



OLD SECOND BANCORP, INC.

ANNUAL REPORT 2020

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2020
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 0-10537



Delaware
(State of Incorporation)

36-3143493
(IRS Employer Identification Number)

37 South River Street, Aurora, Illinois 60507
(Address of principal executive offices, including zip code)

(630) 892-0202
(Registrant's telephone number, including Area Code)

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

<u>Title of Class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$1.00 par value	OSBC	The Nasdaq Stock Market

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

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, on June 30, 2020, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$224.8 million. The number of shares outstanding of the registrant's common stock, par value \$1.00 per share, was 29,125,741 as of March 4, 2021.

DOCUMENTS INCORPORATED BY REFERENCE:

Certain information required by Part III of this Annual Report on Form 10-K is incorporated by reference from the registrant's definitive proxy statement relating to the 2020 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Annual Report on Form 10-K relates.

OLD SECOND BANCORP, INC.

Form 10-K

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report and other publicly available documents of the Company contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act, including, but not limited to, management's expectations regarding future plans, strategies and financial performance, including regulatory developments, industry and economic trends and estimates and assumptions underlying accounting policies, such as the newly adopted credit impairment model for Current Expected Credit Losses, or CECL. Forward-looking statements are based on our current beliefs, expectations and assumptions and on information currently available and, can be identified by the use of words such as "expects," "intends," "believes," "may," "will," "would," "could," "should," "plan," "anticipate," "estimate," "possible," "likely" or other words with similar meaning. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and may be outside of the Company's control. Actual events and results may differ materially from those described in such forward-looking statements due to numerous factors, including:

- our ability to execute our growth strategy;
- the impact of the outbreak of the novel coronavirus, or COVID-19, on our business, including the impact of the actions taken by governmental authorities to try and contain the virus or address the impact of the virus on the United States economy (including, without limitation, the Coronavirus Aid, Relief and Economic Security Act, or the CARES Act), and the resulting effect of these items on our operations, liquidity and capital position, and on the financial condition of our borrowers and other customers;
- negative economic conditions that adversely affect the economy, real estate values, the job market and other factors nationally and in our market area, in each case that may affect our liquidity and the performance of our loan portfolio;
- risks related to future acquisitions, if any, including execution and integration risks;
- the financial success and viability of the borrowers of our commercial loans;
- changes in U.S. monetary policy, the level and volatility of interest rates, the capital markets and other market conditions that may affect, among other things, our liquidity and the value of our assets and liabilities;
- the transition away from LIBOR to an alternative reference rate;
- competitive pressures from other financial service businesses and from nontraditional financial technology ("FinTech") companies;
- any negative perception of our reputation or financial strength;
- our ability to raise additional capital on acceptable terms when needed;
- our ability to raise cost-effective funding to support business plans when needed;
- our ability to use technology to provide products and services that will satisfy customer demands and create efficiencies in operations;
- adverse effects on our information technology systems resulting from system failures, human error or cyberattacks;
- adverse effects of failures by our vendors to provide agreed upon services in the manner and at the cost agreed, particularly our information technology vendors and those vendors performing a service on the Company's behalf;
- the impact of any claims or legal actions, including any effect on our reputation;
- losses incurred in connection with repurchases and indemnification payments related to mortgages;
- the soundness of other financial institutions and other counter-party risk;
- changes in accounting standards, rules and interpretations and the related impact on our financial statements, including assumptions surrounding the ongoing impact of CECL, which are subject to change based on a number of factors including changes in our macroeconomic forecasts, credit quality, loan composition and other factors;
- our ability to receive dividends from our subsidiaries;
- a decrease in our regulatory capital ratios;
- adverse federal or state tax assessments, or changes in tax laws or policies;
- risks associated with actual or potential litigation or investigations by customers, regulatory agencies or others;
- legislative or regulatory changes, particularly changes in regulation of financial services companies;
- increased costs of compliance, heightened regulatory capital requirements and other risks associated with changes in regulation and the current regulatory environment, including changes as a result of the new presidential administration and Democratic control of Congress;
- negative changes in our capital position;
- the adverse effects of events beyond our control that may have a destabilizing effect on financial markets and the economy, such as epidemics and pandemics (including COVID-19), war or terrorist activities, essential utility outages, deterioration in the global economy, instability in the credit markets, disruptions in our customers' supply chains or disruption in transportation;
- changes in trade policy and any related tariffs; and
- each of the factors and risks under the heading "Risk Factors" in our 2020 Annual Report on Form 10-K and in subsequent filings we make with the SEC.

Because the Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain, there can be no assurances that future actual results will correspond to any forward-looking statements and you should not rely on any forward-looking statements. Additionally, all statements in this Form 10-K, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events, except as required by applicable law.

PART I

Item 1. Business

General

Old Second Bancorp, Inc. is a corporation organized under the laws of the State of Delaware in 1981 that serves as the bank holding company for its wholly-owned subsidiary bank, Old Second National Bank. Old Second National Bank (the “Bank”) is a national banking association headquartered in Aurora, Illinois, that operates through 29 banking centers located in Cook, DeKalb, DuPage, Kane, Kendall, LaSalle and Will counties in Illinois.

In this report, unless the context suggests otherwise, references to the “Company” refer to Old Second Bancorp, Inc. and references to “we,” “us,” and “our” mean the combined business of the Company, the Bank and its wholly-owned subsidiaries.

We conduct a full service community banking and trust business through the Bank and its wholly-owned subsidiaries:

- Old Second Affordable Housing Fund, L.L.C., which was formed for the purpose of providing down payment assistance for home ownership to qualified individuals;
- Station I, LLC, which is wholly-owned by the Bank to hold property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with borrowers; and
- River Street Advisors, LLC, a wholly-owned subsidiary of the Bank, which was formed in May 2010 to provide investment advisory/management services.

Intercompany transactions and balances are eliminated in consolidation.

We are a full-service banking business offering a broad range of deposit products, trust and wealth management services, and lending services, including demand, NOW, money market, savings, time deposit and individual retirement accounts; commercial, industrial, consumer and real estate lending, including installment loans, agricultural loans, lines of credit, lease financing receivables and overdraft checking; safe deposit operations, and an extensive variety of additional services tailored to the needs of individual customers, such as the acquisition of U.S. Treasury notes and bonds, money orders, cashiers’ checks and foreign currency, direct deposit, discount brokerage, debit cards, credit cards, and other special services. Our lending activities include making commercial and consumer loans, primarily on a secured basis. Commercial lending focuses on business, capital, construction, inventory, health care and real estate lending, as well as lease financing. Installment lending includes direct and indirect loans to consumers and commercial customers.

We also offer a full complement of electronic banking services such as online and mobile banking and corporate cash management products including remote deposit capture, mobile deposit capture, investment sweep accounts, zero balance accounts, automated tax payments, ATM access, telephone banking, lockbox accounts, automated clearing house transactions, account reconciliation, controlled disbursement, detail and general information reporting, foreign and domestic wire transfers, vault services for currency and coin, and checking accounts. Additionally, we provide a wide range of wealth management, investment, agency, and custodial services for individual, corporate, and not-for-profit clients. These services include the administration of estates and personal trusts, as well as the management of investment accounts for individuals, employee benefit plans, and charitable foundations. We also originate residential mortgages, offering a wide range of mortgage products including conventional, government, and jumbo loans. We also handle secondary marketing of those mortgages.

We evaluate our operations as one operating segment, which is community banking. Financial information concerning our operations can be found in the financial statements in this annual report.

Market Area

Our main office is located at 37 South River Street, Aurora, Illinois 60507. The city of Aurora is located in northeastern Illinois, approximately 40 miles west of Chicago. The Bank operates primarily in Cook, DeKalb, DuPage, Kane, Kendall, LaSalle, and Will counties in Illinois, and it has developed a strong presence in these counties. The Bank offers its services to retail, commercial, industrial, and public entity customers in the Aurora, North Aurora, Batavia, St. Charles, Burlington, Elburn, Elgin, Kaneville, Sugar Grove, Lisle, Joliet, Yorkville, Plano, Wasco, Ottawa, Oswego, Sycamore, Frankfort, Chicago, Bensenville, and Chicago Heights communities and surrounding areas through its 29 banking locations that are located primarily west and south of the Chicago metropolitan area.

Lending Activities

We provide a broad range of commercial and retail lending services to corporations, partnerships, individuals and government agencies. We market our services to qualified borrowers, and our lending officers actively solicit the business of new borrowers entering our market areas as well as long-standing members of the local business community. We have established lending policies that include a number of underwriting factors to be considered in making a loan, including location, amortization, loan to value ratio, cash flow, pricing,

documentation and the credit history of the borrower. In 2020, we originated approximately \$1.11 billion in loans, and our total loan portfolio grew \$104.0 million year over year due primarily to \$74.1 million of Paycheck Protection Program (“PPP”) loans outstanding at December 31, 2020, as well as organic originations, net of paydowns. We originated approximately \$453.9 million of residential mortgage loans in 2020, which includes originations of loans held for sale of \$384.4 million. Proceeds from the sales of residential mortgage loans to third parties were \$388.5 million in 2020.

Our loan portfolio is comprised of loans in the areas of commercial real estate, residential real estate, general commercial, construction real estate, leases, and consumer lending. As of December 31, 2020, commercial real estate loans represented approximately 45.0% (45.0% at year-end 2019) of our loan portfolio, residential mortgages represented approximately 17.8% (20.6% at year-end 2019), general commercial loans represented approximately 20.0% (17.3% at year-end 2019), home equity lines of credit represented 5.0% (6.4% at year-end 2019), construction lending represented approximately 4.8% (3.6% at year-end 2019), leases represented approximately 7.0% (6.2% at year-end 2019), and consumer and other lending represented less than 1.0% (less than 1.0% at year-end 2019). It is our policy to comply at all times with the various consumer protection laws and regulations including, but not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act, the Truth in Lending Act, and the Home Mortgage Disclosure Act.

