.12  |
| Junior subordinated debentures                                  | 58,378             | 1,287     | 8.82  | 58,378             | 1,197     | 8.20  |
| Subordinated debt   | 45,000             | 196       | 1.74  | 45,000             | 237       | 2.08  |
| Notes payable and other<br>borrowings                           | 500                | 4         | 3.20  | 500                | 4         | 3.16  |
| Total interest bearing liabilities                              | 1,515,977          | 3,588     | 0.95  | 1,492,283          | 4,346     | 1.17  |
| Noninterest bearing deposits                                    | 353,476            | -         | -     | 367,760            | -         | -     |
| Other liabilities   | 33,585             | -         | -     | 21,959             | -         | -     |
| Stockholders equity   | 73,394             | -         | -     | 75,512             | -         | -     |
| Total liabilities and stockholders<br>equity                    | \$ 1,976,432       |           |       | \$ 1,957,514       |           |       |
| Net interest income (tax<br>equivalent)                         |                    | \$ 13,982 |       |                    | \$ 15,184 |       |
| Net interest income (tax<br>equivalent) to total earning assets |                    |           | 3.18% |                    |           | 3.48% |
| Interest bearing liabilities to<br>earning assets               | 85.07%             |           |       | 85.15%             |           |       |

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1. Interest income from loans is shown on a TE basis as discussed below and includes fees of \$671,000 and \$417,000 for the first quarter of 2013 and 2012, respectively. Nonaccrual loans are included in the above-stated average balances.

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As indicated previously, net interest income and net interest income to earning assets have been adjusted to a non-GAAP 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 for the periods indicated:

|   | Effect of Tax Equivalent Adjustment<br>Three Months Ended<br>March 31, |           |      |           |
|---|--|-----------|------|-----------|
|   | 2013   |           | 2012 |           |
| Interest income (GAAP)                                    | \$   | 17,490    | \$   | 19,450    |
| Taxable equivalent adjustment - loans                     |  | 16        |      | 24        |
| Taxable equivalent adjustment - securities                |  | 64        |      | 56        |
| Interest income (TE)                                      |  | 17,570    |      | 19,530    |
| Less: interest expense (GAAP)                             |  | 3,588     |      | 4,346     |
| Net interest income (TE)                                  | \$   | 13,982    | \$   | 15,184    |
| Net interest and income (GAAP)                            | \$   | 13,902    | \$   | 15,104    |
| Average interest earning assets                           | \$   | 1,782,096 | \$   | 1,752,478 |
| Net interest income to total interest earning assets      |  | 3.16%     |      | 3.47%     |
| Net interest income to total interest earning assets (TE) |  | 3.18%     |      | 3.48%     |

**Provision for Loan Losses**

The Company recorded a \$2.5 million loan loss reserve release in the first quarter of 2013 compared to a \$6.1 million provision in the first quarter of 2012. Provision for loan loss creates a reserve for probable and estimable losses inherent in the loan portfolio. On a quarterly basis, management estimates the amount required and records the appropriate provision to maintain an adequate allowance for loan loss. Nonperforming loans decreased to \$69.8 million at March 31, 2013, from \$125.4 million at March 31, 2012, and \$82.6 million at December 31, 2012. Net recoveries totaled \$2.5 million in first quarter 2013 while net charge offs totaled \$10.5 million for the first quarter of 2012. The distribution of the Company's remaining nonperforming loans as well as charge-offs net of recoveries for relevant periods are included in the following tables.

| (in thousands)                  | Nonperforming Loans as of |                      |                   | March 31, 2013<br>Dollar change From |                   |
|---------------------------------|---------------------------|----------------------|-------------------|--------------------------------------|-------------------|
|                                 | March 31,<br>2013         | December 31,<br>2012 | March 31,<br>2012 | December 31,<br>2012                 | March 31,<br>2012 |
| Real estate-construction        | \$ 8,040                  | \$ 9,877             | \$ 24,072         | \$ (1,837)                           | \$ (16,032)       |
| Real estate-residential:        |                           |                      |                   |                                      |                   |
| Investor                        | 8,524                     | 9,910                | 15,855            | (1,386)                              | (7,331)           |
| Owner occupied                  | 8,269                     | 10,610               | 18,399            | (2,341)                              | (10,130)          |
| Revolving and junior liens      | 3,776                     | 3,832                | 2,835             | (56)                                 | 941               |
| Real estate-commercial, nonfarm | 38,588                    | 45,064               | 61,309            | (6,476)                              | (22,721)          |
| Real estate-commercial, farm    | 2,417                     | 2,517                | 1,722             | (100)                                | 695               |
| Commercial                      | 210                       | 762                  | 1,247             | (552)                                | (1,037)           |
| Other                           | -                         | 23                   | -                 | (23)                                 | -                 |
|                                 | \$ 69,824                 | \$ 82,595            | \$ 125,439        | \$ (12,771)                          | \$ (55,615)       |

Nonperforming loans consist of nonaccrual loans, nonperforming restructured accruing loans and loans 90 days or greater past due. The largest decrease in the nonperforming loans since December 31, 2012, was in the real estate commercial, nonfarm segment as upgrades and migration



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to OREO were greater than the migration of loans to nonaccrual. Remediation work continues. Importantly, new migration to nonaccrual continues to be minimal. The Company had only one large dollar credit (approximately \$2.5 million) migrate in to nonaccrual in the quarter while several other relationships

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were upgraded resulting in a reduction in nonaccrual loans of approximately \$4.5 million with an additional \$490 thousand migrated to OREO.

