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# 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 March 31, 2012**

**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** | **36-3143493** |
| (State or other jurisdiction of incorporation or organization) | (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)

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

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

Indicate by check mark 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 o | Accelerated filer o |
| Non-accelerated filer o<br>(do not check if a smaller reporting company) | Smaller reporting company x |

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

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 7, 2012, the Registrant had outstanding 14,084,328 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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## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

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

**Consolidated Balance Sheets**

*(In thousands, except share data)*

| | (Unaudited) March 31, 2012 | December 31, 2011 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 35,455 | $ 2,692 |
| Interest bearing deposits with financial institutions | 41,162 | 48,257 |
| Cash and cash equivalents | 76,617 | 50,949 |
| Securities available-for-sale | 359,371 | 307,564 |
| Federal Home Loan Bank and Federal Reserve Bank stock | 12,583 | 14,050 |
| Loans held-for-sale | 6,405 | 12,806 |
| Loans | 1,322,348 | 1,368,985 |
| Less: allowance for loan losses | 47,610 | 51,997 |
| Net loans | 1,274,738 | 1,316,988 |
| Premises and equipment, net | 49,830 | 50,477 |
| Other real estate owned | 101,680 | 93,290 |
| Mortgage servicing rights, net | 3,806 | 3,487 |
| Core deposit and other intangible assets, net | 4,483 | 4,678 |
| Bank-owned life insurance (BOLI) | 53,090 | 52,595 |
| Other assets | 38,945 | 34,534 |
| Total assets | $ 1,981,548 | $ 1,941,418 |
| | | |
| **Liabilities** | | |
| Deposits: | | |
| Noninterest bearing demand | $ 369,619 | $ 361,963 |
| Interest bearing: | | |
| Savings, NOW, and money market | 811,872 | 761,335 |
| Time | 582,379 | 617,483 |
| Total deposits | 1,763,870 | 1,740,781 |
| Securities sold under repurchase agreements | 1,804 | 901 |
| Other short-term borrowings | 15,000 | |
| Junior subordinated debentures | 58,378 | 58,378 |
| Subordinated debt | 45,000 | 45,000 |
| Notes payable and other borrowings | 500 | 500 |
| Other liabilities | 26,385 | 21,856 |
| Total liabilities | 1,910,937 | 1,867,416 |
| | | |
| **Stockholders Equity** | | |
| Preferred stock | 71,108 | 70,863 |
| Common stock | 18,729 | 18,628 |

| | | |
|---|---|---|
| Additional paid-in capital | 65,985 | 65,999 |
| Retained earnings | 12,916 | 17,107 |
| Accumulated other comprehensive loss | (3,171) | (3,702) |
| Treasury stock | (94,956) | (94,893) |
| Total stockholders equity | 70,611 | 74,002 |
| Total liabilities and stockholders equity | $ 1,981,548 | $ 1,941,418 |

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

**See accompanying notes to consolidated financial statements.**

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

**Consolidated Statements of Operations**

*(In thousands, except share data)*

| | (Unaudited) Three Months Ended March 31, 2012 | (Unaudited) Three Months Ended March 31, 2011 |
|---|---|---|
| **Interest and dividend income** | | |
| Loans, including fees | $ 17,666 | $ 21,216 |
| Loans held-for-sale | 84 | 51 |
| Securities: | | |
| Taxable | 1,498 | 878 |
| Tax-exempt | 103 | 142 |
| Dividends from Federal Reserve Bank and Federal Home Loan Bank stock | 74 | 69 |
| Interest bearing deposits with financial institutions | 25 | 70 |
| Total interest and dividend income | 19,450 | 22,426 |
| **Interest expense** | | |
| Savings, NOW, and money market deposits | 300 | 576 |
| Time deposits | 2,605 | 3,993 |
| Other short-term borrowings | 3 | |
| Junior subordinated debentures | 1,197 | 1,113 |
| Subordinated debt | 237 | 203 |
| Notes payable and other borrowings | 4 | 4 |
| Total interest expense | 4,346 | 5,889 |
| Net interest and dividend income | 15,104 | 16,537 |
| Provision for loan losses | 6,084 | 4,000 |
| Net interest and dividend income after provision for loan losses | 9,020 | 12,537 |
| **Noninterest income** | | |
| Trust income | 1,651 | 1,784 |
| Service charges on deposits | 1,831 | 1,817 |
| Secondary mortgage fees | 296 | 227 |
| Mortgage servicing income | 187 | 370 |
| Net gain on sales of mortgage loans | 2,647 | 1,236 |
| Securities gains, net | 101 | 139 |
| Increase in cash surrender value of bank-owned life insurance | 495 | 463 |
| Debit card interchange income | 760 | 700 |
| Lease revenue from other real estate owned | 1,179 | 520 |
| Net gain on sale of other real estate owned | 23 | 234 |
| Litigation related income | 116 | |
| Other income | 1,178 | 1,451 |
| Total noninterest income | 10,464 | 8,941 |
| **Noninterest expense** | | |
| Salaries and employee benefits | 9,049 | 8,929 |
| Occupancy expense, net | 1,235 | 1,345 |
| Furniture and equipment expense | 1,155 | 1,460 |
| FDIC insurance | 1,000 | 1,739 |
| General bank insurance | 846 | 825 |
| Amortization of core deposit and other intangible assets | 195 | 229 |
| Advertising expense | 318 | 233 |
| Debit card interchange expense | 342 | 373 |
| Legal fees | 685 | 943 |

| | | | | |
|---|---|---|---|---|
| Other real estate expense | | 4,654 | | 5,314 |
| Other expense | | 2,973 | | 3,208 |
| Total noninterest expense | | 22,452 | | 24,598 |
| Loss before income taxes | | (2,968) | | (3,120) |
| Benefit for income taxes | | | | |
| **Net loss** | | (2,968) | | (3,120) |
| **Preferred stock dividends and accretion of discount** | | 1,223 | | 1,159 |
| **Net loss available to common shareholders** | $ | (4,191) | $ | (4,279) |
| | | | | |
| **Share and per share information:** | | | | |
| Ending number of shares | | 14,084,328 | | 14,034,991 |
| Average number of shares | | 14,043,545 | | 13,973,870 |
| Diluted average number of shares | | 14,196,143 | | 14,213,701 |
| Basic loss per share | $ | (0.30) | $ | (0.30) |
| Diluted loss per share | | (0.30) | | (0.30) |
| Dividends paid per share | | | | |

See accompanying notes to consolidated financial statements.

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

**Consolidated Statements of Comprehensive loss**

*(In thousands, except share data)*

| | Three Months Ended March 31, 2012 | | Three Months Ended March 31, 2011 | |
|---|---|---|---|---|
| Net loss | $ | (2,968) | $ | (3,120) |
| | | | | |
| Unrealized holding gains (losses) on available-for-sale securities arising during the period | | | | |
| U.S. Treasury | | (5) | | (5) |
| U.S. government agencies | | (97) | | (171) |
| U.S. government agency mortgage-backed | | 235 | | (692) |
| States and political subdivisions | | (104) | | 380 |
| Corporate Bonds | | 1,055 | | |
| Collateralized mortgage obligations | | 105 | | (40) |
| Asset-backed securities | | 98 | | |
| Collateralized debt obligations | | (283) | | 684 |
| Equity securities | | | | 6 |
| Total unrealized holding gains on available-for-sale securities arising during the period | | 1,004 | | 162 |
| Related tax (expense) benefit | | (413) | | 8 |
| Holding income after tax | | 591 | | 170 |
| | | | | |
| Less: Reclassification adjustment for the net gains and losses realized during the period | | | | |
| Realized gains by security type: | | | | |
| U.S. government agency mortgage-backed | | 101 | | |
| Collateralized mortgage obligations | | | | 139 |
| Net realized gain | | 101 | | 139 |
| Income tax expense on net realized gains | | (41) | | (57) |
| Net realized gain after tax | | 60 | | 82 |
| Total other comprehensive income | | 531 | | 88 |
| Comprehensive loss | $ | (2,437) | $ | (3,032) |

**See accompanying notes to consolidated financial statements.**

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

**Consolidated Statements of Cash Flows**

(In thousands)

| | (Unaudited) Three Months Ended March 31, 2012 | 2011 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net loss | $ (2,968) | $ (3,120) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 801 | 1,084 |
| Change in market value on mortgage servicing rights | 123 | (62) |
| Provision for loan losses | 6,084 | 4,000 |
| Originations of loans held-for-sale | (64,140) | (48,517) |
| Proceeds from sales of loans held-for-sale | 72,729 | 56,889 |
| Net gain on sales of mortgage loans | (2,647) | (1,236) |
| Increase in cash surrender value of bank-owned life insurance | (495) | (463) |
| Change in accrued interest receivable and other assets | (4,635) | (5,157) |
| Change in accrued interest payable and other liabilities | 3,420 | 513 |
| Net premium amortization on securities | 403 | 65 |
| Securities gains, net | (101) | (139) |
| Amortization of core deposit and other intangible assets | 195 | 229 |
| Stock based compensation | 87 | 238 |
| Net gain on sale of other real estate owned | (23) | (234) |
| Write-down of other real estate owned | 2,500 | 2,393 |
| Net cash provided by operating activities | 11,333 | 6,483 |
| **Cash flows from investing activities** | | |
| Proceeds from maturities and pre-refunds including pay down of securities available-for-sale | 17,254 | 4,764 |
| Proceeds from sales of securities available-for-sale | 8,359 | 3,755 |
| Purchases of securities available-for-sale | (76,819) | (2,000) |
| Net sales (purchases) of Federal Reserve Bank and Federal Home Loan Bank stock | 1,467 | (359) |
| Net change in loans | 20,248 | 61,737 |
| Investment in other real estate owned | (318) | (2,022) |
| Proceeds from sales of other real estate owned | 5,369 | 9,357 |
| Net purchases of premises and equipment | (154) | (94) |
| Net cash (used in) provided by investing activities | (24,594) | 75,138 |
| **Cash flows from financing activities** | | |
| Net change in deposits | 23,089 | (6,179) |
| Net change in securities sold under repurchase agreements | 903 | (140) |
| Net change in other short-term borrowings | 15,000 | 438 |
| Purchase of treasury stock | (63) | (49) |
| Net cash provided by (used in) financing activities | 38,929 | (5,930) |
| Net change in cash and cash equivalents | 25,668 | 75,691 |
| Cash and cash equivalents at beginning of period | 50,949 | 98,758 |
| Cash and cash equivalents at end of period | $ 76,617 | $ 174,449 |