Commercial Loans. We continue to focus on identifying commercial and industrial prospects in our new business pipeline, which led to favorable results in 2020. As noted above, we are an active commercial lender in the Chicago metropolitan area, with primary markets in the city of Chicago, as well as west and south of Chicago. In 2019, we enhanced our commercial lending team with new hires specializing in health care and professional services, bringing additional expertise to our developing presence in the Chicago metropolitan market, which led to continued growth in 2020, specifically in health care lending. Commercial lending is comprised of revolving lines of credit for working capital, lending for capital expenditures on manufacturing equipment and lending to small business manufacturers, service companies, medical and dental entities as well as specialty contractors. We also have commercial and industrial loans to customers in food product manufacturing, food process and packing, machinery tooling manufacturing as well as service and technology companies. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. In addition, we often obtain personal guarantees to help assure repayment. Loans may be made on an unsecured basis if warranted by the overall financial condition of the borrower. Commercial term loans range principally from one to seven years with the majority falling in the one to five year range. Interest rates on commercial loans are a mixture of fixed and variable rates, with these rates often tied to the prime rate, a spread over the FHLB Chicago index rate, a Treasury constant maturity index, or LIBOR.

Repayment of commercial loans is largely dependent upon the cash flows generated by the operations of the commercial borrower. Our underwriting procedures identify the sources of those cash flows and seek to match the repayment terms of the commercial loans to those sources. Secondary repayment sources are typically found in collateralization and guarantor support.

Lease Financing Receivables. We continued growth of our lease portfolio in 2020 with organic lease originations. The collateral for lease financing receivables primarily includes construction and transportation equipment, and lease terms typically range from one to seven years, with the majority falling in the one to five year range. Growth in this portfolio reflects management’s efforts to diversify lending product offerings, and lessen our commercial real estate loan concentration.

Commercial Real Estate Loans. While management has been actively working to reduce our concentration in real estate loans, a large portion of the loan portfolio continues to be comprised of commercial real estate loans. As of December 31, 2020, approximately \$333.1 million, or 36.3% (39.9%, at year-end 2019) of the total commercial real estate loan portfolio of \$915.1 million consisted of loans to borrowers secured by owner occupied property. A primary repayment risk for owner occupied commercial real estate loans is a reduction of or discontinuance of cash flows from underlying operations; for non-owner occupied loans, cash flow disruptions may occur with the loss of a tenant or rental income reductions. Repayment could also be influenced by economic events, which may or may not be under the control of the borrower, or changes in regulations that negatively impact the future cash flow and market values of the affected properties. Repayment risk can also arise from general downward shifts in the valuations of classes of properties over a given geographic area, and property valuations could continue to be affected by changes in demand and other economic factors, which could further influence cash flows associated with the borrower and/or the property. We seek to mitigate these risks by staying apprised of market conditions and by maintaining underwriting practices that provide for adequate cash flow margins and multiple repayment sources as well as remaining in regular contact with our borrowers. In most cases, we have collateralized these loans and/or have taken personal guarantees to help assure repayment. Commercial real estate loans are primarily made based on the identified cash flow of the borrower and/or the property at origination and secondarily on the underlying real estate acting as collateral. Additional credit support is provided by the borrower for most of these loans and the probability of repayment is based on the liquidation value of the real estate and enforceability of personal and corporate guarantees if any exist.

Construction Loans. Our construction and development portfolio increased from \$69.6 million at December 31, 2019, to \$98.5 million at December 31, 2020. We use underwriting and construction loan guidelines to determine whether to issue loans on build-to-suit or build out arrangements of existing borrower properties.

Construction loans are structured most often to be converted to permanent loans at the end of the construction phase or, infrequently, to be paid off upon receiving financing from another financial institution. Construction loans are generally limited to our local market area. Lending decisions have been based on the “as-is” and “prospective” appraised value of the property as determined by an independent

appraiser, an analysis of the potential marketability and profitability of the project and identification of a cash flow source to service the permanent loan or verification of a refinancing source. Construction loans generally have terms of 12 to 24 months, with extensions as needed. The Bank disburses loan proceeds in increments as construction progresses and as inspections warrant.

Development lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. Therefore, development lending generally involves more risk than other lending because it is based on future estimates of value and economic circumstances. While appraisals are required prior to funding, loan advances are limited to the lesser of the cost to complete or “prospective” value determined by the appraisal, therefore there is the possibility of an unforeseen event affecting the value and/or costs of the project. Development loans are primarily used for multi-family developments, where the leasing of units is tied to local demand and rental rates, and commercial developments, where the success of the project is tied to the demand for commercial space, cap rates and leasing rates. If the borrower defaults prior to completion of the project, we may be required to fund additional amounts so that another developer can complete the project. We are located in an area where a large amount of development activity has occurred as rural and semi-rural areas are being suburbanized. This type of growth presents some economic risks should local demand for commercial buildings and multi-family housing shift. We address these risks by closely monitoring local real estate activity, adhering to proper underwriting procedures, closely monitoring construction projects, and limiting the amount of construction development lending by project type and obligor.

Residential Real Estate Loans. Residential first mortgage loans and second mortgages are included in this category. First mortgage loans may include fixed rate loans that are generally sold to investors. We are a direct seller to the Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation (“FHLMC”) and to several large financial institutions. We retain servicing rights for mortgages sold to FNMA and FHLMC. The retention of such servicing rights is a source of noninterest income and also allows us an opportunity to have regular contact with mortgage customers and can help to solidify our community involvement. Other loans that are not sold include adjustable rate mortgages, lot loans, and construction loans that are held in our portfolio. Federal Housing Administration (“FHA”) and the Veterans Administration (“VA”) loans are sold to third party investors with servicing released. We experienced significant growth in residential mortgage purchase activity in 2020, as falling interest rates resulted in an increase in volume and mixture of both refinance and purchase financing opportunities.

Home Equity Lines of Credit. Our home equity lines of credit, or HELOCs, consist of originated as well as purchased HELOCs acquired in 2017 and 2018. We experienced a decline in our home equity lending in 2020, as HELOC payoffs were accelerated on both the organic and purchased portfolios held.

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

Competition

Our market area is highly competitive and our business activities require us to compete with many other financial institutions. A number of these financial institutions are affiliated with large bank holding companies headquartered outside of our principal market area as well as other institutions that are based in Aurora’s surrounding communities and in Chicago, Illinois. All of these financial institutions operate banking offices in the greater Chicago area or actively compete for customers within our market area. We also face competition from finance companies, insurance companies, credit unions, mortgage companies, securities brokerage firms, money market funds, loan production offices and other providers of financial services, including nontraditional financial technology companies or FinTech companies. Many of our nonbank competitors which are not subject to the same extensive federal regulations that govern bank holding companies and banks, such as the Company and the Bank, may have certain competitive advantages.

We compete for loans principally through the quality of our client service and our responsiveness to client needs in addition to competing on interest rates and loan fees. Management believes that our long-standing presence in the community and personal one-on-one service philosophy enhances our ability to compete favorably in attracting and retaining individual and business customers. We actively solicit deposit-related clients and compete for deposits by offering personal attention, competitive interest rates, and professional services made available through experienced bankers and multiple delivery channels that fit the needs of our market. In wealth management and trust services, we compete with a variety of custodial banks as well as a diverse group of investment managers.

We believe the financial services industry will likely continue to become more competitive as further technological advances enable more financial institutions to provide expanded financial services without having a physical presence in our market.

Human Capital Resources

Our business is relationship-driven, and we believe that our continued growth and future success will depend in large part on the quality of service provided by our employees. Accordingly, we seek to attract, develop and retain employees who can drive our financial and strategic growth objectives and build long-term stockholder value. We respect, value and invite diversity in our team members, customers, suppliers, marketplace, and community.

We seek to provide a compelling value proposition to our employees by providing market-competitive pay and benefits which include retirement programs, broad-based bonuses, health and welfare benefits, financial counseling, paid time off, family leave and flexible work schedules. We have also created internal programs to support employee development and retention, which has contributed to our long-term tenure rates, with the average length of service for our employees at over ten years, with 28% of our employees having at least 15 years of services, as of December 31, 2020. We believe that employee development and retention starts with relationships, both among employees and with the communities we serve. Our “O2 Cares Committee,” led by three members of our executive management team, provides oversight and direction to various subcommittees to ensure our corporate priorities of community outreach and employee support are achieved. These subcommittees include the Women’s Resource Group, Community Service Collaboration, Executive Spotlight, Employee Appreciation and Relationship Events. Each subcommittee has a specific mandate related to serving our communities, elevating our employees, building trust and relationships, and creating a culture of support and respect. In 2020, we also initiated a management development program that provided 40 employees with the opportunity to participate in a Management Development Workshop Series that included over ten hours of structured content curated to cover topics critical to management development. We believe these programs improve job satisfaction, retention and advancement.

The health, safety and well-being of our employees, customers and communities is a top priority. The COVID-19 pandemic presented challenges to maintain employee and customer safety, while continuing to be open for business. In March 2020, as part of our efforts to exercise social distancing, we closed all of our banking lobbies (other than by appointment) and conducted most of our business through drive-thru tellers and through electronic and online means. At this time, our lobbies have been reopened, but we continue to encourage customers to use electronic and online means to conduct their banking activity, and we are following social distancing and personal protective protocols as directed by the Center for Disease Control and Prevention. In addition, a significant percentage of our workforce has been working from home since mid-March 2020, and we expect this to continue through the second quarter of 2021, or until vaccines are widely available. In response to the pandemic, we are also monitoring employee morale and stress levels, developing new paid leave practices and providing personal protective equipment.

At December 31, 2020, we employed 533 full-time equivalent employees.

Available Information

We maintain a corporate website at <https://www.oldsecond.com>. We make available free of charge on or through our website the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission (the “SEC”). Many of our policies, committee charters and other investor information including our Code of Business Conduct and Ethics are available on our website. No information contained on our website is intended to be included as part of, or incorporated by reference into, this Annual Report on Form 10-K. The Company’s reports, proxy and informational statements and other information regarding the Company are also available free of charge on the SEC’s website (<https://www.sec.gov>). We will also provide copies of our filings free of charge upon written request to: Investor Relations, Old Second Bancorp, Inc., 37 South River Street, Aurora, Illinois 60507.