| Loan Charge-offs, net of recoveries<br>(in thousands) | Three Months Ended |                      |                   |
|---|--------------------|----------------------|-------------------|
|   | March 31,<br>2013  | December 31,<br>2012 | March 31,<br>2012 |
| Real estate-construction                              |                    |                      |                   |
| Homebuilder   | \$ 3               | \$ 426               | \$ 632            |
| Land  | (1)                | 14                   | (666)             |
| Commercial speculative                                | (767)              | 180                  | 284               |
| All other   | (1)                | 51                   | (17)              |
| Total real estate-construction                        | (766)              | 671                  | 233               |
| Real estate-residential                               |                    |                      |                   |
| Investor  | (149)              | 987                  | 1,160             |
| Owner occupied  | (19)               | 342                  | 670               |
| Revolving and junior liens                            | 349                | 530                  | 296               |
| Total real estate-residential                         | 181                | 1,859                | 2,126             |
| Real estate-commercial, nonfarm                       |                    |                      |                   |
| Owner general purpose                                 | (19)               | 46                   | 830               |
| Owner special purpose                                 | 117                | 131                  | 2,376             |
| Non-owner general purpose                             | (317)              | (1,608)              | 1,032             |
| Non-owner special purpose                             | (824)              | -                    | (46)              |
| Retail properties                                     | (1,173)            | 367                  | 3,899             |
| Total real estate-commercial, nonfarm                 | (2,216)            | (1,064)              | 8,091             |
| Real estate-commercial, farm                          |                    |                      |                   |
| Commercial  | 235                | 151                  | 4                 |
| Other   | 29                 | 43                   | 17                |
|   | \$ (2,537)         | \$ 1,660             | \$ 10,471         |

Large recoveries in the real estate construction segment resulted from settlements with and payments received from a guarantor. Large recoveries in the real estate commercial segment stemmed from settlements of large relationships for cash and in some instances collateral property going to OREO. Charge off activity continued to be moderate and improved from last year.

| (in thousands)                  | Classified loans as of |                      |                   | March 31, 2013<br>Dollar Change From |                   |
|---------------------------------|------------------------|----------------------|-------------------|--------------------------------------|-------------------|
|                                 | March 31,<br>2013      | December 31,<br>2012 | March 31,<br>2012 | December 31,<br>2012                 | March 31,<br>2012 |
| Real estate-construction        | \$ 12,656              | \$ 14,140            | \$ 29,161         | \$ (1,484)                           | \$ (16,505)       |
| Real estate-residential:        |                        |                      |                   |                                      |                   |
| Investor                        | 8,913                  | 12,007               | 32,220            | (3,094)                              | (23,307)          |
| Owner occupied                  | 10,463                 | 12,946               | 16,764            | (2,483)                              | (6,301)           |
| Revolving and junior liens      | 5,722                  | 5,694                | 4,374             | 28                                   | 1,348             |
| Real estate-commercial, nonfarm | 61,442                 | 67,851               | 104,977           | (6,409)                              | (43,535)          |
| Real estate-commercial, farm    | 2,417                  | 2,517                | 3,663             | (100)                                | (1,246)           |
| Commercial                      | 747                    | 1,063                | 1,705             | (316)                                | (958)             |
| Other                           | 1                      | 26                   | 10                | (25)                                 | (9)               |
|                                 | \$ 102,361             | \$ 116,244           | \$ 192,874        | \$ (13,883)                          | \$ (90,513)       |

Classified loans include nonaccrual, performing troubled debt restructurings and all other loans considered substandard. All three components are down since December 31, 2012. Classified assets include both classified loans and OREO. Management monitors a ratio of classified assets

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to the sum of Bank Tier 1 capital and the allowance for loan and lease loss reserve as another measure of overall change in loan related asset quality. With the decline in both classified loans and OREO, this ratio improved to 71.2% at March 31, 2013, down from 82.9% at December 31, 2012, and 132.4% at March 31, 2012.

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Allowance for Loan and Lease Losses

Below is a reconciliation for the activity for loan losses for the periods indicated (in thousands):

| March 31,<br>2013 | Three Months Ending<br>December 31,<br>2012 | March 31,<br>2012 |
|-------------------|---|-------------------|
|-------------------|---|-------------------|

The coverage ratio of the allowance for loan losses to nonperforming loans was 55.33% as of March 31, 2013, which reflects an increase from 46.73% as of December 31, 2012. Management updated the estimated specific allocations in the first quarter after receiving more recent appraisals for detailed collateral valuations or information on cash flow trends related to the impaired credits. The estimated general allocation increased modestly by \$1.3 million from December 31, 2012, as the overall credit condition of our loan portfolio adjusted for environmental factors remained relatively stable during the quarter. Management determined the estimated amount to provide in the allowance for loan losses based upon a number of considerations, 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.

Management regularly reviews the performance of the higher risk pool within commercial real estate 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

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3.9% at March 31, 2013, as compared to December 31, 2012. Also, compared to December 31, 2012, management increased the loss factor assigned to this pool by 6.5% 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 were showing some signs of stabilization. Those signs included a reduction in loan migration to watch status, as well as a decrease in 30 to 89 day past due loans and some stabilization in values of certain properties.

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

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included in the assessment of the adequacy of the allowance for loan losses. After a review of the adequacy of the March 31, 2013, loan loss reserve, management concluded that a \$2.5 million reserve release was justified. When measured as a percentage of loans outstanding, the total allowance for loan losses decreased from 3.60% of total loans as of March 31, 2012, to 3.47% of total loans at March 31, 2013. In management's judgment, an adequate allowance for estimated losses has been established for inherent losses at March 31, 2013; however, there can be no assurance that actual losses will not exceed the estimated amounts in the future.