| | 2012 | 2011 |
|---|---|---|
| **Supplemental cash flow information** | | |

| | | |
|---|---|---|
| Interest paid for deposits | $ 3,394 | $ 4,893 |
| Interest paid for borrowings | 243 | 207 |
| Non-cash transfer of loans to other real estate | 15,918 | 19,451 |
| Change in dividends declared not paid | 978 | 929 |
| Accretion on preferred stock warrants | 245 | 230 |

See accompanying notes to consolidated financial statements.

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**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 Loss | Treasury Stock | Total Stockholders Equity |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2010 | $ 18,467 | $ 69,921 | $ 65,209 | $ 28,335 | $ (3,130) | $ (94,844) | $ 83,958 |
| Net loss | | | | (3,120) | | | (3,120) |
| Change in net unrealized loss on securities available- for-sale net of $65 tax effect | | | | | 88 | | 88 |
| Change in restricted stock | 161 | | (161) | | | | |
| Stock based compensation | | | 238 | | | | 238 |
| Purchase of treasury stock | | | | | | (49) | (49) |
| Preferred dividends declared and accrued (5% per preferred share) | | 230 | | (1,159) | | | (929) |
| Balance, March 31, 2011 | $ 18,628 | $ 70,151 | $ 65,286 | $ 24,056 | $ (3,042) | $ (94,893) | $ 80,186 |
| | | | | | | | |
| 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 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 dividends declared and accrued (5% per preferred share) | | 245 | | (1,223) | | | (978) |
| Balance, March 31, 2012 | $ 18,729 | $ 71,108 | $ 65,985 | $ 12,916 | $ (3,171) | $ (94,956) | $ 70,611 |

**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, 2012, are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011. 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, 2011. 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.

In May 2011, the FASB issued ASU No. 2011-04 Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. The Company has assessed the impact of ASU 2011-04 on its fair value disclosures and found no material impact on its fair value disclosures.

In June 2011, the FASB issued ASU No. 2011-05 Comprehensive Income (Topic 220) - Presentation of Comprehensive Income. ASU 2011-05 requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. Retrospective application of the standard is required. In December 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-12: Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05, to defer the effective date for the part of

ASU No. 2011-05 that would require adjustments of items out of accumulated other income to be presented on the components of both net income and other comprehensive income in financial statements. The Company has included the consolidated statements of comprehensive income beginning this interim period. There was no impact on the consolidated statements of operations or balance sheets based on the adoption of this standard.

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**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.

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 $7.8 million at March 31, 2012, a decrease of $1.5 million from December 31, 2011. FRB stock was recorded at $4.8 million at March 31, 2012, which was unchanged from December 31, 2011. Our FHLB stock is necessary to maintain our program of access to FHLB advances. Management at the Bank evaluated the October 17, 2011, FHLBC Capital Plan and determined the best overall course was to accept the stock conversion as of January 1, 2012.
Subsequently, Management redeemed excess stock the Bank held with the FHLBC reducing the value of stock held to $7.8 million at February 15, 2012.

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The following table summarizes the amortized cost and fair value of the available-for-sale securities at March 31, 2012 and December 31, 2011 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive loss were as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **March 31, 2012:** | | | | |
| U.S. Treasury | $ 1,501 | $ 18 | $ | $ 1,519 |
| U.S. government agencies | 45,147 | 194 | (5) | 45,336 |
| U.S. government agency mortgage-backed | 153,010 | 2,329 | (661) | 154,678 |
| States and political subdivisions | 14,166 | 1,577 | (24) | 15,719 |
| Corporate Bonds | 37,073 | 176 | (89) | 37,160 |
| Collateralized mortgage obligations | 47,542 | 366 | (755) | 47,153 |
| Asset-backed securities | 48,420 | 37 | (353) | 48,104 |
| Collateralized debt obligations | 17,903 | | (8,201) | 9,702 |
| | $ 364,762 | $ 4,697 | $ (10,088) | $ 359,371 |
| **December 31, 2011:** | | | | |
| U.S. Treasury | $ 1,501 | $ 23 | $ | $ 1,524 |
| U.S. government agencies | 43,112 | 286 | | 43,398 |
| U.S. government agency mortgage-backed | 152,473 | 1,553 | (19) | 154,007 |
| States and political subdivisions | 12,152 | 1,657 | | 13,809 |
| Corporate Bonds | 32,357 | 14 | (982) | 31,389 |
| Collateralized mortgage obligations | 25,616 | 242 | (736) | 25,122 |
| Asset-backed securities | 28,755 | | (414) | 28,341 |
| Collateralized debt obligations | 17,892 | | (7,918) | 9,974 |
| | $ 313,858 | $ 3,775 | $ (10,069) | $ 307,564 |

Securities valued at $42.0 million as of March 31, 2012 (slightly up from $40.9 million at year end 2011) were pledged to secure deposits and for other purposes.

At March 31, 2012 and December 31, 2011, collateralized debt obligations ( CDO ) held, as issued by Trapeza CDO XIII, Ltd, were greater than 10% of stockholders equity. Additional detailed information related to these securities is provided below.

The fair value, amortized cost and weighted average yield of debt securities at March 31, 2012, 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.

| | Amortized Cost | Weighted Average Yield | Fair Value |
|---|---|---|---|
| Due in one year or less | $ 475 | 4.36% | $ 480 |
| Due after one year through five years | 70,216 | 2.29% | 70,734 |
| Due after five years through ten years | 10,420 | 4.74% | 11,046 |
| Due after ten years | 16,776 | 4.57% | 17,474 |
| | 97,887 | 2.95% | 99,734 |
| Mortgage-backed securities | 200,552 | 2.01% | 201,831 |

| | | | | | |
|---|---|---|---|---|---|
| Asset-back securites | | 48,420 | 1.77% | | 48,104 |
| Collateralized debt obligations | | 17,903 | 1.88% | | 9,702 |
| | $ | 364,762 | 2.22% | $ | 359,371 |

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Securities with unrealized losses at March 31, 2012, and December 31, 2011, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

| | Less than 12 months in an unrealized loss position | | | Greater than 12 months in an unrealized loss position | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| **March 31, 2012** | **Number of Securities** | **Unrealized Losses** | **Fair Value** | **Number of Securities** | **Unrealized Losses** | **Fair Value** | **Number of Securities** | **Unrealized Losses** | **Fair Value** |
| U.S. government agencies | 2 | $ 5 | $ 4,635 | | $ | $ | 2 | $ 5 | 4,635 |
| U.S. government agency mortgage-backed | 4 | 661 | 30,330 | | | | 4 | 661 | 30,330 |
| States and political subdivisions | 1 | 24 | 2,079 | | | | 1 | 24 | 2,079 |
| Corporate bonds | 6 | 89 | 16,380 | | | | 6 | 89 | 16,380 |
| Collateralized mortgage obligations | 11 | 755 | 33,050 | | | | 11 | 755 | 33,050 |
| Asset-backed securities | 6 | 353 | 27,167 | | | | 6 | 353 | 27,167 |
| Collateralized debt obligations | | | | 2 | 8,201 | 9,702 | 2 | 8,201 | 9,702 |
| | 30 | $ 1,887 | $ 113,641 | 2 | $ 8,201 | $ 9,702 | 32 | $ 10,088 | $ 123,343 |

| | Less than 12 months in an unrealized loss position | | | Greater than 12 months in an unrealized loss position | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| **December 31, 2011** | **Number of Securities** | **Unrealized Losses** | **Fair Value** | **Number of Securities** | **Unrealized Losses** | **Fair Value** | **Number of Securities** | **Unrealized Losses** | **Fair Value** |
| U.S. government agency mortgage-backed | 4 | $ 19 | $ 27,935 | | $ | $ | 4 | $ 19 | $ 27,935 |
| Corporate bonds | 11 | 982 | 28,605 | | | | 11 | 982 | 28,605 |
| Collateralized mortgage obligations | 3 | 736 | 9,032 | | | | 3 | 736 | 9,032 |
| Asset-backed securities | 4 | 414 | 28,341 | | | | 4 | 414 | 28,341 |
| Collateralized debt obligations | | | | 2 | 7,918 | 9,974 | 2 | 7,918 | 9,974 |
| | 22 | $ 2,151 | $ 93,913 | 2 | $ 7,918 | $ 9,974 | 24 | $ 10,069 | $ 103,887 |

Recognition of other-than-temporary impairment was not necessary in the three months ended March 31, 2012, or the year ended December 31, 2011. 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 increased in the period from December 31, 2011 to March 31, 2012.