SUPERVISION AND REGULATION

General

FDIC-insured institutions, their holding companies and their affiliates, are extensively regulated under federal and state law. As a result, our growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Office of the Comptroller of the Currency (the “OCC”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Federal Deposit Insurance Corporation (the “FDIC”) and the Consumer Financial Protection Bureau (the “CFPB”). Furthermore, taxation laws administered by the Internal Revenue Service (the “IRS”) and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (“FASB”), securities laws administered by the Securities and Exchange Commission (the “SEC”) and state securities authorities, and anti-money laundering laws enforced by the U.S. Department of the Treasury (“Treasury”) have an impact on our business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to our operations and results.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of FDIC-insured institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than stockholders. These laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of our business, the kinds and amounts of investments we may make, reserve requirements, required capital levels relative to assets, the nature and amount of collateral for loans, the establishment of branches, our ability to merge, consolidate and acquire, dealings with our insiders and affiliates and our payment of dividends. We experienced heightened regulatory requirements and scrutiny following the 2008 global financial crisis, and as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). In addition, newer regulatory developments implemented in response to the COVID-19 pandemic, including the CARES Act and the Consolidated Appropriations Act, 2021, which enhanced and expanded certain provisions of the CARES Act, have had and will continue to have an impact on our operations.

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

The following is a summary of certain of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision. These statutes and regulations are subject to change, and additional statutes, regulations, and corresponding guidance may be adopted. We are unable to predict these future changes or the effects, if any, that these changes could have on our business, revenues, and results of operations.

Recent Regulatory Developments

The CARES Act and Initiatives Related to COVID-19. On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, was signed into law. The CARES Act provided for approximately \$2.2 trillion in direct economic relief in response to the public health and economic impacts of COVID-19. Many of the CARES Act's programs are, and remain, dependent upon the direct involvement of financial institutions like the Bank. These programs have been implemented through rules and guidance adopted by federal departments and agencies, including the U.S. Department of Treasury, the Federal Reserve and other federal bank regulatory authorities, including those with direct supervisory jurisdiction over the Company and the Bank. Furthermore, as the COVID-19 pandemic evolves, federal regulatory authorities continue to issue additional guidance with respect to the implementation, life cycle, and eligibility requirements for the various CARES Act programs, as well as industry-specific recovery procedures for COVID-19. In addition, it is possible that Congress will enact supplementary COVID-19 response legislation, including amendments to the CARES Act or new bills comparable in scope to the CARES Act. We continue to assess the impact of the CARES Act and other statutes, regulations and supervisory guidance related to the COVID-19 pandemic.

Paycheck Protection Program. A principal provision of the CARES Act amended the SBA's loan program to create a guaranteed, unsecured loan program, the Paycheck Protection Program, or PPP, to fund operational costs of eligible businesses, organizations and self-employed persons impacted by COVID-19. These loans are eligible to be forgiven if certain conditions are satisfied and are fully guaranteed by the SBA. Additionally, loan payments will also be deferred for the first six months of the loan term. The PPP commenced on April 3, 2020 and was available to qualified borrowers through August 8, 2020. No collateral or personal guarantees were required. On December 27, 2020, the President signed into law omnibus federal spending and economic stimulus legislation titled the "Consolidated Appropriations Act, 2021" that included the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (the "HHSB Act"). Among other things, the HHSB Act renewed the PPP, allocating \$284.45 billion for both new first time PPP loans under the existing PPP and the expansion of existing PPP loans for certain qualified, existing PPP borrowers. In addition to extending and amending the PPP, the HHSB Act also creates a new grant program for "shuttered venue operators." As a participating lender in the PPP, we continue to monitor legislative, regulatory, and supervisory developments related thereto, including the most recent changes implemented by the HHSB Act.

Troubled Debt Restructurings and Loan Modifications for Affected Borrowers. The CARES Act, as extended by certain provisions of the Consolidated Appropriations Act, 2021, permits banks to suspend requirements under GAAP for loan modifications to borrowers affected by COVID-19 that may otherwise be characterized as troubled debt restructurings and suspend any determination related thereto if (i) the borrower was not more than 30 days past due as of December 31, 2019, (ii) the modifications are related to COVID-19, and (iii) the modification occurs between March 1, 2020 and the earlier of 60 days after the date of termination of the national emergency or January 1, 2022. Federal bank regulatory authorities also issued guidance to encourage banks to make loan modifications for borrowers affected by COVID-19.

Main Street Lending Program. The CARES Act encouraged the Federal Reserve, in coordination with the Secretary of the Treasury, to establish or implement various programs to help mid-size businesses, nonprofit organizations, and municipalities. On April 9, 2020, the Federal Reserve proposed the creation of the Main Street Lending Program (the "MSLP") to implement certain of these recommendations. The MSLP supported lending to small- and medium-sized businesses that were in sound financial condition before the onset of the COVID-19 pandemic. The MSLP, which expired on January 8, 2021, operated through three facilities: the Main Street New Loan Facility, the Main Street Priority Loan Facility, and the Main Street Expanded Loan Facility. As of December 31, 2020, we had participated in the origination of two loans under the MSLP, which resulted in \$305,000 outstanding as of year end.

Regulatory Emphasis on Capital

Regulatory capital represents the net assets of a banking organization available to absorb losses. Because of the risks attendant to their business, FDIC-insured institutions are generally required to hold more capital than other businesses, which directly affects our earnings capabilities. While capital has historically been one of the key measures of the financial health of both bank holding companies and

banks, its role became fundamentally more important in the wake of the global financial crisis, as the banking regulators recognized that the amount and quality of capital held by banks prior to the crisis was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, establish strengthened capital standards for banks and bank holding companies that are meaningfully more stringent than those in place previously.

Basel III Capital Standards. Regulatory capital rules adopted in July 2013 and fully-phased in as of January 1, 2019, which we refer to as the Basel III rules or Basel III, impose minimum capital requirements for bank holding companies and banks. The Basel III rules apply to all national and state banks and savings and loan associations regardless of size and bank holding companies and savings and loan holding companies other than “small bank holding companies,” generally holding companies with consolidated assets of less than \$3 billion. The Company was considered a “small bank holding company” as of December 31, 2020. If we have total assets in excess of \$3.0 billion as of June 30, 2021, we will no longer be considered a small bank holding company in March of 2022. More stringent requirements are imposed on “advanced approaches” banking organizations which are organizations with \$250 billion or more in total consolidated assets, \$10 billion or more in total foreign exposures, or that have opted into the Basel III capital regime.

Specifically, the Bank (and the Company, if it is no longer a small bank holding company) is required to maintain the following minimum capital levels:

- a common equity Tier 1 (“CET1”), risk-based capital ratio of 4.5%;
- a Tier 1 risk-based capital ratio of 6%;
- a total risk-based capital ratio of 8%; and
- a leverage ratio of 4%.

Under Basel III, Tier 1 capital includes two components: CET1 capital and additional Tier 1 capital. The highest form of capital, CET1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, otherwise referred to as AOCI, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital is primarily comprised of noncumulative perpetual preferred stock, Tier 1 minority interests and grandfathered trust preferred securities (as discussed below). Tier 2 capital generally includes the allowance for loan losses up to 1.25% of risk-weighted assets, qualifying preferred stock, subordinated debt and qualifying tier 2 minority interests, less any deductions in Tier 2 instruments of an unconsolidated financial institution. Cumulative perpetual preferred stock is included only in Tier 2 capital, except that the Basel III rules permit bank holding companies with less than \$15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 Capital (but not in CET1 capital), subject to certain restrictions. AOCI is presumptively included in CET1 capital and often would operate to reduce this category of capital. When implemented, Basel III provided a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI. We made this opt-out election and, as a result, retained our pre-existing treatment for AOCI.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, under Basel III, a banking organization must maintain a “capital conservation buffer” on top of its minimum risk-based capital requirements. This buffer must consist solely of CET1 capital, but the buffer applies to all three risk-based measurements (CET1, Tier 1 capital and total capital). The 2.5% capital conservation buffer was phased in incrementally over time, and became fully effective for us on January 1, 2019, resulting in the following effective minimum capital plus capital conservation buffer ratios: (i) a CET1 capital ratio of 7.0%, (ii) a Tier 1 risk-based capital ratio of 8.5%, and (iii) a total risk-based capital ratio of 10.5%.

On December 21, 2018, the federal banking agencies issued a joint final rule to revise their regulatory capital rules to (i) address the upcoming implementation of a new credit impairment model, the Current Expected Credit Loss, or CECL model, an accounting standard under GAAP; (ii) provide an optional three-year phase-in period for the day-one adverse regulatory capital effects that banking organizations are expected to experience upon adopting CECL; and (iii) require the use of CECL in stress tests beginning with the 2020 capital planning and stress testing cycle for certain banking organizations that are subject to stress testing. As part of its response to the impact of the COVID-19 pandemic, in the first quarter of 2020, U.S. federal regulatory authorities issued an interim final rule that provides banking organizations that adopted CECL during the 2020 calendar year with the option to delay for two years the estimated impact of CECL on regulatory capital relative to regulatory capital determined under the prior incurred loss methodology, followed by a three-year transition period to phase out the aggregate amount of the capital benefit provided during the initial two-year delay (i.e., a five-year transition in total). In connection with our adoption of CECL on January 1, 2020, we elected to utilize the five-year CECL transition. The cumulative amount that is not recognized in regulatory capital, in addition to the \$3.8 million Day One impact of CECL adoption, will be phased in at 25% per year beginning January 1, 2022. As of December 31, 2020, the capital measures of the Company exclude \$5.7 million, which is the Day One impact to retained earnings, and 25% of the \$10.4 million increase, net of taxes, in the allowance for credit losses in the twelve months ended December 31, 2020, excluding purchased credit deteriorated loans.

In November 2019, the federal banking regulators published final rules implementing a simplified measure of capital adequacy for certain banking organizations that have less than \$10 billion in total consolidated assets. Under the final rules, which went into effect on January 1, 2020, depository institutions and depository institution holding companies that have less than \$10 billion in total consolidated assets and meet other qualifying criteria, including a leverage ratio of greater than 9%, off-balance-sheet exposures of 25% or less of total consolidated assets, and trading assets plus trading liabilities of 5% or less of total consolidated assets, are deemed “qualifying community banking organizations” and are eligible to opt into the “community bank leverage ratio framework.” A qualifying community banking organization that elects to use the community bank leverage ratio framework and that maintains a leverage ratio of greater than 9% is considered to have satisfied the generally applicable risk-based and leverage capital requirements under the Basel III rules and, if

applicable, is considered to have met the “well capitalized” ratio requirements for purposes of its primary federal regulator’s prompt corrective action rules, discussed below. The final rules include a two-quarter grace period during which a qualifying community banking organization that temporarily fails to meet any of the qualifying criteria, including the greater-than 9% leverage capital ratio requirement, is generally still deemed “well capitalized” so long as the banking organization maintains a leverage capital ratio greater than 8%. A banking organization that fails to maintain a leverage capital ratio greater than 8% is not permitted to use the grace period and must comply with the generally applicable requirements under the Basel III rules and file the appropriate regulatory reports. We do not have any immediate plans to elect to use the community bank leverage ratio framework but may make such an election in the future.