**Other Real Estate**

OREO decreased \$6.8 million from \$72.4 million at December 31, 2012, to \$65.7 million at March 31, 2013. Disposition activity and valuation writedowns in the first quarter exceeded numerous but smaller dollar additions to OREO leading to this overall decrease. In the first quarter of 2013, 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. As a result, holdings in all categories (vacant land suitable for farming, single family residences, lots suitable for development, multi-family and commercial property) were flat or decreased in the quarter. Overall, a net gain on sale of \$181,000 was realized in the first quarter. Lower total OREO (down from \$101.7 million at March 31, 2012) has resulted in reduced expenses to carry and operate remaining properties.

| (in thousands)               | Three Months Ended |        |                |         |
|------------------------------|--------------------|--------|----------------|---------|
|                              | March 31, 2013     |        | March 31, 2012 |         |
| Beginning balance            | \$                 | 72,423 | \$             | 93,290  |
| Property additions           |                    | 6,985  |                | 15,918  |
| Development improvements     |                    | 50     |                | 318     |
| Less:                        |                    |        |                |         |
| Property disposals           |                    | 11,661 |                | 5,346   |
| Period valuation adjustments |                    | 2,134  |                | 2,500   |
| Other real estate owned      | \$                 | 65,663 | \$             | 101,680 |

The OREO valuation reserve decreased to \$31.0 million, which is 32.1% of gross OREO at March 31, 2013. The valuation reserve represented 19.1% and 30.3% of gross OREO at March 31, 2012, and December 31, 2012, respectively. In management's judgment, an adequate property valuation allowance has been established to present OREO at current estimates of fair value less costs to sell; however, there can be no assurance that additional losses will not be incurred on disposition or update to valuation in the future.

**OREO Properties by Type**

| (in thousands)                      | March 31, 2013 |            |     | December 31, 2012 |            |     | March 31, 2012 |            |     |
|-------------------------------------|----------------|------------|-----|-------------------|------------|-----|----------------|------------|-----|
|                                     | Amount         | % of Total |     | Amount            | % of Total |     | Amount         | % of Total |     |
| Single family residence             | \$             | 9,854      | 15% | \$                | 10,624     | 15% | \$             | 12,533     | 12% |
| Lots (single family and commercial) |                | 26,130     | 40% |                   | 26,473     | 37% |                | 35,615     | 35% |
| Vacant land                         |                | 4,610      | 7%  |                   | 6,745      | 9%  |                | 8,812      | 9%  |
| Multi-family                        |                | 2,134      | 3%  |                   | 4,372      | 6%  |                | 8,297      | 8%  |
| Commercial property                 |                | 22,935     | 35% |                   | 24,209     | 33% |                | 36,423     | 36% |

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|                       |    |        |      |    |        |      |    |         |      |
|-----------------------|----|--------|------|----|--------|------|----|---------|------|
| Total OREO properties | \$ | 65,663 | 100% | \$ | 72,423 | 100% | \$ | 101,680 | 100% |
|-----------------------|----|--------|------|----|--------|------|----|---------|------|

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December 31, 2012, data reflects a \$5.9 million reclassification of OREO participations from a liability to a contra OREO asset reduced to \$2.6 million at March 31, 2013. The contra OREO asset effectively reduces total OREO properties as reported.

**Net OREO Aging**

| (in thousands)     | March 31, 2013 |            | December 31, 2012 |            | March 31, 2012 |            |
|--------------------|----------------|------------|-------------------|------------|----------------|------------|
|                    | Amount         | % of Total | Amount            | % of Total | Amount         | % of Total |
| 0-90 Days          | \$ 3,929       | 6%         | \$ 6,666          | 9%         | \$ 14,980      | 15%        |
| 91-180 Days        | 3,666          | 5%         | 5,762             | 8%         | 9,658          | 9%         |
| 181 Days - 1 Year  | 5,661          | 9%         | 10,069            | 14%        | 26,864         | 26%        |
| 1 Year to 2 Years  | 27,067         | 41%        | 25,945            | 36%        | 38,391         | 38%        |
| 2 Years to 3 Years | 17,101         | 26%        | 17,605            | 24%        | 7,083          | 7%         |
| 3 Years to 4 Years | 4,392          | 7%         | 2,536             | 4%         | 4,704          | 5%         |
| 4 Years +          | 3,847          | 6%         | 3,840             | 5%         | -              | 0%         |
| Total              | \$ 65,663      | 100%       | \$ 72,423         | 100%       | \$ 101,680     | 100%       |

December 31, 2012 data reflects a \$5.9 million reclassification of OREO participations from a liability to a contra OREO asset reduced to \$2.6 million at March 31, 2013.

As part of our OREO management process, we age or track the time that OREO is held for sale. The table above shows that, in total, where 31% of our OREO at December 31, 2012, had been held for less than one year, that percentage dropped to 20% at March 31, 2013. When properties are tracked as being held for one to three years, the percentage of total OREO in that age class rose to 67% at March 31, 2013, up from 60% at December 31, 2012. While the totals held for more than three years were smaller than other aging categories, a similar trend was found in properties held in OREO for more than three years (13% as of March 31, 2013, up 4% and 8% from December 31, 2012, and March 31, 2012, respectively) with approximately \$3.9 million held for over four years at March 31, 2013.

**Noninterest Income**

**Noninterest Income Analysis**

| (in thousands)               | Three Months Ended |                   |                | March 31, 2013<br>Dollar Change From |                |
|------------------------------|--------------------|-------------------|----------------|--------------------------------------|----------------|
|                              | March 31, 2013     | December 31, 2012 | March 31, 2012 | December 31, 2012                    | March 31, 2012 |
| <b>Noninterest income</b>    |                    |                   |                |                                      |                |
| Trust income                 | \$ 1,491           | \$ 1,438          | \$ 1,651       | \$ 53                                | \$ (160)       |
| Service charges on deposits  | 1,677              | 1,976             | 1,831          | (299)                                | (154)          |
| Residential mortgage revenue | 2,450              | 3,605             | 3,130          | (1,155)                              | (680)          |
| Securities gains, net        | 1,453              | 269               | 101            | 1,184                                | 1,352          |



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|   |           |           |           |            |        |
|---|-----------|-----------|-----------|------------|--------|
| Increase in cash surrender value of bank-owned life insurance | 407       | 362       | 495       | 45         | (88)   |
| Debit card interchange income                                 | 792       | 886       | 760       | (94)       | 32     |
| Lease revenue from other real estate owned                    | 408       | 567       | 1,179     | (159)      | (771)  |
| Net gain on sales of other real estate owned                  | 181       | 1,800     | 23        | (1,619)    | 158    |
| Other income  | 1,737     | 803       | 1,294     | 934        | 443    |
| <b>Total noninterest income</b>                               | \$ 10,596 | \$ 11,706 | \$ 10,464 | \$ (1,110) | \$ 132 |

Active portfolio management and our efforts to shorten overall portfolio duration produced gains on securities sales in first quarter 2013 that are up sharply from prior periods. The significant increase in other noninterest income from past periods reflects recapture of \$612,000 in expense previously recorded on restricted stock awards. As a result of the Treasury auction of preferred stock in first quarter, stock previously granted to executives was recaptured by the Company as required by TARP regulations. Trust income reflected intensely competitive pricing in our market areas. Residential mortgage revenue and deposit service charges reflected an overall market slowdown in those two product areas.

