

OLD SECOND BANCORP INC
Form 10-Q
November 12, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2013

OR

o **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 60506

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(Registrant's telephone number, including area code)

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

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 Exchange Act Rule 12b-2).

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 November 9, 2013, the Registrant had outstanding 13,917,108 shares of common stock, \$1.00 par value per share.

Table of Contents

OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

Table of Contents

PART I

| | Page Number |
|---|----------------|
| <u>Item 1.</u> <u>Financial Statements</u> | 3 |
| <u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 41 |
| <u>Item 3.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 59 |
| <u>Item 4.</u> <u>Controls and Procedures</u> | 60 |

PART II

| | |
|---|----|
| <u>Item 1.</u> <u>Legal Proceedings</u> | 62 |
| <u>Item 1.A.</u> <u>Risk Factors</u> | 62 |
| <u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 62 |
| <u>Item 3.</u> <u>Defaults Upon Senior Securities</u> | 62 |
| <u>Item 4.</u> <u>Mine Safety Disclosure</u> | 62 |
| <u>Item 5.</u> <u>Other Information</u> | 62 |
| <u>Item 6.</u> <u>Exhibits</u> | 62 |
| <u>Signatures</u> | 63 |

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) September 30, 2013 | December 31, 2012 |
|---|--------------------------------------|----------------------|
| Assets | | |
| Cash and due from banks | \$ 47,486 | \$ 44,221 |
| Interest bearing deposits with financial institutions | 32,586 | 84,286 |
| Cash and cash equivalents | 80,072 | 128,507 |
| Securities available-for-sale, at fair value | 373,478 | 579,886 |
| Securities held-to-maturity, at amortized cost | 258,101 | - |
| Federal Home Loan Bank and Federal Reserve Bank stock | 10,292 | 11,202 |
| Loans held-for-sale | 3,129 | 9,571 |
| Loans | 1,077,640 | 1,150,050 |
| Less: allowance for loan losses | 29,547 | 38,597 |
| Net loans | 1,048,093 | 1,111,453 |
| Premises and equipment, net | 46,392 | 47,002 |
| Other real estate owned | 49,066 | 72,423 |
| Mortgage servicing rights, net | 5,456 | 4,116 |
| Core deposit, net | 1,702 | 3,276 |
| Bank-owned life insurance (BOLI) | 55,005 | 54,203 |
| Deferred tax assets, net | 78,865 | 928 |
| Other assets | 23,137 | 23,232 |
| Total assets | \$ 2,032,788 | \$ 2,045,799 |
| Liabilities | | |
| Deposits: | | |
| Noninterest bearing demand | \$ 373,499 | \$ 379,451 |
| Interest bearing: | | |
| Savings, NOW, and money market | 809,521 | 826,976 |
| Time | 490,103 | 510,792 |
| Total deposits | 1,673,123 | 1,717,219 |
| Securities sold under repurchase agreements | 20,719 | 17,875 |
| Other short-term borrowings | 55,000 | 100,000 |
| Junior subordinated debentures | 58,378 | 58,378 |
| Subordinated debt | 45,000 | 45,000 |
| Notes payable and other borrowings | 500 | 500 |
| Other liabilities | 38,029 | 34,275 |
| Total liabilities | 1,890,749 | 1,973,247 |
| Stockholders Equity | | |
| Preferred stock | 72,667 | 71,869 |
| Common stock | 18,830 | 18,729 |
| Additional paid-in capital | 66,168 | 66,189 |
| Retained earnings | 92,612 | 12,048 |

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

| | | | |
|--|----|-----------|--------------|
| Accumulated other comprehensive loss | | (12,435) | (1,327) |
| Treasury stock | | (95,803) | (94,956) |
| Total stockholders' equity | | 142,039 | 72,552 |
| Total liabilities and stockholders' equity | \$ | 2,032,788 | \$ 2,045,799 |