Well-Capitalized Requirements. The ratios described above are minimum standards in order for banking organizations to be considered “adequately capitalized.” Bank regulatory agencies uniformly encourage banks to hold more capital and be “well-capitalized” and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is well-capitalized may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept, roll-over or renew brokered deposits. Higher capital levels could also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve’s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 Capital less all intangible assets), well above the minimum levels.

Under the capital regulations of the OCC, in order to be well-capitalized, a banking organization must maintain:

- A CET1 ratio to risk-weighted assets of 6.5% or more;
- A ratio of Tier 1 Capital to total risk-weighted assets of 8%;
- A ratio of Total Capital to total risk-weighted assets of 10%; and
- A leverage ratio of Tier 1 Capital to total adjusted average quarterly assets of 5% or greater.

Effective with the March 31, 2020 Call Report, qualifying community banking organizations that elected to use the new community bank leverage ratio framework and that maintained a leverage ratio of greater than 9% were considered to have satisfied the risk-based and leverage capital requirements to be deemed well-capitalized.

It is possible under the Basel III Rule to be well-capitalized while remaining out of compliance with the capital conservation buffer discussed above.

As of December 31, 2020, the Bank was well-capitalized, as defined by OCC regulations. As of December 31, 2020, we had regulatory capital in excess of the Federal Reserve’s requirements and met the Basel III Rule requirements to be well-capitalized.

Prompt Corrective Action. An FDIC-insured institution’s capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators’ powers depends on whether the institution in question is “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized,” in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators’ corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution’s asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to sell itself; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

Regulation and Supervision of the Company

General. The Company, as the sole stockholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and subject to regulation, supervision and enforcement by, the Federal Reserve under the Bank Holding Company Act, as amended (the “BHCA”). The Company is legally obligated to act as a source of financial and managerial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve and is required to file with the Federal Reserve periodic reports of the Company’s operations and such additional information regarding the Company and the Bank as the Federal Reserve may require.

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its FDIC-insured institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years)

before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and examiners must rate them well-managed in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see “Regulatory Emphasis on Capital” above.

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

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

Under the Change in Bank Control Act, a person or company is required to file a notice with the Federal Reserve if it will, as a result of the transaction, own or control 10% or more of any class of voting securities or direct the management or policies of a bank or bank holding company and either if the bank or bank holding company has registered securities or if the acquirer would be the largest holder of that class of voting securities after the acquisition. For a change in control at the holding company level, both the Federal Reserve and the subsidiary bank’s primary federal regulator must approve the change in control; at the bank level, only the bank’s primary federal regulator is involved.

In addition, the BHCA prohibits any entity from acquiring 25% (5% if the acquirer is a bank holding company) or more of a bank holding company’s voting securities, or otherwise obtaining control or a controlling influence over the management or policies of a bank or bank holding company without regulatory approval. On January 30, 2020, the Federal Reserve issued a final rule (which became effective September 30, 2020) that clarified and codified the Federal Reserve’s standards for determining whether one company has control over another. The final rule established four categories of tiered presumptions of noncontrol that are based on the percentage of voting shares held by the investor (less than 5%, 5-9.9%, 10-14.9% and 15-24.9%) and the presence of other indicia of control. As the percentage of ownership increases, fewer indicia of control are permitted without falling outside of the presumption of noncontrol. These indicia of control include nonvoting equity ownership, director representation, management interlocks, business relationship and restrictive contractual covenants. Under the final rule, investors can hold up to 24.9% of the voting securities and up to 33% of the total equity of a company without necessarily having a controlling influence.

Capital Requirements. The Federal Reserve imposes certain capital requirements on a bank holding company under the BHCA, including a minimum leverage ratio and a minimum ratio of “qualifying” capital to risk-weighted assets. These requirements are essentially the same as those that apply to the Bank and are described above under “Regulatory Emphasis on Capital.” However, because the Company qualified as a small bank holding company at December 31, 2020, these capital requirements did not apply to the Company in 2020. Subject to certain restrictions, we are able to borrow money to make a capital contribution to the Bank, and these loans may be repaid from dividends paid from the Bank to the Company. Our ability to pay dividends depends on, among other things, the Bank’s ability to pay dividends to us, which is subject to regulatory restrictions as described below in “Regulation and Supervision of the Bank—Dividend Payments.” We are also able to raise capital for contribution to the Bank by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

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

As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer or significantly reduce dividends to stockholders if: (i) the company’s net income available to stockholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company’s capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. In addition, under the Basel III Rule, financial institutions that seek to pay dividends will have to maintain the 2.5% capital conservation buffer. See “Regulatory Emphasis on Capital – Basel III Capital Standards” above.

Incentive Compensation. There have been a number of developments in recent years focused on incentive compensation plans sponsored by bank holding companies and banks, reflecting recognition by the bank regulatory agencies and Congress that flawed incentive

compensation practices in the financial industry were one of many factors contributing to the global financial crisis. Layered on top of that are the abuses in the headlines dealing with product cross-selling incentive plans. The result is interagency guidance on sound incentive compensation practices and proposed rulemaking by the agencies required under Section 956 of the Dodd-Frank Act.

The interagency guidance recognized three core principles; effective incentive plans are required to: (i) provide employees incentives that appropriately balance risk and reward; (ii) be compatible with effective controls and risk-management; and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Much of the guidance addresses large banking organizations and, because of the size and complexity of their operations, the regulators expect those organizations to maintain systematic and formalized policies, procedures, and systems for ensuring that the incentive compensation arrangements for all executive and non-executive employees covered by this guidance are identified and reviewed, and appropriately balance risks and rewards. Smaller banking organizations like the Company that use incentive compensation arrangements are expected to be less extensive, formalized, and detailed than those of the larger banks.

Section 956 of the Dodd-Frank Act required the banking agencies, the National Credit Union Administration, the SEC and the Federal Housing Finance Agency to jointly prescribe regulations that prohibit types of incentive-based compensation that encourage inappropriate risk taking and to disclose certain information regarding such plans. On June 10, 2016, the agencies released an updated proposed rule for comment. Section 956 will only apply to banking organizations with assets of greater than \$1 billion. The Company has consolidated assets greater than \$1 billion and less than \$50 billion and the Company is considered a Level 3 banking organization under the proposed rules. The proposed rules contain mostly general principles and reporting requirements for Level 3 institutions so there are no specific prescriptions or limits, deferral requirements or claw-back mandates. Risk management and controls are required, as is board or committee level approval and oversight. No final rule has been issued yet.

Monetary Policy. The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on bank borrowings and changes in reserve requirements against bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

Federal Securities Regulation. The Company's common stock is registered with the SEC under the Exchange Act. Consequently, the Company is subject to the reporting, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

Corporate Governance. The Dodd-Frank Act addressed many investor protection, corporate governance and executive compensation matters that affect most U.S. publicly traded companies. The Dodd-Frank Act (i) grants stockholders of U.S. publicly traded companies an advisory vote on executive compensation and so-called "golden parachute" payments, (ii) enhances independence requirements for compensation committee members, (iii) requires the SEC to adopt rules directing national securities exchanges to establish listing standards requiring all listed companies to adopt incentive-based compensation clawback policies for executive officers, and (iv) provides the SEC with authority to adopt proxy access rules that would allow stockholders of publicly traded companies to nominate candidates for election as a director and have those nominees included in a company's proxy materials. The SEC has completed the bulk (although not all) of the rulemaking necessary to implement these provisions.

Regulation and Supervision of the Bank

General. The Bank is a national bank, chartered by the OCC under the National Bank Act. The deposit accounts of the Bank are insured by the FDIC's Deposit Insurance Fund (the "DIF") to the maximum extent provided under federal law and FDIC regulations, currently \$250,000 per insured depositor category, and the Bank is a member of the Federal Reserve System. As a national bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the OCC, the chartering authority for national banks. The FDIC, as administrator of the DIF, also has regulatory authority over the Bank.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. Effective July 1, 2016, the FDIC changed its pricing system for banks under \$10 billion, so that minimum and maximum initial base assessment rates are based on supervisory ratings. The initial base assessment rates currently range from three basis points to 30 basis points. At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, increases or decreases the assessment rates, following notice and comment on proposed rulemaking.

The assessment base against which an FDIC-insured institution's deposit insurance premiums paid to the DIF are calculated based on its average consolidated total assets less its average tangible equity. This method shifts the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits.

The reserve ratio is the DIF balance divided by estimated insured deposits. The Dodd-Frank Act altered the minimum reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to FDIC-insured institutions when the reserve ratio exceeds certain thresholds. The reserve ratio reached 1.36% on September 30, 2018. Because the reserve ratio has reached 1.35%, two deposit insurance assessment changes occurred under FDIC regulations: (1) surcharges on insured depository institutions with total consolidated assets of \$10 billion or more (large institutions) ceased; and (2) banks with assets of less than \$10 billion, such as us, received assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15% and 1.35%, which were applied when the reserve

ratio was at or above 1.38%. These assessment credits started with the June 30, 2019, assessment invoiced in September 2019 and were fully used by March 31, 2020.

Supervisory Assessments. National banks are required to pay supervisory assessments to the OCC to fund the operations of the OCC. The amount of the assessment is calculated using a formula that considers the Bank's size and its supervisory condition. During the year ended December 31, 2020, the Bank paid supervisory assessments to the OCC totaling \$423,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see "Regulatory Emphasis on Capital" above.