Table of Contents**Noninterest Expense****Noninterest Expense Analysis**

| (in thousands)                                 | Three Months Ended |                      |                   | March 31, 2013       |   |
|--|--------------------|----------------------|-------------------|----------------------|---|
|  | March 31,<br>2013  | December 31,<br>2012 | March 31,<br>2012 | December 31,<br>2012 | Dollar Change From<br>March 31,<br>2012 |
| <b>Noninterest expense</b>                     |                    |                      |                   |                      |   |
| Salaries and employee benefits                 | \$ 9,032           | \$ 8,154             | \$ 9,049          | \$ 878               | \$ (17)                                 |
| Occupancy expense, net                         | 1,279              | 1,157                | 1,235             | 122                  | 44                                      |
| Furniture and equipment expense                | 1,144              | 1,198                | 1,155             | (54)                 | (11)                                    |
| FDIC insurance                                 | 1,035              | 973                  | 1,000             | 62                   | 35                                      |
| General bank insurance                         | 849                | 846                  | 846               | 3                    | 3                                       |
| Amortization of core deposit intangible assets | 525                | 537                  | 195               | (12)                 | 330                                     |
| Advertising expense                            | 166                | 327                  | 318               | (161)                | (152)                                   |
| Debit card interchange expense                 | 344                | 365                  | 342               | (21)                 | 2                                       |
| Legal fees                                     | 323                | 961                  | 685               | (638)                | (362)                                   |
| OREO valuation expense                         | 1,987              | 4,284                | 2,500             | (2,297)              | (513)                                   |
| Other OREO expense                             | 1,699              | 2,087                | 2,154             | (388)                | (455)                                   |
| Other expense                                  | 3,144              | 3,210                | 2,973             | (66)                 | 171                                     |
| <b>Total noninterest expense</b>               | \$ 21,527          | \$ 24,099            | \$ 22,452         | \$ (2,572)           | \$ (925)                                |

Salaries and benefits are up from fourth quarter 2012 on accrual of management bonus amounts under a Board approved incentive plan. Amortization expense related to core deposit intangible assets increased as the value of those deposits has dropped in the current historically low interest rate environment. Legal fees expenses dropped as management control of legal expense continued while problem loans and OREO also decreased. OREO valuation expenses decreased as declines in property valuations, while still sizable, are more moderate than seen last year.

**Income Taxes**

The Company did not record an income tax expense for the first quarter of 2013, despite a \$5.5 million pre-tax income during that period, due to the establishment of a valuation allowance against the Company's deferred tax assets 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, as of March 31, 2013, 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 quarters ending March 31, 2013, and 2012 was 0%.

The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment 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.

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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 of \$1.5 million related to accumulated other comprehensive loss resulting from the net unrealized loss on available-for-sale securities remains at March 31, 2013, compared to \$928,000 at December 31, 2012. A decrease in rates will generally cause an increase in the fair value of individual securities and results in changes in unrealized gains 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 2 to the consolidated financial statements. Management has both the ability and intent to retain an investment in available-for-sale securities. In each future accounting period, the Company's management will reevaluate whether the current conditions in conjunction with positive and negative

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evidence support 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.

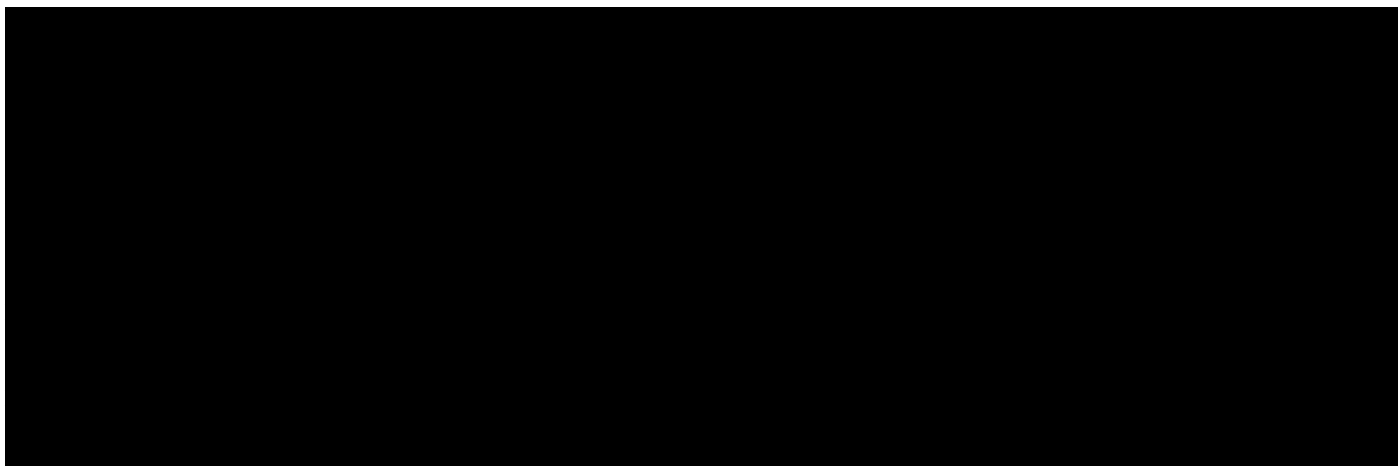
**Financial Condition**

Total assets decreased \$91.8 million, or 4.5%, from December 31, 2012, to close at \$1.95 billion as of March 31, 2013. Loans decreased by \$36.7 million, or 3.2%, as management continued to emphasize capital management and credit quality along with relationship lending. At the same time, loan charge-off activity reduced balances and collateral that previously secured loans moved to OREO. OREO decreased \$6.8 million, or 9.3% at March 31, 2013. Available-for-sale securities decreased by \$4.1 million for the three months ended March 31, 2013.