| | September 30, 2013 | | December 31, 2012 | |
|--------------------|--------------------|--------------|-------------------|--------------|
| | Preferred Stock | Common Stock | Preferred Stock | Common Stock |
| Par value | \$ 1 | \$ 1 | \$ 1 | \$ 1 |
| Liquidation value | 1,000 | n/a | 1,000 | n/a |
| Shares authorized | 300,000 | 60,000,000 | 300,000 | 60,000,000 |
| Shares issued | 73,000 | 18,829,734 | 73,000 | 18,729,134 |
| Shares outstanding | 73,000 | 13,917,108 | 73,000 | 14,084,328 |
| Treasury shares | - | 4,912,626 | - | 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) Three Months Ended September 30, | | (unaudited) Nine Months Ended September 30, | |
|---|--|-----------|---|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Interest and Dividend Income | | | | |
| Loans, including fees | \$ 14,327 | \$ 16,193 | \$ 43,153 | \$ 51,476 |
| Loans held-for-sale | 38 | 68 | 124 | 201 |
| Securities: | | | | |
| Taxable | 3,113 | 1,868 | 8,109 | 5,222 |
| Tax exempt | 148 | 98 | 441 | 303 |
| Dividends from Federal Reserve Bank and Federal Home Loan Bank stock | 76 | 77 | 228 | 228 |
| Interest bearing deposits with financial institutions | 22 | 29 | 91 | 89 |
| Total interest and dividend income | 17,724 | 18,333 | 52,146 | 57,519 |
| Interest Expense | | | | |
| Savings, NOW, and money market deposits | 206 | 253 | 655 | 807 |
| Time deposits | 1,674 | 1,973 | 5,327 | 6,920 |
| Securities sold under repurchase agreements | 1 | 1 | 2 | 2 |
| Other short-term borrowings | 5 | - | 24 | 4 |
| Junior subordinated debentures | 1,336 | 1,243 | 3,937 | 3,660 |
| Subordinated debt | 209 | 223 | 610 | 684 |
| Notes payable and other borrowings | 4 | 5 | 12 | 13 |
| Total interest expense | 3,435 | 3,698 | 10,567 | 12,090 |
| Net interest and dividend income | 14,289 | 14,635 | 41,579 | 45,429 |
| (Release) provision for loan losses | (1,750) | - | (6,050) | 6,284 |
| Net interest and dividend income after provision for loan losses | 16,039 | 14,635 | 47,629 | 39,145 |
| Noninterest Income | | | | |
| Trust income | 1,494 | 1,489 | 4,666 | 4,603 |
| Service charges on deposits | 1,904 | 1,982 | 5,379 | 5,706 |
| Secondary mortgage fees | 183 | 350 | 680 | 957 |
| Mortgage servicing income, net of changes in fair value | 235 | (155) | 1,222 | (365) |
| Net gain on sales of mortgage loans | 814 | 2,504 | 4,601 | 7,509 |
| Securities (losses) gains, net | (7) | 513 | 2,191 | 1,306 |
| Increase in cash surrender value of bank-owned life insurance | 419 | 425 | 1,198 | 1,246 |
| Death benefit realized on bank-owned life insurance | 6 | - | 381 | - |
| Debit card interchange income | 873 | 788 | 2,565 | 2,661 |
| Lease revenue from other real estate owned | 309 | 840 | 974 | 2,930 |
| Net gain on sale of other real estate owned | 608 | 20 | 1,175 | 398 |
| Other income | 1,549 | 1,592 | 4,434 | 4,257 |
| Total noninterest income | 8,387 | 10,348 | 29,466 | 31,208 |
| Noninterest Expense | | | | |
| Salaries and employee benefits | 9,299 | 8,963 | 27,508 | 26,835 |
| Occupancy expense, net | 1,266 | 1,242 | 3,787 | 3,684 |
| Furniture and equipment expense | 1,026 | 1,078 | 3,274 | 3,416 |
| FDIC insurance | 987 | 1,029 | 3,046 | 3,058 |