Uncertainty in the financial markets in the periods presented has resulted in 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, 2012, 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 15 of this quarterly report as of March 31, 2012. 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 collateralized debt obligation, Trapeza 2007-13A, which is secured by a pool of trust preferred securities issued by trusts sponsored by multiple financial institutions. This collateralized debt obligation was rated AAA at the time of purchase by the Company.

| | Amortized Cost | Fair Value | Gross Unrealized Loss | S&P Credit Rating (1) | Number of Banks in Issuance | Issuance Deferrals & Defaults Amount | Issuance Deferrals & Defaults Collateral % | Issuance Excess Subordination Amount | Issuance Excess Subordination Collateral % |
|---|---|---|---|---|---|---|---|---|---|
| **March 31, 2012** | | | | | | | | | |
| Class A1 | $ 9,113 | $ 5,350 | $ (3,763) | CCC+ | 63 | $ 217,750 | 29.0% | $ 177,635 | 23.7% |
| Class A2A | 8,790 | 4,352 | (4,438) | CCC- | 63 | 217,750 | 29.0% | 80,635 | 10.8% |
| | $ 17,903 | $ 9,702 | $ (8,201) | | | | | | |
| | | | | | | | | | |
| **December 31, 2011** | | | | | | | | | |
| Class A1 | $ 9,136 | $ 5,584 | $ (3,552) | CCC+ | 63 | $ 212,750 | 28.4% | $ 181,630 | 24.2% |
| Class A2A | 8,756 | 4,390 | (4,366) | CCC- | 63 | 212,750 | 28.4% | 84,630 | 11.3% |
| | $ 17,892 | $ 9,974 | $ (7,918) | | | | | | |

(1) Moody s credit rating for class A1 and A2A were Baa2 and Ba2, respectively, as of March 31, 2012, and December 31, 2011. The Fitch ratings for class A1 and A2A were BBB and B, respectively, as of March 31, 2012, and December 31, 2011.

**Note 3 Loans**

Major classifications of loans were as follows:

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Commercial | $ 103,203 | $ 98,099 |
| Real estate - commercial | 676,297 | 704,492 |
| Real estate - construction | 60,285 | 71,436 |
| Real estate - residential | 464,596 | 477,200 |
| Consumer | 3,544 | 3,789 |
| Overdraft | 234 | 457 |
| Lease financing receivables | 1,944 | 2,087 |
| Other | 12,211 | 11,498 |
| | 1,322,314 | 1,369,058 |
| Net deferred loan cost (fees) | 34 | (73) |
| | $ 1,322,348 | $ 1,368,985 |

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 90.8% and 91.5% of the portfolio at March 31, 2012, and December 31, 2011, 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 with the Bank and the Office of the Comptroller of the Currency ( OCC ). Regulatory and Capital matters including the Consent Order are discussed in more detail in Note 14 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, 2012 | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater Past Due | Total Past Due | Current | Nonaccrual | Total Financing Receivables | Recorded Investment 90 days or Greater Past Due and Accruing |
|---|---|---|---|---|---|---|---|---|
| Commercial | $ 51 | $ | $ 90 | $ 141 | $ 103,849 | $ 1,157 | $ 105,147 | $ 90 |
| Real estate - commercial | | | | | | | | |
| Owner occupied general purpose | 764 | | 758 | 1,522 | 133,860 | 6,490 | 141,872 | 758 |
| Owner occupied special purpose | 456 | | | 456 | 170,322 | 15,589 | 186,367 | |
| Non-owner occupied general purpose | 650 | | | 650 | 132,920 | 22,397 | 155,967 | |
| Non-owner occupied special purpose | | | | | 106,626 | 631 | 107,257 | |
| Retail properties | | | | | 40,893 | 11,667 | 52,560 | |
| Farm | | | 693 | 693 | 30,552 | 1,029 | 32,274 | 693 |
| Real estate - construction | | | | | | | | |
| Homebuilder | 53 | | | 53 | 8,017 | 7,200 | 15,270 | |
| Land | | | | | 8,361 | 1,288 | 9,649 | |
| Commercial speculative | | | | | 5,042 | 10,672 | 15,714 | |
| All other | 176 | | | 176 | 17,247 | 2,229 | 19,652 | |
| Real estate - residential | | | | | | | | |
| Investor | 405 | | 170 | 575 | 160,544 | 15,529 | 176,648 | 170 |
| Owner occupied | 3,376 | | | 3,376 | 118,955 | 12,608 | 134,939 | |
| Revolving and junior liens | 1,431 | 70 | | 1,501 | 148,673 | 2,835 | 153,009 | |
| Consumer | 4 | 1 | | 5 | 3,539 | | 3,544 | |
| All other | | | | | 12,479 | | 12,479 | |
| | $ 7,366 | $ 71 | $ 1,711 | $ 9,148 | $ 1,201,879 | $ 111,321 | $ 1,322,348 | $ 1,711 |

| December 31, 2011 | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater Past Due | Total Past Due | Current | Nonaccrual | Total Financing Receivables | Recorded Investment 90 days or Greater Past Due and Accruing |
|---|---|---|---|---|---|---|---|---|
| Commercial | $ 161 | $ 20 | $ | $ 181 | $ 98,840 | $ 1,165 | $ 100,186 | $ |
| Real estate - commercial | | | | | | | | |
| Owner occupied general purpose | 912 | | | 912 | 137,250 | 12,744 | 150,906 | |
| Owner occupied special purpose | | 39 | | 39 | 172,624 | 16,564 | 189,227 | |
| Non-owner occupied general purpose | 471 | | 318 | 789 | 147,099 | 12,893 | 160,781 | 318 |
| Non-owner occupied special purpose | | | | | 107,425 | 1,814 | 109,239 | |
| Retail properties | | | | | 42,535 | 15,897 | 58,432 | |
| Farm | 197 | | | 197 | 34,136 | 1,574 | 35,907 | |
| Real estate - construction | | | | | | | | |
| Homebuilder | | | | | 8,725 | 10,193 | 18,918 | |
| Land | | | | | 7,976 | 2,025 | 10,001 | |
| Commercial speculative | | 669 | | 669 | 5,154 | 14,217 | 20,040 | |
| All other | | 74 | | 74 | 17,714 | 4,689 | 22,477 | |
| Real estate - residential | | | | | | | | |
| Investor | 338 | 3,562 | | 3,900 | 162,101 | 15,111 | 181,112 | |
| Owner occupied | 3,414 | 573 | | 3,987 | 119,266 | 15,059 | 138,312 | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Revolving and junior liens | 1,525 | 166 | | 1,691 | 153,244 | 2,841 | 157,776 | |
| Consumer | 8 | | | 8 | 3,781 | | 3,789 | |
| All other | | | | | 11,882 | | 11,882 | |
| | $ 7,026 | $ 5,103 | $ 318 | $ 12,447 | $ 1,229,752 | $ 126,786 | $ 1,368,985 | $ 318 |

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The Bank had no commitments to any borrower whose loans were classified as impaired at March 31, 2012.

**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

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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:

**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. Loans listed as not rated have outstanding loans or commitments less than $50,000 or are included in groups of homogeneous loans.

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

| March 31, 2012 | Pass | Special Mention | Substandard (1) | Doubtful | Total |
|---|---|---|---|---|---|
| Commercial | $ 87,308 | $ 16,134 | $ 1,705 | $ | $ 105,147 |
| Real estate - commercial | | | | | |
| Owner occupied general purpose | 119,839 | 7,541 | 14,492 | | 141,872 |
| Owner occupied special purpose | 153,279 | 5,336 | 27,752 | | 186,367 |
| Non-owner occupied general purpose | 99,111 | 16,687 | 40,169 | | 155,967 |
| Non-owner occupied special purpose | 90,313 | 11,531 | 5,413 | | 107,257 |
| Retail Properties | 27,964 | 7,445 | 17,151 | | 52,560 |
| Farm | 23,006 | 5,605 | 3,663 | | 32,274 |
| Real estate - construction | | | | | |
| Homebuilder | 3,672 | 2,851 | 8,747 | | 15,270 |
| Land | 5,309 | 530 | 3,810 | | 9,649 |
| Commercial speculative | 1,373 | | 14,341 | | 15,714 |
| All other | 16,587 | 802 | 2,263 | | 19,652 |
| Real estate - residential | | | | | |
| Investor | 126,150 | 18,278 | 32,220 | | 176,648 |
| Owner occupied | 117,756 | 419 | 16,764 | | 134,939 |
| Revolving and junior liens | 148,388 | 247 | 4,374 | | 153,009 |
| Consumer | 3,534 | | 10 | | 3,544 |
| All other | 11,366 | 1,113 | | | 12,479 |
| Total | $ 1,034,955 | $ 94,519 | $ 192,874 | $ | $ 1,322,348 |

| December 31, 2011 | Pass | Special Mention | Substandard (1) | Doubtful | Total |
|---|---|---|---|---|---|
| Commercial | $ 94,456 | $ 3,350 | $ 2,380 | $ | $ 100,186 |
| Real estate - commercial | | | | | |
| Owner occupied general purpose | 115,175 | 11,695 | 24,036 | | 150,906 |
| Owner occupied special purpose | 154,650 | 5,254 | 29,323 | | 189,227 |
| Non-owner occupied general purpose | 102,178 | 19,292 | 39,311 | | 160,781 |
| Non-owner occupied special purpose | 85,931 | 6,017 | 17,291 | | 109,239 |
| Retail Properties | 26,391 | 11,660 | 20,381 | | 58,432 |
| Farm | 26,629 | 5,605 | 3,673 | | 35,907 |
| Real estate - construction | | | | | |
| Homebuilder | 4,206 | 2,905 | 11,807 | | 18,918 |
| Land | 3,755 | 3,032 | 3,214 | | 10,001 |
| Commercial speculative | 1,306 | | 18,734 | | 20,040 |
| All other | 17,448 | 303 | 4,726 | | 22,477 |
| Real estate - residential | | | | | |
| Investor | 119,494 | 28,478 | 33,140 | | 181,112 |
| Owner occupied | 118,658 | 271 | 19,383 | | 138,312 |
| Revolving and junior liens | 151,928 | 821 | 5,027 | | 157,776 |
| Consumer | 3,776 | | 13 | | 3,789 |
| All other | 10,755 | 1,127 | | | 11,882 |
| Total | $ 1,036,736 | $ 99,810 | $ 232,439 | $ | $ 1,368,985 |