The core deposit intangible asset related to the Heritage Bank acquisition in February 2008 decreased from \$3.3 million at December 31, 2012, to \$2.8 million as of March 31, 2013. Management performed an annual review of the core deposit intangible assets as of November 30, 2012. Based upon that review and ongoing quarterly monitoring, management determined there was no impairment of the core deposit intangible assets as of March 31, 2013. No assurance can be given that future impairment tests will not result in a charge to earnings.

**Loans**

Total loans were \$1.11 billion as of March 31, 2013, a decrease of \$36.7 million from \$1.15 billion as of December 31, 2012. The decrease in loans is primarily related to satisfactory resolution of classified credits and an overriding effort to develop relationship based loan clients. Our existing commercial clients are not utilizing existing lines of credit to the extent we would prefer. Despite difficult economic conditions and an intensely competitive environment, loan pipelines continued to build with first quarter 2013 new business exceeding new business in first quarter 2012 although growth remains elusive. We have retained several new Relationship Managers who are expected to further develop this trend.



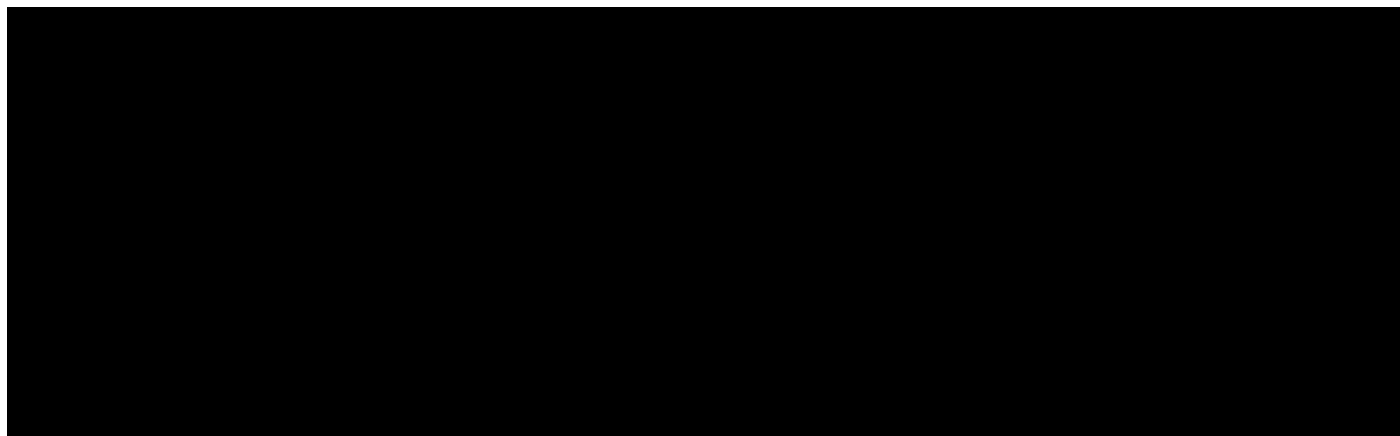
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The quality of the loan portfolio is in large part a reflection of the economic health of the communities in which the Company operates, and the local economy has been affected by the overall continued difficult economic conditions that have been experienced nationwide. The adverse economic conditions continue to affect the Midwest region in particular and financial markets generally, and real estate related activity, including valuations and transactions, continues to experience distress. Because

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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 90.0% of the portfolio as of March 31, 2013, compared to 90.1% of the portfolio as of December 31, 2012. The Company continues to oversee and manage its loan portfolio in accordance with interagency guidance on risk management. Consistent with that commitment and management's response to the Consent Order with the OCC, 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 as result of that process. Management had previously reorganized the lending function by targeted business units and has placed increased emphasis upon commercial and industrial lending in particular. This action included strategic additions and changes to staff as well as a prior realignment of resources.

**Securities**



The Company's portfolio of mortgage-backed securities with single-family residential collateral has been reduced. Management expects that the historically low interest rate environment may prompt increased repayment activity on these securities. During the quarter, the Bank was a net acquirer of asset-backed securities on government backed Federal Family Education Loan Program student loan securities as well as U.S. Government agencies step up notes. The Bank divested collateralized mortgage obligations and mortgage backed securities. The net result of selling longer duration securities was to drop the portfolio duration from 2.44 to 2.15. This restructuring also resulted in a \$1.5 million gain for the quarter.

The net unrealized losses, net of deferred tax benefit, in the portfolio increased by \$875,000 from \$1.3 million as of December 31, 2012, to \$2.2 million as of March 31, 2013. Additional information related to securities available-for-sale is found in Note 2.

**Deposits and Borrowings**

Total deposits increased \$1.0 million, or 0.1%, during the quarter ended March 31, 2013, to close at \$1.72 billion. During first quarter, savings, NOW and money markets increased by \$14.5 million, \$16.5 million and \$7.9 million, or 6.7%, 5.8% and 2.4%, respectively. At the same time, noninterest bearing demand deposits decreased by \$28.1 million, or 7.4%. Time deposits decreased \$9.7 million or 1.9% primarily due to management's pricing strategy discouraging customers with a single service relationship at the Bank. We continue to maintain our number one

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market share in our home counties of Kane and Kendall in Illinois. Market interest rates decreased generally and the average cost of interest bearing deposits decreased from 0.85% in the quarter ended March 31, 2012, to 0.63%, or 22 basis points, in the same period of 2013. Similarly, the average total cost of interest bearing liabilities decreased 22 basis points from 1.17% in the quarter ended March 31, 2012, to 0.95% in the same period of 2013.