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

| | | | | |
|---|-----------|------------|-----------|------------|
| General bank insurance | 489 | 851 | 1,829 | 2,538 |
| Amortization of core deposit and other intangible asset | 524 | 420 | 1,574 | 865 |
| Advertising expense | 347 | 400 | 841 | 982 |
| Debit card interchange expense | 366 | 388 | 1,072 | 1,183 |
| Legal fees | 615 | 760 | 1,424 | 2,215 |
| Other real estate expense | 3,461 | 6,545 | 11,092 | 17,987 |
| Other expense | 3,119 | 3,187 | 9,773 | 9,186 |
| Total noninterest expense | 21,499 | 24,863 | 65,220 | 71,949 |
| Income (loss) before income taxes | 2,927 | 120 | 11,875 | (1,596) |
| Income tax benefit | (69,997) | - | (69,997) | - |
| Net Income (loss) | \$ 72,924 | \$ 120 | \$ 81,872 | \$ (1,596) |
| Preferred stock dividends and accretion | 1,323 | 1,255 | 3,917 | 3,716 |
| Net income (loss) available to common stockholders | \$ 71,601 | \$ (1,135) | \$ 77,955 | \$ (5,312) |
| Basic earnings (loss) per share | \$ 5.08 | \$ (0.08) | \$ 5.52 | \$ (0.37) |
| Diluted earnings (loss) per share | 5.08 | (0.08) | 5.52 | (0.37) |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net Income (loss) | \$ 72,924 | \$ 120 | \$ 81,872 | \$ (1,596) |
| Unrealized holding (losses) gains on available-for-sale securities arising during the period | (3,411) | 2,908 | (16,780) | 3,255 |
| Related tax benefit (expense) | 1,405 | (1,194) | 6,913 | (1,335) |
| Holding (losses) income after tax on available-for-sale securities | (2,006) | 1,714 | (9,867) | 1,920 |
| Less: Reclassification adjustment for the net gains realized during the period | | | | |
| Net realized (losses) gains | (7) | 513 | 2,191 | 1,306 |
| Income tax benefit (expense) on net realized gains | 3 | (208) | (899) | (532) |
| Net realized (losses) gains after tax | (4) | 305 | 1,292 | 774 |
| Other comprehensive (loss) income on available-for-sale securities | (2,002) | 1,409 | (11,159) | 1,146 |
| Accretion of net unrealized holding losses on held-to-maturity transferred from available-for-sale securities | 87 | - | 87 | - |
| Related tax expense | (36) | - | (36) | - |
| Other comprehensive income on held-to-maturity securities | 51 | - | 51 | - |
| Total other comprehensive (loss) income | (1,951) | 1,409 | (11,108) | 1,146 |
| Total comprehensive income (loss) | \$ 70,973 | \$ 1,529 | \$ 70,764 | \$ (450) |

See accompanying notes to consolidated financial statements.

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

(In thousands)

| | (Unaudited) | |
|--|--------------------------|-------------|
| | Nine Months Ended | |
| | September 30, | |
| | 2013 | 2012 |
| Cash flows from operating activities | | |
| Net income (loss) | \$ 81,872 | \$ (1,596) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization of leasehold improvement | 2,147 | 2,339 |
| Change in market value of mortgage servicing rights | (81) | 1,315 |
| (Release) provision for loan losses | (6,050) | 6,284 |
| Gain on recapture of restricted stock | (612) | - |
| Provision for deferred tax benefit | (70,161) | - |
| Originations of loans held-for-sale | (151,601) | (208,710) |
| Proceeds from sales of loans held-for-sale | 160,966 | 222,590 |
| Net gain on sales of mortgage loans | (4,601) | (7,509) |
| Change in current income taxes (payable) receivable | (101) | 815 |
| Increase in cash surrender value of bank-owned life insurance | (1,198) | (1,246) |
| Death claim on bank owned life insurance | 396 | - |
| Change in accrued interest receivable and other assets | (334) | (2,437) |
| Change in accrued interest payable and other liabilities | 4,341 | 4,689 |
| Net discount (accretion)/premium amortization on securities | (131) | 664 |
| Securities gains, net | (2,191) | (1,306) |
| Amortization of core deposit and other intangible assets | 1,574 | 865 |
| Stock based compensation | 123 | 220 |
| Net gain on sale of other real estate owned | (1,175) | (398) |
| Provision for other real estate owned losses | 6,537 | 12,101 |
| Net gain on disposal of fixed assets | (5) | - |
| Net cash provided by operating activities | 19,715 | 28,680 |
| Cash flows from investing activities | | |
| Proceeds from maturities and calls including pay down of securities available-for-sale | 38,175 | 65,940 |
| Proceeds from sales of securities available-for-sale | 484,112 | 185,861 |
| Purchases of securities available-for-sale | (564,372) | (353,992) |
| Proceeds from maturities and calls including pay down of securities held-to-maturity | 541 | - |
| Purchases of securities held-to-maturity | (21,382) | - |
| Net sales of Federal Reserve Bank and Federal Home Loan Bank stock | 910 | 2,250 |
| Net change in loans | 49,885 | 115,728 |
| Investment in other real estate owned | (60) | (646) |
| Proceeds from sales of other real estate owned | 32,103 | 20,915 |
| Proceeds from disposition of fixed assets | 6 | - |
| Net purchases of premises and equipment | (1,538) | (371) |
| Net cash provided by investing activities | 18,380 | 35,685 |
| Cash flows from financing activities | | |
| Net change in deposits | (44,096) | (43,847) |
| Net change in securities sold under repurchase agreements | 2,844 | 837 |
| Net change in other short-term borrowings | (45,000) | - |
| Purchase of treasury stock | (278) | (63) |
| Net cash used in financing activities | (86,530) | (43,073) |