Liquidity Requirements. Liquidity is a measure of the ability and ease with which bank assets may be converted to cash. Liquid assets are those that can be converted to cash quickly if needed to meet financial obligations. To remain viable, FDIC-insured institutions must have enough liquid assets to meet their near-term obligations, such as withdrawals by depositors. Because the 2008 global financial crisis was in part a liquidity crisis, Basel III also includes a liquidity framework that requires FDIC-insured institutions to measure their liquidity against specific liquidity tests. One test, referred to as the Liquidity Coverage Ratio ("LCR"), is designed to ensure that the banking entity has an adequate stock of unencumbered high-quality liquid assets that can be converted easily and immediately in private markets into cash to meet liquidity needs for a 30-calendar day liquidity stress scenario. The other test, known as the Net Stable Funding Ratio ("NSFR") is designed to promote more medium and long-term funding of the assets and activities of FDIC-insured institutions over a one-year horizon. These tests provide an incentive for banks and holding companies to increase their holdings in Treasury securities and other sovereign debt as a component of assets, increase the use of long-term debt as a funding source and rely on stable funding like core deposits (in lieu of brokered deposits).

In addition to liquidity guidelines already in place, the federal bank regulatory agencies implemented the Basel III LCR in 2014 and have proposed the NSFR. While the LCR only applies to the largest banking organizations in the country, as will the NSFR, certain elements are expected to filter down to all FDIC-insured institutions. The Company has adopted a modified version of the LCR as a part of measuring the liquidity at the Bank. The Company has no plans to adopt the NSFR and has not received regulatory guidance indicating a requirement to do so.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under the National Bank Act, a national bank may pay dividends out of its undivided profits in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year that, in the aggregate, exceed the bank's year-to-date net income plus the bank's retained net income for the two preceding years. The payment of dividends by any FDIC-insured institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and an FDIC-insured institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its capital requirements under applicable guidelines as of December 31, 2020. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of dividends by the Bank if it determines such payment would constitute an unsafe or unsound practice. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends will have to maintain the 2.5% capital conservation buffer. See "Regulatory Emphasis on Capital" above.

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

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

On December 22, 2020, the federal banking agencies issued an interagency statement extending the temporary relief from enforcement action against banks or asset managers, which become principal stockholders of banks, with respect to certain extensions of credit by banks that otherwise would violate Regulation O, provided the asset managers and banks satisfy certain conditions designed to ensure that there is a lack of control by the asset manager over the bank. This temporary relief will apply until January 1, 2022, unless amended or extended, while the Federal Reserve, in consultation with the other federal banking agencies, considers whether to amend Regulation O.

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

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the FDIC-insured institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining

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

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the FDIC-insured institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal and reputational risk. In particular, recent regulatory pronouncements have focused on operational risk, which arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. New products and services, third-party risk and cybersecurity are critical sources of operational risk that FDIC-insured institutions are expected to address in the current environment. The Bank is expected to have active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls.

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

The Dodd-Frank Act permits well-capitalized and well-managed banks to establish new interstate branches or acquire individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) without impediments.

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

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of Chicago (the "FHLBC"), which serves as a central credit facility for its members. The FHLBC is funded primarily from proceeds from the sale of obligations of the FHLBC system. It makes loans to member banks in the form of FHLBC advances. All advances from the FHLBC are required to be fully collateralized as determined by the FHLBC.

Transaction Account Reserves. Federal Reserve regulations require FDIC-insured institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2020, the first \$16.9 million of otherwise reservable balances are exempt from reserves and have a zero percent reserve requirement; for transaction accounts aggregating more than \$16.9 million to \$127.5 million, the reserve requirement is 3% of total transaction accounts; and for net transaction accounts in excess of \$127.5 million, the reserve requirement is 3% up to \$127.5 million plus 10% of the aggregate amount of total transaction accounts in excess of \$127.5 million. These reserve requirements are subject to annual adjustment by the Federal Reserve.

Community Reinvestment Act Requirements. The Community Reinvestment Act requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank's effectiveness in meeting its Community Reinvestment Act requirements. The Bank received an overall "outstanding" rating on its most recent CRA performance evaluation.

On May 20, 2020, the OCC issued a final rule to "strengthen and modernize" its existing CRA framework. The rule is designed to increase CRA-related lending, investment and services in low- and moderate-income communities where there is a more significant need for credit and also a greater need to have access to banking services. The rule is effective October 1, 2020, and national banks must comply with the rule by October 1, 2020, January 1, 2023, or January 1, 2024, as applicable.

Anti-Money Laundering. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "Patriot Act") is designed to deny terrorists and criminals the ability to obtain access to the U.S. financial system and has significant implications for FDIC-insured institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act mandates financial services companies to have policies and procedures with respect to measures designed to address any or all of the following matters: (i) customer identification programs; (ii) money laundering; (iii) terrorist financing; (iv) identifying and reporting suspicious activities and currency transactions; (v) currency crimes; and (vi) cooperation between FDIC-insured institutions and law enforcement authorities. Bank regulators routinely examine institutions for compliance with these obligations, and this area has become a particular focus of the regulators in recent years. In addition, the regulators are required to consider compliance

in connection with the regulatory review of certain applications. In recent years, regulators have expressed concern over banking institutions' compliance with anti-money laundering requirements and, in some cases, have delayed approval of their expansionary proposals. The regulators and other governmental authorities have been active in imposing "cease and desist" orders and significant money penalty sanctions against institutions found to be in violation of the anti-money laundering regulations.

Concentrations in Commercial Real Estate. Concentration risk exists when FDIC-insured institutions deploy too many assets to any one industry or segment. A concentration in commercial real estate is one example of regulatory concern. The interagency Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices guidance ("CRE Guidance") provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) non-owner occupied commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. On December 18, 2015, the federal banking agencies issued a statement to reinforce prudent risk-management practices related to CRE lending, having observed substantial growth in many CRE asset and lending markets, increased competitive pressures, rising CRE concentrations in banks, and an easing of CRE underwriting standards. The federal bank agencies reminded FDIC-insured institutions to maintain underwriting discipline and exercise prudent risk-management practices to identify, measure, monitor, and manage the risks arising from CRE lending. In addition, FDIC-insured institutions must maintain capital commensurate with the level and nature of their CRE concentration risk.

Based on the Bank's loan portfolio as of December 31, 2020, concentrations in commercial real estate did not exceed the 300% guideline for non-owner occupied commercial real estate loans, or the 100% guideline for construction and development loans.

Financial Privacy and Cybersecurity. Under privacy protection provisions of the Gramm-Leach-Bliley Act of 1999 and related regulations, we are limited in our ability to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. Federal banking agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of the board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial services.

Consumer Protection Regulations. The activities of the Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The loan operations of the Bank are also subject to federal laws applicable to credit transactions, such as:

- the Truth-In-Lending Act ("TILA") and Regulation Z, governing disclosures of credit and servicing terms to consumer borrowers and including substantial new requirements for mortgage lending and servicing, as mandated by the Dodd-Frank Act;
- the Home Mortgage Disclosure Act of 1975 and Regulation C, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the communities they serve;
- the Equal Credit Opportunity Act and Regulation B, prohibiting discrimination on the basis of race, color, religion, or other prohibited factors in extending credit;
- the Fair Credit Reporting Act of 1978, as amended by the Fair and Accurate Credit Transactions Act and Regulation V, as well as the rules and regulations of the FDIC governing the use and provision of information to credit reporting agencies, certain identity theft protections and certain credit and other disclosures;
- the Fair Debt Collection Practices Act and Regulation F, governing the manner in which consumer debts may be collected by collection agencies; and
- the Real Estate Settlement Procedures Act and Regulation X, which governs aspects of the settlement process for residential mortgage loans.

The deposit operations of the Bank are also subject to federal laws, such as:

- the Federal Deposit Insurance Act (FDIA), which, among other things, limits the amount of deposit insurance available per insured depositor category to \$250,000 and imposes other limits on deposit-taking;
- the Right to Financial Privacy Act, which imposes a duty to maintain the confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- the Electronic Funds Transfer Act and Regulation E, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- the Truth in Savings Act and Regulation DD, which requires depository institutions to provide disclosures so that consumers can make meaningful comparisons about depository institutions and accounts.

The Consumer Financial Protection Bureau (the “CFPB”) is an independent regulatory authority housed within the Federal Reserve. The CFPB has broad authority to regulate the offering and provision of consumer financial products. The CFPB has the authority to supervise and examine depository institutions with more than \$10 billion in assets for compliance with federal consumer laws. The authority to supervise and examine depository institutions with \$10 billion or less in assets, such as the Bank, for compliance with federal consumer laws remains largely with those institutions’ primary regulators. However, the CFPB may participate in examinations of these smaller institutions on a “sampling basis” and may refer potential enforcement actions against such institutions to their primary regulators. As such, the CFPB may participate in examinations of the Bank.

The CFPB has issued a number of significant rules that impact nearly every aspect of the lifecycle of a residential mortgage loan. These rules implement Dodd-Frank Act amendments to the Equal Credit Opportunity Act, TILA and the Real Estate Settlement Procedures Act (“RESPA”). Among other things, the rules adopted by the CFPB require banks to: (i) develop and implement procedures to ensure compliance with a “reasonable ability-to-repay” test; (ii) implement new or revised disclosures, policies and procedures for originating and servicing mortgages, including, but not limited to, pre-loan counseling, early intervention with delinquent borrowers and specific loss mitigation procedures for loans secured by a borrower’s principal residence, and mortgage origination disclosures, which integrate existing requirements under TILA and RESPA; (iii) comply with additional restrictions on mortgage loan originator hiring and compensation; and (iv) comply with new disclosure requirements and standards for appraisals and certain financial products.

Bank regulators take into account compliance with consumer protection laws when considering approval of any proposed expansionary proposals.

Item 1A. Risk Factors

There are risks, many beyond our control, which could cause our results to differ significantly from management’s expectations. Some of these risk factors are described below. Any factor described in this Annual Report on Form 10-K could, by itself or together with one or more other factors, adversely affect our business, results of operations and/or financial condition. Additional risks and uncertainties not currently known to us or that we currently consider to not be material also may materially and adversely affect us. In assessing these risks, you should also refer to other information disclosed in our SEC filings, including the financial statements and notes thereto. The risks discussed below also include forward-looking statements, and actual results may differ substantially from those discussed or implied in these forward-looking statements.

COVID-19 and Economic-Related Risks

The global COVID-19 pandemic has adversely affected our business, financial condition and results of operations, and the ultimate effect of the pandemic on our business, financial condition and results of operations will depend on future developments and other factors that are highly uncertain.