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One of the Company's most significant borrowing relationships continued to be the \$45.5 million credit facility with Bank of America. That credit facility was originally composed of a \$30.5 million senior debt facility and \$500,000 in term debt, as well as \$45.0 million of Subordinated Debt. The subordinated debt and the term debt portion of the senior debt facility mature on March 31, 2018. The interest rate on the senior debt facility resets quarterly and is based on, at the Company's option, either the lender's prime rate or three-month LIBOR plus 90 basis points. The interest rate on the Subordinated Debt resets quarterly, and is equal to three-month LIBOR plus 150 basis points. The Company had no principal outstanding balance on the senior line of credit when it matured, but did have \$500,000 in principal outstanding in term debt and \$45.0 million in principal outstanding in Subordinated Debt at the end of both December 31, 2012, and March 31, 2013. The term debt is secured by all of the outstanding capital stock of the Bank. The Company has made all required interest payments on the outstanding principal amounts on a timely basis. Pursuant to the Written Agreement with the FRB, the Company must receive the FRB's approval prior to making any interest payments on the subordinated debt.

The credit facility agreement contains usual and customary provisions regarding acceleration of the Senior Debt upon the occurrence of an event of default by the Company under the Senior Debt agreement. The senior debt agreement also contains certain customary representations and warranties and financial and negative covenants. At March 31, 2013, the Company was out of compliance with one of the financial covenants contained within the credit agreement. Previously, the Company had been out of compliance with two of the financial covenants. The agreement provides that upon an event of default as the result of the Company's failure to comply with a financial covenant, relating to the Senior Debt, the lender may (i) terminate all commitments to extend further credit, (ii) increase the interest rate on the revolving line of the term debt by 200 basis points, (iii) declare the Senior Debt immediately due and payable and (iv) exercise all of its rights and remedies at law, in equity and/or pursuant to any or all collateral documents, including foreclosing on the collateral. The total outstanding principal amount of the senior debt is the \$500,000 in term debt. Because the Subordinated Debt is treated as Tier 2 capital for regulatory capital purposes, the Senior Debt agreement does not provide the lender with any rights of acceleration or other remedies with regard to the Subordinated Debt upon an event of default caused by the Company's failure to comply with a financial covenant.

The Company increased its securities sold under repurchase agreements \$2.9 million, or 16.4%, from December 31, 2012. The Company's other short-term borrowings decreased \$100.0 million, from December 31, 2012, as a Federal Home Loan Bank of Chicago advance matured and was not replaced.

**Capital**

As of March 31, 2013, total stockholders' equity was \$75.9 million, which was an increase of \$3.3 million, or 4.6%, from \$72.6 million as of December 31, 2012. This increase was primarily attributable to the net income from operations in the first quarter of 2013. Additionally, Total Stockholders' Equity was affected by the Company not accruing a dividend for part of the first quarter of 2013 on its Series B Preferred Stock. As of March 31, 2013, the Company's regulatory ratios of total capital to risk weighted assets, Tier 1 capital to risk weighted assets and Tier 1 leverage increased to 14.33%, 7.46%, and 5.11%, respectively, compared to 13.62%, 6.81%, and 4.85%, respectively, at December 31, 2012. The Company, on a consolidated basis, exceeded the minimum ratios to be deemed adequately capitalized under regulatory defined capital ratios at March 31, 2013. The same capital ratios at the Bank were 15.79%, 14.52% and 9.94%, respectively, at March 31, 2013, compared to 14.86%, 13.59%, and 9.67%, at December 31, 2012. The Bank's ratios exceeded the heightened capital ratios agreed to in the Consent Order.

In July 2011, the Company also entered into the Written Agreement with the FRB designed to maintain the financial soundness of the Company. Key provisions of the Written Agreement include restrictions on the Company's payment of dividends on its capital stock, restrictions on its taking of dividends or other payments from the Bank that reduce the Bank's capital, restrictions on subordinated debenture and trust preferred security distributions, restrictions on incurring additional debt or repurchasing stock, capital planning provisions, requirements to submit cash flow projections to the FRB,





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requirements to comply with certain notice provisions pertaining to changes in directors or senior management, requirements to comply with regulatory restrictions on indemnification and severance payments, and requirements to submit certain reports to the FRB. 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.

As previously announced 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. 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 junior subordinated debentures including compounded interest from July 1, 2010, on the deferred payments totaled \$13.0 million at March 31, 2013.

During the fourth quarter 2012, the U.S. Treasury ( Treasury ) announced the continuation of individual auctions of the preferred stock that was issued through the Troubled Asset Relief Program and Capital Purchase Program (the CPP ). At this time, the Company was informed that the Series B Stock would be auctioned. Auctions were held and transactions were settled in first quarter 2013 reflecting Treasury's efforts to conclude the CPP. The auctions were successful for Treasury as all of the Series B Stock held by Treasury was sold to third parties, including certain of our directors. At December 31, 2012, Old Second Bancorp carried \$71.9 million of Series B Stock in Total Stockholders Equity. At March 31, 2013, the Company carried \$72.1 million of Series B Stock.

As a result of the completed auctions, the Company's Board elected to stop accruing the dividend on the Series B Stock. Previously, the Company had declared and accrued the dividend on the Series B Stock quarterly throughout the deferral period. Given the discount reflected in the results of the auction, the Board believes that the Company will likely be able to repurchase the Series B Stock in the future at a price less than the face amount of the Series B Stock plus accrued and unpaid dividends. Therefore, under GAAP, the Company did not fully accrue the dividend on the Series B Stock in the first quarter and does not anticipate accruing for it through the second quarter. The Company will continue to evaluate whether declaring dividends on the Series B Stock is appropriate in future periods. Pursuant to the terms of the Series B Stock, the dividends paid on the Series B Stock will increase from 5% to 9% in 2014.