(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 as of March 31, 2012 were as follows:

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Year to date March 31, 2012 Average Recorded Investment | Year to date March 31, 2012 Interest Income Recognized |
|---|---|---|---|---|---|
| **With no related allowance recorded** | | | | | |
| Commercial | $ 510 | $ 546 | $ | $ 511 | $ |
| Commercial real estate | | | | | |
| Owner occupied general purpose | 4,320 | 5,486 | | 4,540 | |
| Owner occupied special purpose | 11,204 | 17,762 | | 11,905 | |
| Non-owner occupied general purpose | 11,659 | 14,778 | | 9,980 | 45 |
| Non-owner occupied special purpose | 207 | 209 | | 794 | |
| Retail properties | 11,667 | 17,934 | | 8,126 | |
| Farm | 340 | 342 | | 709 | |
| Construction | | | | | |
| Homebuilder | 8,256 | 10,209 | | 9,464 | 27 |
| Land | 584 | 584 | | 1,305 | |
| Commercial speculative | 6,018 | 8,869 | | 7,783 | |
| All other | 2,127 | 2,395 | | 3,218 | |
| Residential | | | | | |
| Investor | 3,852 | 13,376 | | 3,417 | 2 |
| Owner occupied | 13,167 | 15,287 | | 12,523 | 22 |
| Revolving and junior liens | 1,610 | 1,933 | | 1,549 | |
| Consumer | | | | | |
| Total impaired loans with no recorded allowance | 75,521 | 109,710 | | 75,824 | 96 |
| **With an allowance recorded** | | | | | |
| Commercial | 647 | 743 | 389 | 650 | |
| Commercial real estate | | | | | |
| Owner occupied general purpose | 2,170 | 2,355 | 637 | 5,078 | |
| Owner occupied special purpose | 4,385 | 5,161 | 151 | 4,171 | |
| Non-owner occupied general purpose | 14,515 | 15,691 | 3,515 | 11,456 | |
| Non-owner occupied special purpose | 424 | 434 | 115 | 429 | |
| Retail properties | | | | 5,656 | |
| Farm | 689 | 693 | 150 | 592 | |
| Construction | | | | | |
| Homebuilder | 1,627 | 5,648 | 157 | 1,916 | |
| Land | 704 | 1,474 | 38 | 352 | |
| Commercial speculative | 4,654 | 5,437 | 1,664 | 4,661 | |
| All other | 102 | 142 | 49 | 241 | |
| Residential | | | | | |
| Investor | 11,833 | 12,720 | 1,949 | 12,060 | |
| Owner occupied | 5,232 | 6,300 | 436 | 6,803 | 1 |
| Revolving and junior liens | 1,225 | 1,343 | 397 | 1,288 | |
| Consumer | | | | | |
| Total impaired loans with a recorded allowance | 48,207 | 58,141 | 9,647 | 55,353 | 1 |
| Total impaired loans | $ 123,728 | $ 167,851 | $ 9,647 | $ 131,177 | $ 97 |

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Impaired loans by class of loans were as follows:

| | As of December 31, 2011 | | | Quarter Ended March 31, 2011 | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| **With no related allowance recorded** | | | | | |
| Commercial | $ 512 | $ 560 | $ | $ 1,169 | $ |
| Commercial real estate | | | | | |
| Owner occupied general purpose | 4,759 | 6,538 | | 8,623 | |
| Owner occupied special purpose | 12,606 | 15,862 | | 15,658 | |
| Non-owner occupied general purpose | 8,301 | 11,734 | | 10,385 | 32 |
| Non-owner occupied special purpose | 1,380 | 1,545 | | 2,796 | 5 |
| Retail properties | 4,586 | 5,920 | | 7,635 | |
| Farm | 1,078 | 1,198 | | 968 | |
| Construction | | | | | |
| Homebuilder | 10,672 | 17,643 | | 18,194 | 29 |
| Land | 2,025 | 6,222 | | 6,918 | |
| Commercial speculative | 9,549 | 27,134 | | 7,252 | |
| All other | 4,309 | 6,576 | | 5,413 | |
| Residential | | | | | |
| Investor | 2,981 | 11,927 | | 8,238 | |
| Owner occupied | 11,880 | 13,487 | | 14,716 | 78 |
| Revolving and junior liens | 1,489 | 1,693 | | 1,006 | |
| Consumer | | | | 6 | |
| Total impaired loans with no recorded allowance | 76,127 | 128,039 | | 108,977 | 144 |
| **With an allowance recorded** | | | | | |
| Commercial | 653 | 740 | 392 | 2,174 | |
| Commercial real estate | | | | | |
| Owner occupied general purpose | 7,985 | 8,291 | 1,397 | 8,248 | |
| Owner occupied special purpose | 3,958 | 5,448 | 407 | 9,510 | |
| Non-owner occupied general purpose | 8,397 | 9,942 | 2,187 | 12,515 | |
| Non-owner occupied special purpose | 434 | 437 | 98 | 8,262 | |
| Retail properties | 11,311 | 12,389 | 3,506 | 15,884 | |
| Farm | 496 | 496 | 28 | | |
| Construction | | | | | |
| Homebuilder | 2,204 | 2,816 | 376 | 8,189 | |
| Land | | | | 8,479 | |
| Commercial speculative | 4,668 | 5,371 | 1,683 | 7,278 | |
| All other | 380 | 422 | 225 | 216 | |
| Residential | | | | | |
| Investor | 12,287 | 12,844 | 1,808 | 10,252 | 5 |
| Owner occupied | 8,373 | 9,762 | 626 | 9,568 | 34 |
| Revolving and junior liens | 1,352 | 1,656 | 321 | 718 | |
| Consumer | | | | | |
| Total impaired loans with a recorded allowance | 62,498 | 70,614 | 13,054 | 101,293 | 39 |
| Total impaired loans | $ 138,625 | $ 198,653 | $ 13,054 | $ 210,270 | $ 183 |

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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 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 outstanding by class are summarized as follows:

| | As of March 31, 2012 | | | |
|---|---|---|---|---|
| | TDR Modifications Accruing interest | | TDR Modifications Nonaccrual | |
| | # of contracts | Recorded investment | # of contracts | Recorded investment |
| **Troubled debt restructurings** | | | | |
| Commercial | | $ | 1 | $ 17 |
| Real estate - commercial | | | | |
| Owner occupied special purpose | | | 1 | 368 |
| Non-owner occupied general purpose | 2 | 3,777 | 3 | 1,741 |
| Non-owner occupied special purpose | | | 1 | 424 |
| Real estate - construction | | | | |
| Homebuilder | 2 | 2,683 | 1 | 1,626 |
| Commercial speculative | | | 2 | 496 |
| Real estate - residential | | | | |
| Investor | 1 | 156 | 4 | 1,285 |
| Owner occupied | 36 | 5,791 | 24 | 3,989 |
| | 41 | $ 12,407 | 37 | $ 9,946 |

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

| Accruing interest: | # of contracts | | TDR Modifications Three months ended 3/31/12 Pre-modification recorded investment | | Post-modification recorded investment |
|---|---|---|---|---|---|
| **Troubled debt restructurings** | | | | | |
| Owner occupied | | | | | |
| Deferral(1) | | 1 | | 108 | 108 |
| | $ | 1 | $ | 108 | $ 108 |

| Nonaccrual: | # of contracts | | TDR Modifications Three months ended 3/31/12 Pre-modification recorded investment | | Post-modification recorded investment |
|---|---|---|---|---|---|
| **Troubled debt restructurings** | | | | | |
| Real estate - construction | | | | | |
| Interest(2) | | 1 | | 430 | 460 |
| | $ | 1 | $ | 430 | $ 460 |

(1) Deferral: Refers to the deferral of principal

(2) Interest: Interest rate concession below normal market

TDR s are classified as being in default on a case-by-case basis when they fail to be in compliance with the modified terms. 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 | TDR Default Activity Three Months ending 3/31/12 # of contracts | Pre-modification outstanding recorded investment | TDR Default Activity Three Months ending 3/31/11 # of contracts | Pre-modification outstanding recorded investment |
|---|---|---|---|---|
| Real estate - residential | | | | |
| Investor | | | 1 | 110 |
| Owner occupied | | | 5 | 732 |
| | | $ | 6 | $ 842 |

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**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, 2012, were as follows:

| | Commercial | Real Estate Commercial(1) | Real Estate Construction | Real Estate Residential | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for credit losses:** | | | | | | | |
| 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 |
| | | | | | | | |
| **Financing receivables:** | | | | | | | |
| 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.