The global COVID-19 pandemic and related government-imposed and other measures intended to control the spread of the disease, including restrictions on travel and the conduct of business, such as stay-at-home orders, quarantines, travel bans, border closings, business and school closures and other similar measures, have had a significant impact on global economic conditions and have negatively impacted certain aspects of our business, financial condition and results of operations, and may continue to do so in the future. The governmental and social response to the COVID-19 pandemic has resulted in an unprecedented slow-down in economic activity and a related increase in unemployment. The COVID-19 pandemic, and related efforts to contain it, have also caused significant disruptions in the functioning of the financial markets and have increased economic and market uncertainty and volatility.

Given the ongoing, dynamic and unprecedented nature of the COVID-19 pandemic, it is difficult to predict the full impact the pandemic will have on our business. While certain factors point to improving economic conditions, uncertainty remains regarding the path of the economic recovery, the mitigating impacts of government interventions, the success of vaccine distribution and the efficacy of administered vaccines, as well as the effects of the change in leadership resulting from the recent elections. The COVID-19 pandemic may subject us to any of the following risks, any of which could have a material adverse effect on our business, financial condition, liquidity, results of operations, risk-weighted assets and regulatory capital:

- because the incidence of reported COVID-19 cases and related hospitalizations and deaths varies significantly by state and locality, the economic downturn caused by the pandemic may be deeper and more sustained in certain areas, including those in which we do business, relative to other areas of the country;
- our ability to market our products and services may be impaired by a variety of external factors, including a prolonged reduction in economic activity and continued economic and financial market volatility, which could cause demand for our products and services to decline, in turn making it difficult for us to grow assets and income;
- if the economy is unable to substantially reopen and high levels of unemployment continue for an extended period of time, loan delinquencies, problem assets, and foreclosures may increase, resulting in increased charges and reduced income;
- collateral for loans, especially real estate, may decline in value, which may reduce our ability to liquidate such collateral and could cause loan losses to increase and impair our ability over the long run to maintain our targeted loan origination volume;
- our allowance for credit losses may have to be increased if borrowers experience financial difficulties beyond forbearance periods, which will adversely affect our net income;

- an increase in non-performing loans due to the COVID-19 pandemic would result in a corresponding increase in the risk-weighting of assets and therefore an increase in required regulatory capital;
- the net worth and liquidity of borrowers and loan guarantors may decline, impairing their ability to honor commitments to us;
- as the result of the reduction of the Federal Reserve’s target federal funds rate to near 0%, the yield on our assets may decline to a greater extent than the decline in our cost of interest-bearing liabilities, reducing our net interest margin and spread and reducing net income;
- deposits could decline if customers need to draw on available balances as a result of the economic downturn;
- a material decrease in net income or a net loss over several quarters could result in a decrease in the rate of our quarterly cash dividend;
- the borrowing needs of our clients may increase, especially during this challenging economic environment, which could result in increased borrowing against our contractual obligations to extend credit;
- we face heightened cybersecurity risk in connection with our operation of a remote working environment, which risks include, among others, greater phishing, malware, and other cybersecurity attacks, vulnerability to disruptions of our information technology infrastructure and telecommunications systems, increased risk of unauthorized dissemination of confidential information, limited ability to restore our systems in the event of a systems failure or interruption, greater risk of a security breach resulting in destruction or misuse of valuable information, and potential impairment of our ability to perform critical functions—all of which could expose us to risks of data or financial loss, litigation and liability and could seriously disrupt our operations and the operations of any impacted customers;
- we rely on third party vendors for certain services and the unavailability of a critical service or limitations on the business capacities of our vendors for extended periods of time due to the COVID-19 pandemic could have an adverse effect on our operations; and
- as a result of the COVID-19 pandemic, there may be unexpected developments in financial markets, legislation, regulations and consumer and customer behavior.

Even after the COVID-19 outbreak has subsided, we may continue to experience materially adverse impacts to our business as a result of the virus’s global economic impact, including the availability of credit, adverse impacts on our liquidity and any recession that has occurred or may occur in the future. There are no comparable recent events that provide guidance as to the effect the spread of COVID-19 as a global pandemic may have, and, as a result, the ultimate impact of the outbreak is highly uncertain and subject to change. We do not yet know the full extent of the impacts on our business, our operations or the global economy as a whole. However, the effects could have a material impact on our results of operations and heighten many of our known risks described herein.

The COVID-19 pandemic has resulted in a higher allowance for credit losses (“ACL”) determined in accordance with the Current Expected Credit Loss, or CECL standard, and may result in increased volatility and further increases in our allowance for credit losses.

The measure of our ACL is dependent on the adoption and interpretation of applicable accounting standards. The Financial Accounting Standards Board issued a new credit impairment model, the Current Expected Credit Loss, or CECL standard, which has become effective and was adopted by us in the first quarter of 2020. Under the CECL model, we are required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount and certain management judgments over the life of the loan. This initial measurement took place as of January 1, 2020, at the time of our adoption of CECL, and measurements occurred periodically thereafter. The adoption of the CECL model has materially affected how we determine our ACL and, combined with the effects of the COVID-19 pandemic, required us to significantly increase our allowance during 2020. As of the date of adoption, the allowance for credit losses on loans increased \$5.9 million, and the allowance for unfunded commitments increased by approximately \$1.7 million, resulting in a corresponding \$2.5 million increase to loans for the reclassified credit-related component of purchase credit deteriorated (“PCD”) loans and a \$3.8 million decrease in retained earnings, net of an adjustment to deferred tax assets of \$1.4 million. Provision expense of \$10.4 million was recorded during 2020, comprised of \$9.2 million for the provision for credit losses on loans, and \$1.2 million for the provision for credit losses on unfunded commitments.

The CECL model is anticipated to create more volatility in the level of our ACL, as compared to the “incurred loss” standard that we previously applied prior to 2020 in determining our allowance. The CECL model requires us to estimate the lifetime “expected credit loss” with respect to loans and other applicable financial assets, which may change more rapidly than the level of “incurred losses” that would have been used to determine our allowance for loan losses under the prior incurred loss standard. The potentially material effects of the COVID-19 pandemic on lifetime expected credit loss, and the challenges associated with estimating lifetime credit losses in view of the uncertain ultimate impacts of the pandemic, may result in increased volatility and significant additions to our ACL in the future, which could have a material and adverse effect on our business, financial condition and results of operations.

Our business may be adversely affected by economic conditions.

Our financial performance generally, and in particular, the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer and whose success we rely on to drive our growth, is highly dependent upon the business environment in the primary markets where we operate and in the

United States as a whole. Unlike larger financial institutions that are more geographically diversified, our banking franchise is concentrated in Aurora, Illinois, and its surrounding communities, as well as Cook County. The city of Aurora is located in northeastern Illinois, approximately 40 miles west of Chicago. In addition, the State of Illinois continues to experience severe fiscal challenges, which could result in future state tax increases, impact the economic vitality of the businesses operating in Illinois, encourage businesses to leave the state or discourage new employers to start or move businesses to Illinois, all of which could have a material adverse effect on our financial condition and results of operations.

Unfavorable market conditions can result in a deterioration in the credit quality of our borrowers and the demand for our products and services, an increase in the number of loan delinquencies, defaults and charge-offs, foreclosures, additional provisions for loan losses, adverse asset values of the collateral securing our loans and an overall material adverse effect on the quality of our loan portfolio, and a reduction in assets under management or administration. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability of or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; epidemics and pandemics (such as COVID-19); state or local government insolvency; or a combination of these or other factors.

The impact of the COVID-19 pandemic is fluid and continues to evolve and there is pervasive uncertainty surrounding the future economic conditions that will emerge in the months and years following the onset of the pandemic. Even after the COVID-19 pandemic subsides, the U.S. economy will likely require some time to recover from its effects, the length of which is unknown, and during which we may experience a recession. In addition, there are continuing concerns related to, among other things, the level of U.S. government debt and fiscal actions that may be taken to address that debt, depressed oil prices and a potential resurgence of economic and political tensions with China that may have a destabilizing effect on financial markets and economic activity. Economic pressure on consumers and overall economic uncertainty may result in changes in consumer and business spending, borrowing and saving habits. These economic conditions and/or other negative developments in the domestic or international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate values and sales volumes and high unemployment or underemployment may also result in higher than expected loan delinquencies, increases in our levels of nonperforming and classified assets and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity and financial condition.

Our trust and wealth management business may be negatively impacted by changes in economic and market conditions and clients may seek legal remedies for investment performance.

Our trust and wealth management business may be negatively impacted by changes in general economic and market conditions because the performance of this businesses is directly affected by conditions in the financial and securities markets. The financial markets and businesses operating in the securities industry are highly volatile (meaning that performance results can vary greatly within short periods of time) and are directly affected by, among other factors, domestic and foreign economic conditions and general trends in business and finance, and by the threat, as well as the occurrence of global conflicts, all of which are beyond our control. We cannot assure you that broad market performance will be favorable in the future. Declines in the financial markets or a lack of sustained growth may result in a decline in the performance of our wealth management business and may adversely affect the market value and performance of the investment securities that we manage, which could lead to reductions in our wealth management fees, because they are based primarily on the market value of the securities we manage, and could lead some of our clients to reduce their assets under management by us or seek legal remedies for investment performance. If any of these events occur, the financial performance of our wealth management business could be materially and adversely affected.

Credit and Interest Rate Risks

If we fail to effectively manage credit risk, our business and financial condition will suffer.

We must effectively manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their original contractual terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. This risk has been and may be further exacerbated by the effects of the COVID-19 pandemic. In addition, there are risks inherent in making any loan, including risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers, including the risk that a borrower may not provide information to us about its business in a timely manner, and/or may present inaccurate or incomplete information to us, and risks relating to the value of collateral. In order to manage credit risk successfully, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our lenders follow those standards. The weakening of these standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we significantly increase our allowance for credit losses, each of which could adversely affect our net income. Our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition or results of operations.

Our allowance for credit losses, or ACL, and fair value adjustments with respect to acquired loans, may be insufficient to absorb potential losses in our loan portfolio, which may adversely affect our business, financial condition and results of operations.

Our success depends significantly on the quality of our assets, particularly loans. Like other financial institutions, we are exposed to the risk that our borrowers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs to dispose of the collateral. As a result, we may experience significant loan, lease or commitment credit losses that may have a material adverse effect on our operating results and financial condition.