In addition to the above regulatory ratios, the Company's non-GAAP tangible common equity to tangible assets and the Tier 1 common equity to risk weighted assets increased to 0.05% and 0.20%, respectively, at March 31, 2013, compared to (0.13)% and (0.12)%, respectively, at December 31, 2012.

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|   | (unaudited)<br>As of March 31, |              | (unaudited)<br>December 31, |           |
|---|--------------------------------|--------------|-----------------------------|-----------|
|   | 2013                           | 2012         | 2012                        |           |
|   | (dollars in thousands)         |              |                             |           |
| <b>Tier 1 capital</b>   |                                |              |                             |           |
| Total stockholders' equity  | \$ 75,854                      | \$ 70,611    | \$                          | 72,552    |
| Tier 1 adjustments:   |                                |              |                             |           |
| Trust preferred securities  | 26,019                         | 24,594       |                             | 24,626    |
| Cumulative other comprehensive loss                                 | 2,202                          | 3,171        |                             | 1,327     |
| Disallowed intangible assets  | (2,751)                        | (4,483)      |                             | (3,276)   |
| Disallowed deferred tax assets                                      | -                              | (2,220)      |                             | -         |
| Other   | (447)                          | (381)        |                             | (412)     |
| Tier 1 capital  | \$ 100,877                     | \$ 91,292    | \$                          | 94,817    |
| <b>Total capital</b>  |                                |              |                             |           |
| Tier 1 capital  | \$ 100,877                     | \$ 91,292    | \$                          | 94,817    |
| Tier 2 additions:   |                                |              |                             |           |
| Allowable portion of allowance for loan losses                      | 17,162                         | 19,705       |                             | 17,656    |
| Additional trust preferred securities disallowed for tier 1 capital | 30,606                         | 32,031       |                             | 31,999    |
| Subordinated debt   | 45,000                         | 45,000       |                             | 45,000    |
| Tier 2 additions subtotal   | 92,768                         | 96,736       |                             | 94,655    |
| Allowable Tier 2  | 92,768                         | 91,292       |                             | 94,655    |
| Other Tier 2 capital components                                     | (6)                            | (7)          |                             | (6)       |
| Total capital   | \$ 193,639                     | \$ 182,577   | \$                          | 189,466   |
| <b>Tangible common equity</b>                                       |                                |              |                             |           |
| Total stockholders' equity  | \$ 75,854                      | \$ 70,611    | \$                          | 72,552    |
| Less: Preferred equity  | 72,130                         | 71,108       |                             | 71,869    |
| Intangible assets   | 2,751                          | 4,483        |                             | 3,276     |
| Tangible common equity  | \$ 973                         | \$ (4,980)   | \$                          | (2,593)   |
| <b>Tier 1 common equity</b>   |                                |              |                             |           |
| Tangible common equity  | \$ 973                         | \$ (4,980)   | \$                          | (2,593)   |
| Tier 1 adjustments:   |                                |              |                             |           |
| Cumulative other comprehensive loss                                 | 2,202                          | 3,171        |                             | 1,327     |
| Other   | (447)                          | (2,601)      |                             | (412)     |
| Tier 1 common equity  | \$ 2,728                       | \$ (4,410)   | \$                          | (1,678)   |
| <b>Tangible assets</b>  |                                |              |                             |           |
| Total assets  | \$ 1,954,044                   | \$ 1,981,548 | \$                          | 2,045,799 |
| Less:   |                                |              |                             |           |
| Intangible assets   | 2,751                          | 4,483        |                             | 3,276     |
| Tangible assets   | \$ 1,951,293                   | \$ 1,977,065 | \$                          | 2,042,523 |
| <b>Total risk-weighted assets</b>                                   |                                |              |                             |           |
| On balance sheet  | \$ 1,316,171                   | \$ 1,514,322 | \$                          | 1,356,762 |
| Off balance sheet   | 35,327                         | 34,138       |                             | 34,804    |
| Total risk-weighted assets  | \$ 1,351,498                   | \$ 1,548,460 | \$                          | 1,391,566 |
| <b>Average assets</b>   |                                |              |                             |           |
| Total average assets for leverage                                   | \$ 1,973,234                   | \$ 1,950,430 | \$                          | 1,955,000 |

In addition, management believes the presentation of other financial measures such as core earnings, which excludes taxes, provisions for loan losses, income and expenses associated with OREO, and other nonrecurring items as detailed immediately below, provides useful supplemental

information that is helpful in understanding our financial results. Management considers this information useful since

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certain items such as provisions for loan losses and OREO activities in the current credit cycle are well above historic levels. These disclosures should not be viewed as substitutes for the results determined to be in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

|  | <b>As of and for the<br/>Three Months Ended<br/>March 31,</b> |            |             |
|--|---|------------|-------------|
|  | <b>2013</b>   |            | <b>2012</b> |
|  | <b>(dollars in thousands)<br/>(unaudited)</b>                 |            |             |
| <b>Core earnings</b>                   |   |            |             |
| Pre-tax income (loss)                  | \$  | 5,471      | \$ (2,968)  |
| Excluding impact of:                   |   |            |             |
| Other real estate owned, net of income |   | 3,097      | 3,452       |
| Provision for loan losses              |   | (2,500)    | 6,084       |
| Litigation related income              |   | (11)       | (116)       |
| <i>Core Earnings</i>                   | \$  | 6,057      | \$ 6,452    |
| <b>Earnings per core diluted share</b> |   |            |             |
| Average diluted number of shares       |   | 14,157,523 | 14,196,143  |
| <i>Core diluted earnings per share</i> | \$  | 0.43       | \$ 0.45     |

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**Item 3. 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 operating activities, investment in and maturity of assets, changes in balances of deposits and borrowings, and its ability to borrow funds. The Company monitors borrowing capacity at correspondent banks as well as the FHLBC and FRB as part of its liquidity management process.