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

| | | |
|--|-----------|-----------|
| Net change in cash and cash equivalents | (48,435) | 21,292 |
| Cash and cash equivalents at beginning of period | 128,507 | 50,949 |
| Cash and cash equivalents at end of period | \$ 80,072 | \$ 72,241 |

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

(In thousands)

| Supplemental cash flow information | (Unaudited) | |
|---|--|-------------|
| | Nine Months Ended September 30, | |
| | 2013 | 2012 |
| Income taxes paid (received) | \$ 266 | \$ (815) |
| Interest paid for deposits | 6,144 | 8,444 |
| Interest paid for borrowings | 656 | 702 |
| Non-cash transfer of loans to other real estate owned | 14,196 | 26,944 |
| Non-cash transfer of loans to securities available-for-sale | 5,329 | - |
| Non-cash transfer of securities available-for-sale to securities held-to-maturity | 237,154 | - |
| Change in dividends declared not paid | 510 | 2,968 |
| Accretion on preferred stock warrants | 798 | 748 |
| Fair value difference on recapture of restricted stock | 43 | - |

See accompanying notes to consolidated financial statements.

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

(In thousands, except share data)

| | Common Stock | Preferred Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total Stockholders Equity |
|--|-----------------|--------------------|----------------------------------|----------------------|--|-------------------|---------------------------------|
| Balance, December 31, 2011 | \$ 18,628 | \$ 70,863 | \$ 65,999 | \$ 17,107 | \$ (3,702) | \$ (94,893) | \$ 74,002 |
| Net loss | | | | (1,596) | | | (1,596) |
| Change in net unrealized gain on securities available-for-sale net of \$803 tax effect | | | | | 1,146 | | 1,146 |
| Change in restricted stock | 101 | | (101) | | | | - |
| Stock based compensation | | | 220 | | | | 220 |
| Purchase of treasury stock | | | | | | (63) | (63) |
| Preferred dividends declared and accrued (5% per preferred share) | | 748 | | (3,716) | | | (2,968) |
| Balance, September 30, 2012 | \$ 18,729 | \$ 71,611 | \$ 66,118 | \$ 11,795 | \$ (2,556) | \$ (94,956) | \$ 70,741 |

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

| | | | | | | | |
|---|-----------|-----------|-----------|-----------|-------------|-------------|------------|
| Balance, December 31, 2012 | \$ 18,729 | \$ 71,869 | \$ 66,189 | \$ 12,048 | \$ (1,327) | \$ (94,956) | \$ 72,552 |
| Net income | | | | 81,872 | | | 81,872 |
| Change in net unrealized loss on securities net of \$7,776 tax effect | | | | | (11,108) | | (11,108) |
| Change in restricted stock | 101 | | (101) | | | | - |
| Recapture of restricted stock | | | (43) | | | (569) | (612) |
| Stock based compensation | | | 123 | | | | 123 |
| Purchase of treasury stock | | | | | | (278) | (278) |
| Preferred dividends declared and accrued (5% per preferred share) | | 798 | | (1,308) | | | (510) |
| Balance, September 30, 2013 | \$ 18,830 | \$ 72,667 | \$ 66,168 | \$ 92,612 | \$ (12,435) | \$ (95,803) | \$ 142,039 |

See accompanying notes to consolidated financial statements.

Table of Contents

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 September 30, 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 United States generally accepted accounting practices (GAAP) 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 consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the 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 consolidated 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 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) and has been reflected in the Company's financial statements since January 1, 2013.