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, 2011, were as follows:

| | Commercial | Real Estate Commercial(1) | Real Estate Construction | Real Estate Residential | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for credit losses:** | | | | | | | |
| Beginning balance | $ 6,764 | $ 42,242 | $ 18,344 | $ 6,999 | $ 880 | $ 1,079 | $ 76,308 |
| Charge-offs | 145 | 5,694 | 1,970 | 1,164 | 114 | | 9,087 |
| Recoveries | 32 | 577 | 15 | 1,168 | 115 | | 1,907 |
| Provision | (1,041) | 6,709 | (3,058) | 1,407 | (19) | 2 | 4,000 |
| Ending balance | $ 5,610 | $ 43,834 | $ 13,331 | $ 8,410 | $ 862 | $ 1,081 | $ 73,128 |
| | | | | | | | |
| Ending balance: Individually evaluated for impairment | $ 671 | $ 9,933 | $ 5,260 | $ 4,145 | $ | $ | $ 20,009 |
| Ending balance: Collectively evaluated for impairment | $ 4,939 | $ 33,901 | $ 8,071 | $ 4,265 | $ 862 | $ 1,081 | $ 53,119 |
| | | | | | | | |
| **Financing receivables:** | | | | | | | |
| Ending balance | $ 141,898 | $ 794,251 | $ 104,630 | $ 531,311 | $ 4,599 | $ 25,072 | $ 1,601,761 |
| Ending balance: Individually evaluated for impairment | $ 3,019 | $ 93,568 | $ 55,861 | $ 40,213 | $ 5 | $ | $ 192,666 |
| Ending balance: Collectively evaluated for impairment | $ 138,879 | $ 700,683 | $ 48,769 | $ 491,098 | $ 4,594 | $ 25,072 | $ 1,409,095 |

**(1)** As of March 31, 2011, this segment consisted of performing loans that included a higher risk pool of loans rated as substandard that totaled $119.3 million. The amount of general allocation that was estimated for that portion of these performing substandard rated loans was $19.1 million at March 31, 2011.

**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 March 31, 2012 | 2011 |
|---|---|---|
| Balance at beginning of period | $ 93,290 | $ 75,613 |
| Property additions | 15,918 | 19,451 |
| Development improvements | 318 | 2,022 |
| Less: | | |
| Property disposals | 5,346 | 9,123 |
| Period valuation adjustments | 2,500 | 2,393 |
| Balance at end of period | $ 101,680 | $ 85,570 |

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Activity in the valuation allowance was as follows:

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Balance at beginning of period | $ 23,462 | $ 22,220 |
| Addition charged to expense | 2,500 | 2,325 |
| Write-downs taken on sales | (1,968) | (2,730) |
| Other adjustments | | 68 |
| Balance at end of period | $ 23,994 | $ 21,883 |

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

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Gain on sales, net | $ (23) | $ (234) |
| Provision for unrealized losses | 2,500 | 2,325 |
| Operating expenses | 2,154 | 2,989 |
| Less: | | |
| Lease revenue | 1,179 | 520 |
| | $ 3,452 | $ 4,560 |

**Note 6 Core Deposit Intangible**

The core deposit intangible is reviewed for impairment on an annual basis or more often if events or circumstances indicate that it may be impaired. Management performed a detailed annual review of the core deposit intangible asset as of November 30, 2011. In addition, management monitors the actual versus the projected amortization of core deposit balances monthly. Based upon these reviews, management determined there was no impairment of the core deposit asset as of March 31, 2012. No assurance can be given that future impairment tests will not result in a charge to earnings.

The following table presents the estimated future amortization expense for core deposit and other intangible as of March 31, 2012, for periods ended December 31 (in thousands):

| | Amount |
|---|---|
| 2012 (Nine months ended December 31, 2012) | $ 585 |
| 2013 | 732 |
| 2014 | 679 |
| 2015 | 623 |
| 2016 | 562 |
| Thereafter | 1,302 |
| Total | $ 4,483 |

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**Note 7 Mortgage Servicing Rights**

Changes in capitalized mortgage servicing rights as of March 31, are summarized as follows:

| | 2012 | 2011 |
|---|---|---|
| Balance at beginning of period | $ 3,487 | $ 3,897 |
| Additions | 442 | 371 |
| Mark to market | (123) | 62 |
| Balance at end of period | $ 3,806 | $ 4,330 |

The Company accounts for servicing rights using the fair value measurement method. Management believed that the fair value method of accounting would better allow management to mitigate interest rate risk. Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in net gain on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. Additional disclosure related to fair value of mortgage servicing rights is found in Note 15.

Under the fair value measurement method, the Company measures servicing rights at fair value at each reporting date and reports changes in fair value of servicing assets in earnings in the period in which the changes occur, and are included with net gain on sales of mortgage loans on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

**Note 8 Deposits**

Major classifications of deposits were as follows:

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Noninterest bearing demand | $ 369,619 | $ 361,963 |
| Savings | 213,702 | 196,870 |
| NOW accounts | 287,650 | 275,957 |
| Money market accounts | 310,520 | 288,508 |
| Certificates of deposit of less than $100,000 | 366,264 | 390,530 |
| Certificates of deposit of $100,000 or more | 216,115 | 226,953 |
| | $ 1,763,870 | $ 1,740,781 |

**Note 9 Borrowings**

The following table is a summary of borrowings as of March 31, 2012, and December 31, 2011, and junior subordinated debentures are discussed in detail in Note 10:

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Securities sold under repurchase agreements | $ 1,804 | $ 901 |
| FHLB advances | 15,000 | |
| Junior subordinated debentures | 58,378 | 58,378 |
| Subordinated debt | 45,000 | 45,000 |
| Notes payable and other borrowings | 500 | 500 |
| | $ 120,682 | $ 104,779 |

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The Company enters into sales of securities under agreements to repurchase (repurchase agreements) which generally mature within 1 to 90 days from the transaction date. These repurchase agreements are treated as financings and were secured by mortgage-backed securities with a carrying amount of $4.7 and $3.7 million at March 31, 2012, and December 31, 2011, respectively. The securities sold under agreements to repurchase consisted of U.S. government agencies and mortgage-backed securities during the two-year reporting period.

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 lesser of 35% of total assets or 60% of the book value of certain mortgage loans. As of March 31, 2012, there was a $15 million advance at 0.13% interest which matured on April 20, 2012 without replacement. The Bank owned FHLBC stock of $7.8 million and had a collateralized loan balance of $45.5 million with FHLBC. At December 31, 2011, there were no advances on the FHLBC stock of $9.3 million and loans totaling $48.4 million. The Company has also established borrowing capacity at the FRB that was not used at either March 31, 2012, or December 31, 2011. The Company currently has $81.0 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, which began in January 2008, was originally comprised of a $30.5 million senior debt facility, which included a $30.0 million revolving line that matured on March 31, 2010, 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 portions 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 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 the end of both December 31, 2011 and March 31, 2012. 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 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, 2012, the Company continued to be 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 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 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. In November 2009, the lender provided notice to the Company that it was invoking the default rate, thereby increasing the rate on the term debt by 200 basis points retroactive to July 30, 2009. This action by the lender resulted in nominal additional interest expense as it only applies to the $500,000 of outstanding term debt.

**Note 10 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

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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 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 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.

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 18. 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 total $8.0 million at March 31, 2012.

**Note 11 - 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 10,925 at March 31, 2012. 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 2012 or 2011. All stock options are granted for a term of ten years.

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.

Total compensation cost that has been charged for those plans was $87,000 in the first quarter of 2012 and $238,000 in the first quarter of 2011.

There were no stock options exercised during the first quarter of 2012 or 2011 and the Company did not grant any options of the Company s common stock during either of those periods. 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. Total unrecognized compensation cost related to

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nonvested stock options granted under the Incentive Plan was $6,000 as of March 31, 2011, and was recognized over a weighted-average period of 0.83 years.

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

| March 31, 2012 | Shares | | Weighted Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | | Aggregate Intrinsic Value |
|---|---|---|---|---|---|---|
| Beginning outstanding | 500,000 | $ | 27.34 | | | |
| Canceled | (1,500) | | 7.49 | | | |
| Ending outstanding | 498,500 | $ | 27.40 | 3.3 | $ | |
| | | | | | | |
| Exercisable at end of quarter | 498,500 | $ | 27.40 | 3.3 | $ | |

| March 31, 2011 | Shares | | Weighted Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | | Aggregate Intrinsic Value |
|---|---|---|---|---|---|---|
| Beginning outstanding | 614,832 | $ | 25.81 | | | |
| Canceled | (14,000) | | 28.84 | | | |
| Ending outstanding | 600,832 | $ | 25.74 | 3.9 | $ | |
| | | | | | | |
| Exercisable at end of quarter | 596,832 | $ | 25.86 | 3.8 | $ | |

A summary of changes in the Company s nonvested options in the Incentive Plan is as follows:

| | 2012 | | |
|---|---|---|---|
| | Shares | | Weighted Average Grant Date Fair Value |
| Nonvested at January 1 | 4,000 | $ | 2.01 |
| Forfeited | (500) | | 2.01 |
| Vested | (3,500) | | 2.01 |
| Nonvested at March 31 | | | |

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. Both restricted stock and restricted units were granted in 2010 and both are redeemable in common stock at the time of vesting. There were 60,000 restricted awards issued during the first quarter of 2012 and 141,320 restricted awards issued during the first quarter of 2011. 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 non-vested restricted awards is as follows:

| | March 31, 2012 | | March 31, 2011 | |
|---|---|---|---|---|
| | Shares | Weighted Average Grant Date Fair Value | Shares | Weighted Average Grant Date Fair Value |
| Nonvested at January 1 | 426,192 | $ 4.15 | 464,298 | $ 6.76 |
| Granted | 60,000 | 1.25 | 141,320 | 1.06 |
| Vested | (144,976) | 7.14 | (98,770) | 10.71 |
| Forfeited | (13,296) | 3.28 | (38,938) | 4.54 |
| Nonvested at March 31 | 327,920 | $ 2.33 | 467,910 | $ 4.39 |

Total unrecognized compensation cost of restricted awards is $294,000 as of March 31, 2012, which is expected to be recognized over a weighted-average period of 1.29 years. Total unrecognized compensation cost of restricted awards was $1.3 million as of March 31, 2011, which was expected to be recognized over a weighted-average period of 1.33 years.