Net cash inflows from operating activities were \$2.2 million during the first quarter of 2013, compared with net cash inflows of \$11.3 million in the same period in 2012. Proceeds from sales of loans held-for-sale, net of funds used to originate loans held-for-sale, continued to be a source of inflows for both of the first quarters of 2013 and 2012. Interest paid, net of interest received, combined with changes in other assets and liabilities were a source of outflows for both of the first quarters of 2013 and 2012. 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 inflows from investing activities were \$46.7 million in the first quarter of 2013, compared to net cash outflows of \$24.6 million in the same period in 2012. In the first quarter 2013, securities transactions accounted for net inflows of \$9.0 million, and net principal received on loans accounted for net inflows of \$27.0 million. In the first quarter of 2012, securities transactions accounted for net outflows of \$49.7 million, and net principal received on loans accounted for net inflows of \$20.2 million. Proceeds from sales of OREO accounted for \$11.8 million and \$5.4 million in investing cash inflows for the first quarters of 2013 and 2012, respectively. Investing cash outflows for investment in OREO were \$50,000 in the first quarter of 2013 as compared to \$318,000 in the same period in 2012.

Net cash outflows from financing activities in the first quarter of 2013 were \$96.2 million, compared with net cash inflows of \$38.9 million in the first quarter of 2012. Net deposit inflows in the first quarter of 2013 were \$1.0 million compared to net deposit inflows of \$23.1 million in the first quarter of 2012. Other short-term borrowings had net cash outflows of \$100.0 million related to the FHLBC advance repayment in the first quarter of 2013, whereas the first quarter of 2012 had a cash inflow in other short-term borrowings of \$15.0 million. Changes in securities sold under repurchase agreements accounted for \$2.9 million in net inflows and \$903,000 in net inflows, respectively, in the first quarters of 2013 and 2012.

**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 with (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.

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The Company manages various market risks in its normal course of operations, including credit, liquidity, 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 Company's interest rate risk exposures from March 31, 2013, and December 31, 2012, are outlined in the table below.

Like most financial institutions, the Company's net income can be significantly influenced by a

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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 balance sheet growth or contraction. The Company's Asset and Liability Committee 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 13 of the financial statements included in this quarterly 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 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, 2012, the Company had greater earnings gains (in dollars) if interest rates should rise. This increase in rising-rate benefit reflects the Company's ability to obtain certain variable rate securities that both contributed to this rising-rate benefit and maintained the investment portfolio yield to support the margin. The Company also sold some securities that had longer maturities further contributing to the increase in rising-rate benefit. Federal Funds rates and the Bank's prime rate were stable throughout the first quarter of 2013 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% assuming no change in the slope of the yield curve. The -2% and -1% 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**

|                          | <b>Immediate Changes in Rates</b> |       |       |          |          |          |
|--------------------------|-----------------------------------|-------|-------|----------|----------|----------|
|                          | -2.0%                             | -1.0% | -0.5% | 0.5%     | 1.0%     | 2.0%     |
| <b>March 31, 2013</b>    |                                   |       |       |          |          |          |
| Dollar change            | N/A                               | N/A   | N/A   | \$ 1,259 | \$ 2,583 | \$ 5,615 |
| Percent change           | N/A                               | N/A   | N/A   | +2.4%    | +5.0%    | +10.9%   |
| <b>December 31, 2012</b> |                                   |       |       |          |          |          |
| 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%    |

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.

**Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**



The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended, as of March 31, 2013. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2013, the Company's internal controls were effective to ensure that information required to be

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disclosed by the Company in reports that it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified.

There were no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2013, that have materially affected, or are reasonably likely to affect, the Company's internal control over financial reporting.

**Forward-looking Statements**

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as believe, expect, anticipate, plan, intend, estimate, will, would, could, should or other similar expressions. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries, are detailed in the Risk Factors section included under Item 1A. of Part I of the Company's Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including ours, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

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**PART II - OTHER INFORMATION**

**Item 1. 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 the Employee Retirement Income Security Act of 1974, as amended (ERISA). The complaint sought equitable and 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 with respect to these matters, without conceding liability, the named defendants negotiated a settlement in principle with the plaintiffs. On March 1, 2013, the Court preliminarily approved the parties' settlement agreement. The Court has scheduled a hearing on June 14, 2013 to make a final determination on the settlement. The Company and its legal counsel expect that the Court will issue a final approval of the settlement agreement after the June 14th hearing 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 1.A. Risk Factors**

There have been no material changes from the risk factors set forth in Part I, Item 1.A. Risk Factors, of the Company's Form 10-K for the year ended December 31, 2012. Please refer to that section of the Company's Form 10-K for disclosures regarding the risks and uncertainties related to the Company's business.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

N/A

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

**Exhibits:**

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets at March 31, 2013, and December 31, 2011; (ii) Consolidated Statements of Operations for the three ended March 31, 2013, and March 31, 2012; (iii) Consolidated Statements of Stockholders' Equity for the three months ended March 31, 2013, and March 31, 2012; (iv) Consolidated Statements of Cash Flows for the three months ended March 31, 2013, and March 31, 2012; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text and in detail.\*

\* As provided in Rule 406T of Regulation S-T, these interactive data files shall not be deemed filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 as amended, or otherwise subject to liability under those sections.

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SIGNATURES

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

OLD SECOND BANCORP, INC.

BY: /s/ William B. Skoglund  
William B. Skoglund  
  
Chairman of the Board, Director  
President and Chief Executive Officer (principal executive officer)

BY: /s/ J. Douglas Cheatham  
J. Douglas Cheatham  
  
Executive Vice-President and  
Chief Financial Officer, Director  
(principal financial and accounting officer)

DATE: May 15, 2013