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 Old Second National Bank (the Bank), portions of the portfolio also serve as income producing assets. The size of the portfolio reflects liquidity needs, loan demand and interest income objectives. The Company views the September 30, 2013, securities available-for-sale portfolio (\$386.5 million amortized cost and \$373.5 million fair value) as a substantial source of liquidity that will allow for loan growth without having to raise deposits. Consistent with the comments above, management views the portion of the portfolio not carried in an unrealized loss

Table of Contents

position and the Bank's ability to borrow a substantial amount with securities as collateral providing the Bank a comfortable liquidity position. Portfolio size and composition may be adjusted from time to time.

Investments are comprised of debt securities and non-marketable equity investments. Until the third quarter 2013, all debt securities had been classified as available-for-sale. Past purchases and sales were done under our management and asset/liability 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 changes as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital. As of September 1, 2013, securities with a fair value of \$237.2 million, and a cost basis of \$245.4 million, with an August 31, 2013 unrealized loss of \$8.2 million, were transferred from available-for-sale to held-to-maturity. In addition new held-to-maturity securities purchases were made during September. Specifically, two purchases were made of securities issued by the Government National Mortgage Association. In accordance with GAAP, the Company has the positive intent and ability to hold the securities to maturity. Securities held-to-maturity are carried at amortized cost and the discount or premium created in the transfer is accreted or amortized to the maturity or expected payoff date but not an earlier call. The Company has followed and will follow GAAP accounting on all securities holdings.

Nonmarketable equity investments include Federal Home Loan Bank of Chicago (FHLBC) stock and Federal Reserve Bank of Chicago (FRB) stock. FHLBC stock was recorded at a value of \$5.5 million at September 30, 2013, and \$6.4 million at December 31, 2012. FRB stock was recorded at \$4.8 million at September 30, 2013, and December 31, 2012. Our FHLBC stock is necessary to maintain access to FHLBC advances.

Table of Contents

The following table summarizes the amortized cost and fair value of the securities portfolio at September 30, 2013 and December 31, 2012 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive loss (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| September 30, 2013: | | | | |
| Securities Available-for-Sale | | | | |
| U.S. Treasury | \$ 1,554 | \$ - | \$ (6) | \$ 1,548 |
| U.S. government agencies | 1,745 | - | (52) | 1,693 |
| States and political subdivisions | 19,275 | 731 | (165) | 19,841 |
| Corporate bonds | 22,889 | 75 | (764) | 22,200 |
| Collateralized mortgage obligations | 51,619 | 182 | (3,676) | 48,125 |
| Asset-backed securities | 272,236 | 1,575 | (4,827) | 268,984 |
| Collateralized debt obligations | 17,173 | - | (6,086) | 11,087 |
| Total Securities Available-for-Sale | \$ 386,491 | \$ 2,563 | \$ (15,576) | \$ 373,478 |
| Securities Held-to-Maturity | | | | |
| U.S. government agency mortgage-backed | \$ 35,241 | \$ 547 | \$ - | \$ 35,788 |
| Collateralized mortgage obligations | 222,860 | 1,773 | - | 224,633 |
| Total Securities Held-to-Maturity | \$ 258,101 | \$ 2,320 | \$ - | \$ 260,421 |
| December 31, 2012: | | | | |
| 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 |
| Total Securities Available-for-Sale | \$ 582,141 | \$ 7,899 | \$ (10,154) | \$ 579,886 |

The fair value, amortized cost and weighted average yield of debt securities at September 30, 2013, by contractual maturity, were as follows in the table below. Securities not due at a single maturity date, primarily mortgage-backed securities (MBS), asset-backed securities, and collateralized debt obligations are shown separately (in thousands):

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

Table of Contents

| | Amortized Cost | Weighted Average Yield | Fair Value |
|--|-------------------|------------------------------|---------------|
| Securities Available-for-Sale | | | |
| Due in one year or less | \$ 772 | 3.58% | \$ 789 |
| Due after one year through five years | 4,425 | 2.35% | 4,510 |
| Due after five years through ten years | 29,271 | 3.04% | 28,885 |
| Due after ten years | 10,995 | 4.31% | 11,098 |
| | 45,463 | 3.29% | 45,282 |
| Collateralized mortgage obligations | 51,619 | 2.62% | 48,125 |
| Asset-back securities | 272,236 | 1.67% | 268,984 |
| Collateralized debt obligations | 17,173 | 1.62% | 11,087 |
| | \$ 386,491 | 1.99% | \$ 373,478 |
| Securities Held-to-Maturity | | | |
| Mortgage-backed securities | \$ 258,101 | 3.07% | \$ 260,421 |