**Note 12 Loss Per Share**

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| Basic loss per share: | | |
| Weighted-average common shares outstanding | 14,043,545 | 13,973,870 |
| Weighted-average common shares less stock based awards | 13,855,339 | 13,769,856 |
| Weighted-average common shares stock based awards | 340,804 | 443,845 |
| Net loss | $ (2,968) | $ (3,120) |
| Dividends and accretion of discount on preferred shares | 1,223 | 1,159 |
| Net loss available to common stockholders | (4,191) | (4,279) |
| Undistributed Loss | (4,191) | (4,279) |
| Basic loss per share common undistributed loss | (0.30) | (0.30) |
| Basic loss per share of common stock | $ (0.30) | $ (0.30) |
| Diluted loss per share: | | |
| Weighted-average common shares outstanding | 14,043,545 | 13,973,870 |
| Dilutive effect of nonvested restricted awards | 152,598 | 239,831 |
| Diluted average common shares outstanding | 14,196,143 | 14,213,701 |
| Net loss available to common stockholders | $ (4,191) | $ (4,279) |
| Diluted loss per share | $ (0.30) | $ (0.30) |
| | | |
| Number of antidilutive options excluded from the diluted earnings per share calculation | 1,313,839 | 1,416,171 |

The above loss per share calculation did not include 815,339 common stock warrants that were outstanding as of March 31, 2012 and March 31, 2011.

**Note 13 Retirement Plans**

The Company maintains tax-qualified contributory and non-contributory profit sharing plans covering substantially all full-time and regular part-time employees. The expense of these plans was $111,000 and $161,000 in the first three months of 2012 and 2011, respectively. The Company eliminated the profit sharing contribution and lowered the amount of the 401(K) match beginning in second quarter of 2009.

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**Note 14 - Regulatory & Capital Matters**

On May 16, 2011, the Bank, the wholly-owned banking subsidiary of the Company, entered into a Stipulation and Consent to the Issuance of a Consent Order (the Consent Order ) with the OCC. Pursuant to the Consent Order, the Bank has agreed to take certain actions and operate in compliance with the Consent Order s provisions during its terms.

Under the terms of the Consent Order, the Bank is required to, among other things: (i) adopt and adhere to a three-year written strategic plan that establishes objectives for the Bank s overall risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital adequacy, reduction in nonperforming assets and its product development; (ii) adopt and maintain a capital plan; (iii) by September 30, 2011, achieve and thereafter maintain a total risk-based capital ratio of at least 11.25% and a Tier 1 capital ratio of at least 8.75%; (iv) seek approval of the OCC prior to paying any dividends on its capital stock; (v) develop a program to reduce the Bank s credit risk; (vi) obtain or update appraisals on certain loans secured by real estate; (vii) implement processes to ensure that real estate valuations conform to applicable standards; (viii) take certain actions related to credit and collateral exceptions; (ix) reaffirm the Bank s liquidity risk management program; and (x) appoint a compliance committee of the Bank s Board of Directors to help ensure the Bank s compliance with the Consent Order. The Bank is also required to submit certain reports to the OCC with respect to the foregoing requirements.

Both capital ratio objectives in the OCC agreement have been exceeded since June 30, 2011. At March 31, 2012, the Bank s leverage ratio was 9.22%, down 12 basis points from December 31, 2011, and 47 basis points above the objective the Bank had agreed with the OCC to maintain of 8.75%. The Bank s total capital ratio was 12.88%, down 9 basis points from December 31, 2011, and 163 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 it entered into with the OCC on May 16, 2011; (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, 2012, and December 31, 2011. 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, 2012, the Company, on a consolidated basis, exceeded the minimum thresholds to be considered adequately capitalized under regulatory defined capital ratios. The Company and the 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 at year-end | | Minimum Required for Capital Adequacy Purposes | | Minimum Required to be Well Capitalized (1) | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **March 31, 2012** | | | | | | |
| Total capital to risk weighted assets | | | | | | |
| Consolidated | $ 182,577 | 11.79% | $ 123,886 | 8.00% | N/A | N/A |
| Old Second Bank | 199,505 | 12.88 | 123,916 | 8.00 | 154,895 | 10.00 |
| Tier 1 capital to risk weighted assets | | | | | | |
| Consolidated | 91,292 | 5.90 | 61,893 | 4.00 | N/A | N/A |
| Old Second Bank | 179,807 | 11.61 | 61,949 | 4.00 | 92,924 | 6.00 |
| Tier 1 capital to average assets | | | | | | |
| Consolidated | 91,292 | 4.68 | 78,027 | 4.00 | N/A | N/A |
| Old Second Bank | 179,807 | 9.22 | 78,007 | 4.00 | 97,509 | 5.00 |
| | | | | | | |
| **December 31, 2011** | | | | | | |
| Total capital to risk weighted assets | | | | | | |
| Consolidated | $ 191,439 | 12.38% | $ 123,709 | 8.00% | N/A | N/A |
| Old Second Bank | 200,716 | 12.97 | 123,803 | 8.00 | 154,754 | 10.00 |
| Tier 1 capital to risk weighted assets | | | | | | |
| Consolidated | 95,986 | 6.21 | 61,827 | 4.00 | N/A | N/A |
| Old Second Bank | 180,981 | 11.70 | 61,874 | 4.00 | 92,811 | 6.00 |
| Tier 1 capital to average assets | | | | | | |
| Consolidated | 95,986 | 4.98 | 77,097 | 4.00 | N/A | N/A |
| Old Second Bank | 180,981 | 9.34 | 77,508 | 4.00 | 96,885 | 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, 2012, trust preferred proceeds of $24.6 million qualified as Tier 1 regulatory capital and $32.0 million qualified as Tier 2 regulatory capital. As of December 31, 2011, trust preferred proceeds of $25.9 million qualified as Tier 1 regulatory capital and $30.7 million qualified as Tier 2 regulatory capital.

**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, 2011 operating loss, funds were no longer available for

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the payment of dividends by the Bank to the Company and this restriction continued at March 31, 2012.

As discussed in Note 10, as of March 31, 2012, 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, which are approximately $4.3 million each year, on the debentures for a period of up to 20 consecutive quarters, and elected to begin such a deferral period 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, 2012, was $8.0 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 the Treasury all accrued and unpaid dividends on the Series B Preferred Stock before it may reinstate the payment of dividends on the common stock. The total amount of deferred Series B Preferred Stock dividends as of March 31, 2012, was $6.1 million. Moreover, even if all accrued payments were paid in full, the Company has been restricted from any increase in the dividends payable on its common stock beyond the level that it had most recently declared prior to Treasury s investment until January of 2012 without the consent of Treasury, provided Treasury still holds the preferred stock. That restriction has now expired. However, 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 10 and 18.

**Note 15 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 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:

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.

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.

The Company uses the following methods and significant assumptions to estimate fair value:

- Securities available-for-sale are valued primarily by a third party pricing agent and both the market and income valuation approaches are implemented using the following types of inputs:

- U.S. treasuries are priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

- 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.

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- Other government-sponsored agency securities, mortgage-backed securities and some of the actively traded REMICs and CMOs are primarily priced using available market information including benchmark yields, prepayment speeds, spreads and volatility of similar securities.

- 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.

- Collateralized debt obligations are collateralized by trust preferred security issuances of other financial institutions. Uncertainty in the financial markets in the periods presented has resulted in reduced liquidity for these investment securities, which continued to affect market pricing in the period presented. 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. Management initially made that adjustment to Level 3 valuation at June 30, 2009 because the level of market activity for CDO securities continued to decrease and information on orderly sale transactions were not generally available.

- Marketable equity securities are priced using available market information.

- 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.

- 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 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.