We maintain an ACL at a level we believe is adequate to absorb estimated credit losses that are expected to occur within the existing loan portfolio through their contractual terms. The level of the ACL is inherently subjective and is dependent upon a variety of factors beyond our control, including, but not limited to, the performance of the loan portfolio, consideration of current economic trends, changes in interest rates and property values, estimated losses on pools of homogeneous loans based on an analysis that uses historical loss experience for prior periods that are determined to have like characteristics with management's economic forecast period, such as pre-recessionary, recessionary, or recovery periods, portfolio growth and concentration risk, management and staffing changes, the interpretation of loan risk classifications by regulatory authorities and other credit market factors. We expect economic uncertainty to continue into 2021, which may result in a significant increase to our ACL in future periods. In addition, bank regulatory agencies periodically review our ACL and may require an increase in the provision for credit losses or the recognition of additional loan charge-offs, based on judgments different from those of management. If charge-offs in future periods exceed the ACL, we will need additional provisions to increase the allowance. Any increases in the ACL will result in a decrease in net income and capital and may have a material adverse effect on our financial condition and results of operations. We may be required to make significant increases in the provision for credit losses and to charge-off additional loans in the future.

The application of the purchase method of accounting in any future acquisitions will impact our ACL. Under the purchase method of accounting, all acquired loans are recorded in our consolidated financial statements at their estimated fair value at the time of acquisition and any related ACL is eliminated because credit quality, among other factors, is considered in the determination of fair value. To the extent that our estimates of fair value are too high, we will incur losses associated with the acquired loans.

Our loan portfolio is concentrated heavily in commercial and residential real estate loans, including exposure to construction loans, which involve risks specific to real estate values and the real estate markets in general.

Our loan portfolio generally reflects the profile of the communities in which we operate. Because we operate in areas that saw rapid historical growth, real estate lending of all types is a significant portion of our loan portfolio. Total real estate lending was \$1.48 billion, or approximately 72.5%, of our loan portfolio at December 31, 2020, compared to \$1.46 billion, or approximately 75.4%, at December 31, 2019. Given that the primary (if not only) source of collateral on these loans is real estate, adverse developments affecting real estate values in our market area could increase the credit risk associated with our real estate loan portfolio.

In addition, with respect to commercial real estate loans, the banking regulators are examining commercial real estate lending activity with greater scrutiny, and may require banks with higher levels of commercial real estate loans to implement improved underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly higher levels of allowances for credit losses and capital levels as a result of commercial real estate lending growth and exposures. At December 31, 2020, our outstanding commercial real estate loans, including owner occupied real estate, and undrawn commercial real estate commitments were equal to 274.1% of our Tier 1 capital plus allowance for loan and lease losses, which is under our policy limit and regulatory guidance of 300%. If our regulators require us to maintain higher levels of capital than we would otherwise be expected to maintain, this could limit our ability to leverage our capital and have a material adverse effect on our business, financial condition, results of operations and prospects.

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

Many of our nonperforming real estate loans are collateral-dependent, meaning the repayment of the loan is largely dependent upon the value of the property securing the loan and the borrower's ability to refinance, recapitalize or sell the property. For collateral-dependent loans, we estimate the value of the loan based on the appraised value of the underlying collateral less costs to sell. Our OREO portfolio essentially consists of properties acquired through foreclosure or deed in lieu of foreclosure in partial or total satisfaction of certain loans as a result of borrower defaults. Some property in OREO reflects property formerly utilized as a bank premise or land that was acquired with the expectation that a bank premise would be established at the location. In some cases, the market for such properties has been significantly depressed, and we have been unable to sell them at prices or within timeframes that we deem acceptable. OREO is recorded at the fair value of the property when acquired, less estimated selling costs. In determining the value of OREO properties and loan collateral, an orderly disposition of the property is generally assumed. Significant judgment is required in estimating the fair value of property, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility. In response to market conditions and other economic factors, we may utilize alternative sale strategies other than orderly disposition as part of our OREO disposition strategy, such as immediate liquidation sales. In this event, as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from

such sales transactions could differ significantly from appraisals, comparable sales and other estimates used to determine the fair value of our OREO properties.

We are subject to interest rate risk, and a change in interest rates could have a negative effect on our net income.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions, our competition and policies of various governmental and regulatory agencies, particularly the Federal Reserve. Changes in monetary policy could influence our earnings. When interest-bearing liabilities mature or reprice more quickly, or to a greater degree than interest-earning assets in a period, an increase in interest rates could reduce net interest income. Similarly, when interest-earning assets mature or reprice more quickly, or to a greater degree than interest-bearing liabilities, falling interest rates could reduce net interest income. Additionally, an increase in the general level of interest rates may also, among other things, adversely affect our current borrowers' ability to repay variable rate loans, the demand for loans and our ability to originate loans and decrease loan prepayment rates. Conversely, a decrease in the general level of interest rates, among other things, may lead to increased prepayments on our loan and mortgage-backed securities portfolios and increased competition for deposits. Accordingly, changes in the general level of market interest rates may adversely affect our net yield on interest-earning assets, loan origination volume and our overall results.

In response to the COVID-19 pandemic, the FOMC cut short-term interest rates to a record low range of 0% to 0.25%, and the Federal Reserve has indicated it expects rates to remain within this range through 2023 and possibly longer. If short-term interest rates continue to remain at their historically low levels for a prolonged period and assuming longer-term interest rates fall further, we could experience net interest margin compression as our interest-earning assets would continue to reprice downward while our interest-bearing liability rates could fail to decline in tandem, which would have an adverse effect on our net interest income and could have an adverse effect on our business, financial condition and results of operations. Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on our results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations.

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

Our nonperforming loans (which consist of nonaccrual loans, loans past due 90 days or more still accruing interest and restructured loans still accruing interest), were \$23.0 million at December 31, 2020, an increase of 45.4%, compared to \$15.8 million at December 31, 2019. Other real estate owned, or OREO, totaled \$2.5 million at December 31, 2020, a decreased of 50.6%, compared to \$5.0 million at December 31, 2019. In 2019, we did not consider our purchased credit impaired loans, or PCI loans, to be nonperforming assets as long as their cash flows and the timing of such cash flows continue to be estimable and probable of collection, because we recognized interest income on these loans through accretion of the difference between the carrying value of these loans and the present value of expected future cash flows. As a result, management excluded PCI loans from nonperforming assets for 2019. After the adoption of CECL as of January 1, 2020, the credit adjustment outstanding on PCI loans was reclassified to the allowance for credit losses, and PCI loans became purchase credit deteriorated, or PCD loans; all PCD loans are now included within each relevant loan type and are not separately reported as PCI loans, because such loans are now included within the Company's nonperforming loan disclosures, if such loans otherwise meet the definition of a nonperforming loan.

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

Operational Risks

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values: being an integral part of the communities we serve; delivering superior service to our customers; and caring about our customers and associates. Damage to our reputation could undermine the confidence of our current and potential clients in our ability to provide financial services. Such damage could also impair the confidence of our counterparties and business partners, and ultimately affect our ability to effect transactions. Maintenance of our reputation depends not only on our success in maintaining our core values and controlling and mitigating the various risks described herein, but also on our success in identifying and appropriately addressing issues that may arise in areas such as potential conflicts of interest, anti-money laundering, client personal information and privacy issues, record-keeping, regulatory investigations and any litigation that may arise from the failure or perceived failure of us to comply with legal and regulatory requirements. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and,

therefore, our operating results may be materially adversely affected. Further, negative public opinion can expose us to litigation and regulatory action as we seek to implement our growth strategy, which could adversely affect our business, financial condition and results of operations.

We operate in a highly competitive industry and market area and may face severe competitive disadvantages.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and have more financial resources. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, other financial service businesses, including investment advisory and wealth management firms, mutual fund companies, and securities brokerage and investment banking firms, as well as super-regional, national and international financial institutions that operate offices in our primary market areas and elsewhere. Local competitors continue to expand their presence in the western suburbs of Chicago, including the communities that surround Aurora, Illinois, and these competitors may be better positioned than us to compete for loans, acquisitions and personnel. As customers' preferences and expectations continue to evolve, technology has lowered barriers to entry and made it possible for banks to expand their geographic reach by providing services over the Internet and for non-banks to offer products and services traditionally provided by banks, such as business and consumer lending, automatic transfer and automatic payment systems. There has also been significant advancement in the exchange of digital assets ("cryptocurrency") that could materially impact the financial services industry in the future. Because of this rapidly changing technology, our future success will depend in part on our ability to address our customers' needs by using technology. Customer loyalty can be easily influenced by a competitor's new products, especially offerings that could provide cost savings or a higher return to the customer. Moreover, the financial services industry could become even more competitive as a result of legislative and regulatory changes, and many large scale competitors can leverage economies of scale to offer better pricing for products and services compared to what we can offer.

We compete with these institutions in attracting deposits and assets under management, processing payment transactions, and in making loans. We may not be able to compete successfully with other financial institutions in our markets, particularly with larger financial institutions operating in our markets that have significantly greater resources than us and offer financial products and services that we are unable to offer, putting us at a disadvantage in competing with them for loans and deposits and wealth management clients, and we may have to pay higher interest rates to attract deposits, accept lower yields on loans to attract loans and pay higher wages for new employees, resulting in lower net interest margin and reduced profitability. In addition, competitors that are not depository institutions are generally not subject to the extensive regulations that apply to us. If we are unable to compete effectively with those banking or other financial services businesses, we could find it more difficult to attract new and retain existing clients and our net interest margin, net interest income and wealth management fees could decline, which would adversely affect our results of operations and could cause us to incur losses in the future.

In addition, our ability to successfully attract and retain wealth management clients is dependent on our ability to compete with competitors' investment products, level of investment performance, client services and marketing and distribution capabilities. If we are not successful in attracting new and retaining existing clients, our business, financial condition, results of operations and prospects may be materially and adversely affected.

We depend on our executive officers and other key employees, and our ability to attract additional key personnel, to continue the implementation of our long-term business strategy, and we could be harmed by the unexpected loss of their services.