Securities with unrealized losses at September 30, 2013, and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (in thousands except for number of securities):

| September 30, 2013 | Less than 12 months in an unrealized loss position | | | Greater than 12 months in an unrealized loss position | | | Total | | |
|--|---|----------------------|---------------|--|----------------------|---------------|-------------------------|----------------------|---------------|
| | Number of Securities | Unrealized Losses | Fair Value | Number of Securities | Unrealized Losses | Fair Value | Number of Securities | Unrealized Losses | Fair Value |
| Securities Available-for-Sale | | | | | | | | | |
| U.S. Treasury | 1 | \$ 6 | \$ 1,548 | - | \$ - | \$ - | 1 | \$ 6 | \$ 1,548 |
| U.S. government agencies States and political subdivisions | 1 | 52 | 1,693 | - | - | - | 1 | 52 | 1,693 |
| Corporate bonds | 7 | 165 | 6,195 | - | - | - | 7 | 165 | 6,195 |
| Collateralized mortgage obligations | 5 | 717 | 13,009 | 2 | 47 | 2,162 | 7 | 764 | 15,171 |
| Asset-backed securities | 3 | 3,676 | 35,471 | - | - | - | 3 | 3,676 | 35,471 |
| Collateralized debt obligations | 18 | 4,784 | 162,705 | 1 | 43 | 3,791 | 19 | 4,827 | 166,496 |
| | - | - | - | 2 | 6,086 | 11,087 | 2 | 6,086 | 11,087 |
| | 35 | \$ 9,400 | \$ 220,621 | 5 | \$ 6,176 | \$ 17,040 | 40 | \$ 15,576 | \$ 237,661 |

| December 31, 2012 | Less than 12 months in an unrealized loss position | | | Greater than 12 months in an unrealized loss position | | | Total | | |
|---|---|----------------------|---------------|--|----------------------|---------------|----------------------------|----------------------|---------------|
| | Number of Securities | Unrealized Losses | Fair Value | Number of Securities | Unrealized Losses | Fair Value | Number of Securities | Unrealized Losses | Fair Value |
| Securities Available-for-Sale | | | | | | | | | |
| U.S. government agencies | 4 | \$ 120 | \$ 17,039 | - | \$ - | \$ - | 4 | \$ 120 | \$ 17,039 |
| U.S. government agency mortgage-backed | 12 | 583 | 53,184 | - | - | - | 12 | 583 | 53,184 |
| Corporate bonds | 4 | 55 | 9,724 | - | - | - | 4 | 55 | 9,724 |
| Collateralized mortgage 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 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 nine months ended September 30, 2013, or the year ended December 31, 2012. The changes in fair values related primarily to interest rate fluctuations and were not related to credit quality deterioration.

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

Further to this point as shown in tables below, the amount of deferrals and defaults in the pooled collateralized debt obligations (CDOs) decreased in the period from December 31, 2012, to September 30, 2013.

Uncertainty in the financial markets in the periods presented has resulted in reduced liquidity for certain investments, particularly the CDOs. In the case of the CDOs fair value measurement, management included a risk premium adjustment as of September 30, 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 September 30, 2013. As of September 30, 2013, management did 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.

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

Table of Contents

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 Cost | Fair Value | Gross Unrealized Loss | S&P Credit Rating 1 | Number of Banks in Issuance | Issuance Deferrals & Defaults | | Issuance Excess Subordination | |
|---------------------------|-------------------|---------------|-----------------------------|---------------------------|--------------------------------------|----------------------------------|--------------|----------------------------------|--------------|
| | | | | | | Amount | Collateral % | Amount | Collateral % |
| September 30, 2013 | | | | | | | | | |
| Class A1 | \$ 8,157 | \$ 5,619 | \$ (2,538) | BB+ | 63 | \$ 207,000 | 27.6% | \$ 227,472 | 30.3% |
| Class A2A | 9,016 | 5,468 | (3,548) | B+ | 63 | 207,000 | 27.6% | 130,472 | 17.4% |
| | \$ 17,173 | \$ 11,087 | \$ (6,086) | | | | | | |
| December 31, 2012 | | | | | | | | | |
| 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) | | | | | | |

1 Moody's credit rating for class A1 and A2A were upgraded to Baa1 and Baa3, respectively, as of September 30, 2013, compared to Baa2 and Ba2 at December 31, 2012. The Fitch ratings for class A1 and A2A were also upgraded to A and BBB, respectively, as of September 30, 2013, compared to BBB and B at December 31, 2012.