- Other Real Estate Owned: 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, 2012, and December 31, 2011, respectively, which are measured by the Company at fair value on a recurring basis:

| | March 31, 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Securities available-for-sale | | | | |
| U.S. Treasury | $ 1,519 | $ | $ | $ 1,519 |
| U.S. government agencies | | 45,336 | | 45,336 |
| U.S. government agency mortgage-backed | | 154,678 | | 154,678 |
| States and political subdivisions | | 15,581 | 138 | 15,719 |
| Corporate Bonds | | 37,160 | | 37,160 |
| Collateralized mortgage obligations | | 47,153 | | 47,153 |
| Asset-backed securities | 3,304 | 44,800 | | 48,104 |
| Collateralized debt obligations | | | 9,702 | 9,702 |
| Loans held-for-sale | | 6,405 | | 6,405 |
| Mortgage servicing rights | | | 3,806 | 3,806 |
| Other assets (Interest rate swap agreements net of swap credit valuation) | | 2,924 | (78) | 2,846 |
| Other assets (Forward MBS) | | 809 | | 809 |
| Total | $ 4,823 | $ 354,846 | $ 13,568 | $ 373,237 |
| | | | | |
| Liabilities: | | | | |
| Other liabilities (Interest rate swap agreements) | $ | $ 2,924 | $ | $ 2,924 |
| Other liabilities (Interest rate lock commitments to borrowers) | | 3 | | 3 |
| Total | $ | $ 2,927 | $ | $ 2,927 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Securities available-for-sale | | | | |
| U.S. Treasury | $ 1,524 | $ | $ | $ 1,524 |
| U.S. government agencies | | 43,398 | | 43,398 |
| U.S. government agency mortgage-backed | | 154,007 | | 154,007 |
| States and political subdivisions | | 13,671 | 138 | 13,809 |
| Corporate Bonds | | 31,389 | | 31,389 |
| Collateralized mortgage obligations | | 25,122 | | 25,122 |
| Asset-backed securities | | 28,341 | | 28,341 |
| Collateralized debt obligations | | | 9,974 | 9,974 |
| Loans held-for-sale | | 12,806 | | 12,806 |
| Mortgage servicing rights | | | 3,487 | 3,487 |
| Other assets (Interest rate swap agreements net of swap credit valuation) | | 3,152 | (80) | 3,072 |
| Other assets (Forward MBS) | | 107 | | 107 |
| Total | $ 1,524 | $ 311,993 | $ 13,519 | $ 327,036 |
| | | | | |
| Liabilities: | | | | |
| Other liabilities (Interest rate swap agreements) | $ | $ 3,152 | $ | $ 3,152 |

| | | | | |
|---|---|---|---|---|
| Other liabilities (Interest rate lock commitments to borrowers) | | 50 | | 50 |
| Total | $ | $ 3,202 | $ | $ 3,202 |

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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, 2012 | | | |
|---|---|---|---|---|
| | Securities available-for-sale | | | |
| | Collateralized Debt Obligations | States and Political Subdivisons | Mortgage Servicing Rights | Interest Rate Swap Valuation |
| Beginning balance January 1, 2012 | $ 9,974 | $ 138 | $ 3,487 | $ (80) |
| 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) |

| | March 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Securities available-for-sale | | | | | |
| | Equity Securities | Collateralized Debt Obligations | States and Political Subdivisons | Mortgage Servicing Rights | Interest Rate Swap Valuation | Risk Participation Agreement |
| Beginning balance January 1, 2011 | $ 6 | $ 11,073 | $ 3,000 | $ 3,897 | $ (108) | $ (38) |
| Transfers into Level 3 | | | | | | |
| Transfers out of Level 3 | | | (3,000) | | | |
| Total gains or losses | | | | | | |
| Included in earnings (or changes in net assets) | | 28 | | 62 | 12 | (2) |
| Included in other comprehensive income | 1 | 684 | | | | |
| Purchases, issuances, sales, and settlements | | | | | | |
| Issuances | | | | 371 | | |
| Settlements | | (33) | | | | |
| Ending balance March 31, 2011 | $ 7 | $ 11,752 | $ | $ 4,330 | $ (96) | $ (40) |

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

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, 2012, and December 31, 2011, 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, 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Impaired loans(1) | $ | $ | $ 44,802 | $ 44,802 |
| Other real estate owned, net(2) | | | 101,680 | 101,680 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Total** | $ | | $ | | $ | 146,482 | $ | 146,482 |

(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 $54.4 million, with a valuation allowance of $9.6 million, resulting in a decrease of specific allocations within the provision for loan losses of $3.4 million for the quarter ending March 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 $101.7 million, which is made up of the outstanding balance of $125.7 million, net of a valuation allowance of $24.0 million, at March 31, 2012, resulting in a charge to expense of $2.5 million for the quarter ended March 31, 2012.

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| | December 31, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | | Level 2 | | Level 3 | | Total | |
| Impaired loans(1) | $ | | $ | | $ | 51,075 | $ | 51,075 |
| Other real estate owned, net(2) | | | | | | 93,290 | | 93,290 |
| Total | $ | | $ | | $ | 144,365 | $ | 144,365 |

(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 $64.1 million, with a valuation allowance of $13.0 million, resulting in a decrease of specific allocations within the provision for loan losses of $9.9 million for the year ending December 31, 2011.

(2) OREO is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of $93.3 million, which is made up of the outstanding balance of $116.8 million, net of a valuation allowance of $23.5 million, at December 31, 2011, resulting in a charge to expense of $15.1 million for the year ended December 31, 2011.

## Note 16 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

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 into 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 $5.2 million in investment securities pledged to support interest rate swap activity with two correspondent financial institutions at March 31, 2012 and December 31, 2011. In connection with each transaction, the Bank agrees 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 agrees 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 15 above. At March 31, 2012, the notional amount of non-hedging interest rate swaps was $116.7 million with a weighted average maturity of 1.99 years. At December 31, 2011, the notional amount of non-hedging interest rate swaps was $117.8 million with a weighted average maturity of 2.24 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

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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 MBS 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, 2012, 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.

| | Notional or Contractual Amount | Asset Derivaties | | Liability Derivatives | |
|---|---|---|---|---|---|
| | | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Interest rate swap contracts net of credit valuation | $ 116,742 | Other Assets | $ 2,846 | Other Liabilities | $ 2,924 |
| Commitments(1) | 236,253 | Other Assets | 809 | N/A | |
| Forward contracts(2) | 28,645 | N/A | | Other Liabilities | 3 |
| Total | | | $ 3,655 | | $ 2,927 |

(1)Includes unused loan commitments and interest rate lock commitments.

(2)Includes forward MBS contracts and forward loan contracts.

The following table presents derivatives not designated as hedging instruments as of December 31, 2011.

| | 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 | $ 117,756 | Other Assets | $ 3,072 | Other Liabilities | $ 3,152 |
| Commitments(1) | 237,970 | Other Assets | 107 | N/A | |
| Forward contracts(2) | 26,000 | N/A | | Other Liabilities | 50 |
| Total | | | $ 3,179 | | $ 3,202 |

(1)Includes unused loan commitments and interest rate lock commitments.

(2)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 is essentially the same as that involved in extending loan commitments to our customers.

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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, 2012, and December 31, 2011.

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Commitments to extend credit: borrowers | | |
| Financial standby letters of credit | $ 2,889 | $ 2,837 |
| Performance standby letters of credit | 6,991 | 8,554 |
| Commercial letters of credit | 51 | 375 |
| Total letters of credit: borrowers | 9,931 | 11,766 |
| | | |
| Commitments to extend credit: other | | |
| Financial standby letters of credit | 550 | 550 |
| Performance standby letters of credit | 2,191 | 2,324 |
| Commercial letters of credit | | |
| Total letters of credit: other | 2,741 | 2,874 |
| | | |
| Total letters of credit | | |
| Financial standby letters of credit | 3,439 | 3,387 |
| Performance standby letters of credit | 9,182 | 10,878 |
| Commercial letters of credit | 51 | 375 |
| Total letters of credit | $ 12,672 | $ 14,640 |

**Note 17 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 include 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 are discussed in detail in Note 15. It is not practicable to determine the fair value of Federal Home Loan Bank stock due to restrictions on 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.

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

| | March 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| **Financial assets:** | | | | | |
| Cash, due from banks and federal funds sold | $ 35,455 | $ 35,455 | $ 35,455 | $ | $ |
| Interest bearing deposits with financial institutions | 41,162 | 41,162 | 41,162 | | |
| Securities available-for-sale | 359,371 | 359,371 | 4,823 | 344,708 | 9,840 |
| FHLB and FRB Stock | 12,583 | 12,583 | | | 12,583 |
| Bank-owned life insurance | 53,090 | 53,090 | | 53,090 | |
| Loans held for sale | 6,405 | 6,405 | | 6,405 | |
| Loans, net | 1,274,738 | 1,307,503 | | | 1,307,503 |
| Accrued interest receivable | 6,395 | 6,395 | 6,395 | | |
| | | | | | |
| **Financial liabilities:** | | | | | |
| Noninterest bearing deposits | $ 369,619 | $ 369,619 | $ 369,619 | $ | $ |
| Interest bearing deposits | 1,394,251 | 1,398,065 | | | 1,398,065 |
| Securities sold under repurchase agreements | 1,804 | 1,804 | | | 1,804 |
| Other short-term borrowings | 15,000 | 14,998 | | | 14,998 |
| Junior subordinated debentures | 58,378 | 28,580 | | | 28,580 |
| Subordinated debenture | 45,000 | 21,832 | | | 21,832 |
| Note payable and other borrowings | 500 | 268 | | | 268 |
| Borrowing interest payable | 8,012 | 8,012 | | | 8,012 |
| Deposit interest payable | 1,230 | 1,230 | 1,230 | | |

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| **Financial assets:** | | | | | |
| Cash, due from banks and federal funds sold | $ 2,692 | $ 2,692 | $ 2,692 | $ | $ |
| Interest bearing deposits with financial institutions | 48,257 | 48,257 | 48,257 | | |
| Securities available-for-sale | 307,564 | 307,564 | 1,524 | 295,928 | 10,112 |
| FHLB and FRB Stock | 14,050 | 14,050 | | | 14,050 |
| Bank-owned life insurance | 52,595 | 52,595 | | 52,595 | |
| Loans held for sale | 12,806 | 12,806 | | 12,806 | |
| Loans, net | 1,316,988 | 1,352,335 | | | 1,352,335 |
| Accrued interest receivable | 5,708 | 5,708 | 5,708 | | |
| | | | | | |
| **Financial liabilities:** | | | | | |
| Noninterest bearing deposits | $ 361,963 | $ 361,963 | $ 361,963 | $ | $ |
| Interest bearing deposits | 1,378,818 | 1,382,663 | | | 1,382,663 |
| Securities sold under repurchase agreements | 901 | 901 | | | 901 |
| Junior subordinated debentures | 58,378 | 22,203 | | | 22,203 |
| Subordinated debenture | 45,000 | 24,532 | | | 24,532 |
| Note payable and other borrowings | 500 | 260 | | | 260 |
| Borrowing interest payable | 6,815 | 6,815 | | | 6,815 |

| | | | |
|---|---|---|---|
| Deposit interest payable | 1,718 | 1,718 | 1,718 |

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**Note 18 Preferred Stock**

The Series B Preferred Stock was issued as part of the TARP Capital Purchase Program as implemented by the Treasury. The Series B Preferred Stock qualified 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.

The American Recovery and Reinvestment Act of 2009, which was enacted on February 17, 2009, permits the Company to redeem the Series B Preferred Stock at any time by repaying the Treasury, without penalty and without the requirement to raise new capital, subject to the Treasury s consultation with the Company s appropriate regulatory agency.

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 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 preferred stock and the warrants as part of the allocation process in the amounts of $68.2 million and $4.8 million, respectively.

The fair value of the preferred stock was determined by using ASC Topic 820, Fair Value Measurements and Disclosures concepts, using a discounted cash flow approach. Upon review of economic conditions and events that gave rise to the TARP initiative, a discount rate of 15% was selected to reflect management s estimate of a current market rate for the Company. Factors such as the creditworthiness of the Company, its standing as a public company, and the unique economic environment particularly as it related to financial institutions and the Treasury program were considered, as was the ability of the Company to access capital. A final factor was management s belief that the initial stated preferred stock dividend rate (5%) was below market, which also drove the decision to select the higher discount rate of 15%.

As discussed in Note 14, in August 2010 the Company suspended quarterly cash dividends on its outstanding Series B Preferred Stock. Further, as discussed in Note 14, the Company has elected to defer interest payments on certain of its subordinated debentures. During the period in which preferred stock dividends are deferred, such dividends will continue to accrue. The Company did not pay dividends for an aggregate of six quarters, whether or not consecutive, and the holder has the right to appoint representatives to the Company s board of directors. As of January 2012, the Treasury began sending an observer to the Company s board of directors meetings. The Treasury has indicated that it intends to appoint two directors to our board sometime during 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 such unpaid deferred dividends as of March 31, 2012 was $6.1 million.

Pursuant to the terms of the TARP Capital Purchase Program, the ability of the Company to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Common Stock will be subject to restrictions, including a restriction against increasing dividends from the immediately preceding quarter prior to issuance. The redemption, purchase or other acquisition of trust preferred securities of the Company or its affiliates also will be restricted. These restrictions will terminate on the earlier of (a) the third anniversary of the date of issuance of the Preferred Stock or (b) the date on which the Series B Preferred Stock has been redeemed in whole or the Treasury has transferred all of the Series B Preferred Stock to third parties, except that, after the third anniversary of the date of issuance of the Series B Preferred Stock, if the Series B Preferred Stock remains outstanding at such time, the Company may not increase its common dividends per share without obtaining consent of the Treasury.

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The TARP Capital Purchase Program also subjects the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (the EESA ). In this connection, as a condition to the closing of the transaction, the Company s Senior Executive Officers (as defined in the Securities Purchase Agreement, dated January 16, 2009, by and between Old Second Bancorp, Inc. and the Treasury) the Senior Executive Officers, (i) voluntarily waived any claim against Treasury or the Company for any changes to such officer s compensation or benefits that are required to comply with the regulation issued by Treasury under the TARP Capital Purchase Program and acknowledged that the regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements and policies and agreements as they relate to the period Treasury owns the Series B Preferred Stock of the Company; and (ii) entered into a letter with the Company amending the benefit plans with respect to such Senior Executive Officers as may be necessary, during the period that Treasury owns the Preferred Stock of the Company, as necessary to comply with Section 111(b) of the EESA.

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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, 2012, as compared to December 31, 2011, and the results of operations for the three months ended March 31, 2012 and 2011. 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 2011 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, which has resulted in a continued elevated level of nonperforming loans. This 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 $6.1 million provision for loan losses and a net loss of $3.0 million prior to preferred stock dividends and accretion in the first three months of 2012. This compared to a $4.0 million provision for loan losses and a net loss of $3.1 million prior to preferred stock dividends and accretion for the same period in 2011.

**Results of Operations**

The net loss for the first quarter of 2012 was $.30 per diluted share on $3.0 million of net loss. This compares to net loss of $.30 per diluted share, on $3.1 million of net loss, for the first quarter of 2011. The Company recorded a $6.1 million provision for loan losses and net charge-offs totaled $10.5 million in the first quarter of 2012. Unusually adverse and immediate deterioration in a small number of large dollar relationships resulted in the need for prudent and sizable loan loss provisions as well as incremental charge offs. This compared to a provision for loan losses of $4.0 million and net charge-offs totaling $7.2 million in the first quarter of 2011. The net loss available to common stockholders was $4.2 million for the first quarter of 2012 after preferred stock dividends and accretion of $1.2 million. This compared to net loss available to common stockholders of $4.3 million for the first quarter of 2011 after Series B Preferred Stock dividends and accretion of $1.2 million.

**Net Interest Income**

Net interest and dividend income decreased $1.4 million, from $16.5 million for the quarter ended March 31, 2011, to $15.1 million for the quarter ended March 31, 2012. Average earning assets decreased $175.5 million, or 9.1%, from $1.93 billion in the first quarter of 2011, to $1.75 billion in the first quarter of 2012, as management continued to emphasize asset quality and new loan originations continued to be limited. Average loans, including loans held for sale, decreased $298.9 million from the first quarter of 2011 to the first quarter of 2012. This decline was primarily due to the general 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 2012 to 18.1%

of total assets up from 6.7% at March 31, 2011 and 15.8% at the end of 2011. The securities growth from first quarter 2011 to first quarter 2012 was accomplished under management s Investment Policy. For example, as measured by final contractual maturity, the portfolio percentage in the five to ten year maturity classification declined from 28.9% to 7.1% in that period while the portfolio percentage in the one to five year maturity classification increased from 2.8% to 23.7% in the same period.

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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. As a result during the first quarter, average interest bearing liabilities decreased $162.9 million, or 9.8%, from March 31, 2011. The net interest margin (tax-equivalent basis), expressed as a percentage of average earning assets, decreased from 3.50% in the first quarter of 2011 to 3.48% in the first quarter of 2012. The average tax-equivalent yield on earning assets decreased from 4.67% in the first quarter of 2011 to 4.41%, or 26 basis points, in the first quarter of 2012. During the first quarter of 2012, the tax equivalent yield on earning assets was enhanced by collection of previously reversed or unrecognized interest on loans that returned to performing status during the period. The tax equivalent yield on earning assets in the first quarter of 2012 would have been 4.39% without this benefit. At the same time, however, the cost of funds on interest bearing liabilities decreased from 1.44% to 1.17%, or 27 basis points, helping to offset the decrease in yield. The decrease in average earning assets and the growth of lower yielding securities in the current environment of low interest rates were the main causes 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, 2012 and 2011.

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, 2012 and 2011

(Dollar amounts in thousands - unaudited)

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest | Rate | Average Balance | Interest | Rate |
| **Assets** | | | | | | |
| Interest bearing deposits | $ 44,018 | $ 25 | 0.22% | $ 113,100 | $ 70 | 0.25% |
| Federal funds sold | | | | 1,465 | | |
| Securities: | | | | | | |
| Taxable | 326,886 | 1,498 | 1.83 | 128,174 | 878 | 2.74 |
| Non-taxable (tax equivalent) | 10,579 | 159 | 6.01 | 14,976 | 219 | 5.85 |
| Total securities | 337,465 | 1,657 | 1.96 | 143,150 | 1,097 | 3.07 |
| Dividends from FRB and FHLB stock | 13,325 | 74 | 2.22 | 13,698 | 69 | 2.01 |
| Loans and loans held-for-sale (1) | 1,357,670 | 17,774 | 5.18 | 1,656,531 | 21,280 | 5.14 |
| Total interest earning assets | 1,752,478 | 19,530 | 4.41 | 1,927,944 | 22,516 | 4.67 |
| Cash and due from banks | 16,409 | | | 34,882 | | |
| Allowance for loan losses | (51,362) | | | (78,812) | | |
| Other noninterest bearing assets | 239,989 | | | 238,261 | | |
| Total assets | $ 1,957,514 | | | $ 2,122,275 | | |
| **Liabilities and Stockholders Equity** | | | | | | |
| NOW accounts | $ 277,077 | $ 72 | | | | |