Note 3 Loans

Major classifications of loans were as follows:

| | September 30, 2013 | December 31, 2012 |
|-----------------------------|--------------------|-------------------|
| Commercial | \$ 86,822 | \$ 86,941 |
| Real estate - commercial | 554,874 | 579,687 |
| Real estate - construction | 30,996 | 42,167 |
| Real estate - residential | 376,859 | 414,543 |
| Consumer | 2,570 | 3,101 |
| Overdraft | 544 | 994 |
| Lease financing receivables | 11,204 | 6,060 |
| Other | 13,236 | 16,451 |
| | 1,077,105 | 1,149,944 |
| Net deferred loan fees | 535 | 106 |
| | \$ 1,077,640 | \$ 1,150,050 |

It is the policy of the Company to review each prospective credit in order to determine if 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 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 89.3% and 90.1% of the portfolio at September 30, 2013, and December 31, 2012, respectively. The Company has been and remains committed to overseeing and

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

managing its loan portfolio to reduce its real estate credit concentrations. Previously, this was done in accordance with the requirements of the Stipulation and Consent to the Issuance of a Consent Order the Bank entered into with the Office of the Controller of the Currency (the OCC) on May 16, 2011 (the Consent Order), which was terminated on October 17, 2013. Regulatory and Capital matters affecting the Company, including the Consent Order are discussed in more detail in Note 11 of the consolidated financial statements included in this report.

Edgar Filing: OLD SECOND BANCORP INC - Form 10-Q

Table of Contents

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

| September 30, 2013 | | | | | | | | | |
|---------------------------------------|------------------------|------------------------|-----------------------------------|-------------------|--------------|------------|--------------|---|--|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater Past Due | Total Past Due | Current | Nonaccrual | Total Loans | Recorded Investment 90 days or Greater Past Due and Accruing | |
| Commercial | \$ 69 | \$ 132 | \$ - | \$ 201 | \$ 97,796 | \$ 29 | \$ 98,026 | \$ - | |
| Real estate - commercial | | | | | | | | | |
| Owner occupied general purpose | 165 | - | - | 165 | 109,584 | 3,497 | 113,246 | - | |
| Owner occupied special purpose | 650 | 227 | - | 877 | 162,435 | 5,947 | 169,259 | - | |
| Non-owner occupied general purpose | - | - | - | - | 128,084 | 7,273 | 135,357 | - | |
| Non-owner occupied special purpose | - | - | - | - | 75,595 | 438 | 76,033 | - | |
| Retail properties | - | - | - | - | 39,829 | 5,056 | 44,885 | - | |
| Farm | - | - | - | - | 16,094 | - | 16,094 | - | |
| Real estate - construction | | | | | | | | | |
| Homebuilder | - | - | - | - | 4,563 | 168 | 4,731 | - | |
| Land | - | - | - | - | 4,640 | 209 | 4,849 | - | |
| Commercial speculative | - | - | - | - | 8,811 | 3,534 | 12,345 | - | |
| All other | - | - | - | - | 8,323 | 748 | 9,071 | - | |
| Real estate - residential | | | | | | | | | |
| Investor | 213 | - | - | 213 | 122,031 | 8,307 | 130,551 | - | |
| Owner occupied | 625 | - | - | 625 | 112,515 | 5,858 | 118,998 | - | |
| Revolving and junior liens | 522 | 75 | 45 | 642 | 124,170 | 2,498 | 127,310 | 45 | |
| Consumer | - | - | - | - | 2,570 | - | 2,570 | - | |
| All other | - | - | - | - | 14,315 | - | 14,315 | - | |
| | \$ 2,244 | \$ 434 | \$ 45 | \$ 2,723 | \$ 1,031,355 | \$ 43,562 | \$ 1,077,640 | \$ 45 | |

| December 31, 2012 | | | | | | | | | |
|---------------------------------------|------------------------|------------------------|-----------------------------------|-------------------|-----------|------------|-------------|---|--|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater Past Due | Total Past Due | Current | Nonaccrual | Total Loans | Recorded Investment 90 days or Greater Past Due and 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 | - | - | - | - | | | | | |