We believe that our continued growth and future success will depend in large part on the skills of our executive officers and other key employees and our ability to motivate and retain these individuals, as well as our ability to attract, motivate and retain highly qualified senior and middle management and other skilled employees. Our business is primarily relationship-driven in that many of our key personnel have extensive customer or asset management relationships. Loss of key personnel with such relationships may lead to the loss of business if the customers were to follow that employee to a competitor or if asset management expertise was not replaced in a timely manner. Competition for employees is intense, and the process of locating key personnel with the combination of skills and attributes required to execute our business strategy may be lengthy. We may not be successful in retaining key personnel, and the unexpected loss of services of one or more of our key personnel could have a material adverse effect on our business because of their skill, knowledge of our primary markets, years of industry experience and the difficulty of promptly finding qualified replacement personnel. If the services of any of our key personnel should become unavailable for any reason, we may not be able to identify and hire qualified persons on terms acceptable to the Company, or at all, which could have a material adverse effect on our business, financial condition, results of operation and future prospects.

If we are unable to offer our key management personnel long-term incentive compensation, including options, restricted stock, and restricted stock units, as part of their total compensation package, we may have difficulty retaining such personnel, which would adversely affect our operations and financial performance.

We have historically granted equity awards, including restricted stock units and stock options, to key management personnel as part of a competitive compensation package. Our ability to grant equity compensation awards as a part of our total compensation package has been vital to attracting, retaining and aligning stockholder interest with a talented management team in a highly competitive marketplace.

In the future, we may seek stockholder approval to adopt or amend equity compensation plans so that we may issue additional equity awards to management in order for the equity component of our compensation packages to remain competitive in the industry. Stockholder advisory groups have implemented guidelines and issued voting recommendations related to how much equity companies should be able to grant to employees. These advisors influence certain shareholder votes regarding approval of a company's request for approval of new equity compensation plans. The factors used to formulate these guidelines and voting recommendations include the volatility of a company's share price and are influenced by broader macro-economic conditions that can change year to year. The variables used by stockholder advisory groups to formulate equity plan recommendations may limit our ability to obtain approval to adopt or amend equity plans in the future. If we are limited in our ability to grant equity compensation awards, we would need to explore offering other compelling alternatives to supplement our compensation, including long-term cash compensation plans or significantly increased short-term cash compensation, in order to continue to attract and retain key management personnel. If we used these alternatives to long-term equity awards, our compensation costs could increase and our financial performance could be adversely affected. If we are unable to offer key management personnel long-term incentive compensation, including stock options, restricted stock or restricted stock units, as part of their total compensation package, we may have difficulty attracting and retaining such personnel, which would adversely affect our operations and financial performance.

We depend on outside third parties for the processing and handling of our records and data.

We rely on software developed by third party vendors to process various Company transactions. In some cases, we have contracted with third parties to run their proprietary software on our behalf at a location under the control of the third party. These systems include, but are not limited to, core data processing, payroll, loan origination, wealth management record keeping, and securities portfolio management. While we perform a review of controls instituted by the vendor over these programs in accordance with industry standards and institute our own user controls, we must rely on the continued maintenance of the performance controls by these outside parties, including safeguards over the security of customer data. In addition, we create backup copies of key processing output daily in the event of a failure on the part of any of these systems. Nonetheless, we may incur a temporary disruption in our ability to conduct our business or process our transactions, or incur damage to our reputation if a third-party vendor fails to adequately maintain internal controls or institute necessary changes to systems. A disruption or breach of security may ultimately have a material adverse effect on our financial condition and results of operations.

Our use of third party vendors and our other ongoing third party business relationships are subject to regulatory requirements and attention.

We regularly use third party vendors as part of our business. We also have substantial ongoing business relationships with other third parties. These types of third party relationships are subject to demanding regulatory requirements and attention by our federal bank regulators. Recent regulation requires us to enhance our due diligence, risk assessment, ongoing monitoring and control over our third party vendors and other ongoing third party business relationships. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third party relationships and in the performance of the parties with which we have these relationships. As a result, if our regulators conclude that we have not exercised adequate oversight and control over our third party vendors or other ongoing third party business relationships or that such third parties have not performed appropriately, we could be subject to enforcement actions, including civil money penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation, any of which could have a material adverse effect our business, financial condition or results of operations.

We are at risk of increased losses from fraud.

Criminals committing fraud increasingly are using more sophisticated techniques and in some cases are part of larger criminal rings, which allow them to be more effective. The fraudulent activity has taken many forms, ranging from check fraud, mechanical devices attached to ATMs, social engineering and phishing attacks to obtain personal information or impersonation of our clients through the use of falsified or stolen credentials. Additionally, an individual or business entity may properly identify themselves, particularly when banking online, yet seek to establish a business relationship for the purpose of perpetrating fraud. Further, in addition to fraud committed against us, we may suffer losses as a result of fraudulent activity committed against third parties. Increased deployment of technologies, such as chip card technology, defray and reduce aspects of fraud; however, criminals are turning to other sources to steal personally identifiable information, such as unaffiliated healthcare providers and government entities, in order to impersonate the consumer to commit fraud. Many of these data compromises are widely reported in the media. Further, as a result of the increased sophistication of fraud activity, we have increased our spending on systems and controls to detect and prevent fraud. This will result in continued ongoing investments in the future.

Privacy and Technology-Related Risks

Failure to keep pace with technological change could adversely affect our business.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our

operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business, financial condition and results of operations.

Our information systems may experience an interruption or breach in security and cyber-attacks, all of which could have a material adverse effect on our business.

We rely heavily on internal and outsourced technologies, communications, and information systems to conduct our business. Additionally, in the normal course of business, we collect, process and retain sensitive and confidential information regarding our customers. As our reliance on technology has increased, so have the potential risks of a technology-related operation interruption (such as disruptions in our customer relationship management, general ledger, deposit, loan, or other systems) or the occurrence of a cyber-attack (such as unauthorized access to our systems). These risks have increased for all financial institutions as new technologies have emerged, including the use of the Internet and the expansion of telecommunications technologies (including mobile devices) to conduct financial and other business transactions, and as the sophistication of organized criminals, perpetrators of fraud, hackers, terrorists and others have increased.

In addition to cyber-attacks or other security breaches involving the theft of sensitive and confidential information, hackers have engaged in attacks against large financial institutions, particularly denial of service attacks that are designed to disrupt key business services, such as customer-facing web sites. We operate in an industry where otherwise effective preventive measures against security breaches become vulnerable as breach strategies change frequently and cyber-attacks can originate from a wide variety of sources. It is possible that a cyber-incident, such as a security breach, may be undetected for a period of time. However, applying guidance from the Federal Financial Institutions Examination Council, we have identified security risks and employ risk mitigation controls. Following a layered security approach, we have analyzed and will continue to analyze security related to device specific considerations, user access topics, transaction-processing and network integrity. We expect that we will spend additional time and will incur additional costs going forward to modify and enhance protective measures and that effort and spending will continue to be required to investigate and remediate any information security vulnerabilities.

We also face risks related to cyber-attacks and other security breaches in connection with credit card and debit card transactions that typically involve the transmission of sensitive information regarding our customers through various third parties, including merchant-acquiring banks, payment processors, payment card networks and their processors. Some of these parties have in the past been the target of security breaches and cyber-attacks. Because these third parties and related environments such as the point-of-sale are not under our direct control, future security breaches or cyber-attacks affecting any of these third parties could impact us and in some cases we may have exposure and suffer losses for breaches or attacks. We offer our customers protection against fraud and attendant losses for unauthorized use of debit cards in order to stay competitive in the marketplace. Offering such protection exposes us to potential losses which, in the event of a data breach at one or more retailers of considerable magnitude, may adversely affect our business, financial condition, and results of operation. Further cyber-attacks or other breaches in the future, whether affecting us or others, could intensify consumer concern and regulatory focus and result in reduced use of payment cards and increased costs, all of which could have a material adverse effect on our business. To the extent we are involved in any future cyber-attacks or other breaches, our reputation could be affected which may have a material adverse effect on our business, financial condition or results of operations.

Growth and Strategic Risks

We may not be able to implement our growth strategy or manage costs effectively, resulting in lower earnings or profitability.

There can be no assurance that we will be able to continue to grow and to be profitable in future periods, or, if profitable, that our overall earnings will remain consistent or increase in the future. Our strategy is focused on organic growth, supplemented by opportunistic acquisitions, such as our acquisition of ABC Bank. Our growth requires that we increase our loans and deposits while managing risks by following prudent loan underwriting standards without increasing interest rate risk or compressing our net interest margin, maintaining more than adequate capital and liquidity levels at all times, hiring and retaining qualified employees and successfully implementing strategic projects and initiatives. Even if we are able to increase our interest income, our earnings may nonetheless be reduced by increased expenses, such as additional employee compensation or other general and administrative expenses and increased interest expense on any liabilities incurred or deposits solicited to fund increases in assets. Additionally, if our competitors extend credit on terms we find to pose excessive risks, or at interest rates which we believe do not warrant the credit exposure, we may not be able to maintain our lending volume and could experience deteriorating financial performance. Our inability to manage our growth successfully or to continue to expand into new markets could have a material adverse effect on our business, financial condition or results of operations.

Our strategic growth plans contemplate additional organic growth and potential growth through additional mergers and acquisitions, which exposes us to additional risks.

Our strategic growth plans include organic growth and growth through additional mergers and acquisitions. To the extent that we are unable to increase loans through organic loan growth, or to identify and consummate attractive acquisitions, we may be unable to successfully implement our growth strategy, which could materially and adversely affect our financial condition and earnings.

We routinely evaluate opportunities to acquire additional financial institutions or branches or to open new branches. As a result, we regularly engage in discussions or negotiations that, if they were to result in a transaction, could have a material effect on our operating results and financial condition, including short- and long-term liquidity. Our merger and acquisition activities could be material and could require us to use a substantial amount of common stock, cash, other liquid assets, and/or incur debt. In addition, if goodwill recorded in connection with our prior or potential future acquisitions were determined to be impaired, then we would be required to recognize a charge against our earnings, which could materially and adversely affect our results of operations during the period in which the impairment was recognized. Moreover, these types of expansions involve various risks, including:

Management of Growth. We may be unable to successfully:

- maintain loan quality in the context of significant loan growth;
- identify and expand into suitable markets;
- obtain regulatory and other approvals necessary to consummate mergers, acquisitions or other expansion activities, or regulatory approvals may be delayed, impeded, or conditioned due to existing or new regulatory issues surrounding us, the target institution or the proposed combined entity as a result of, among other things, issues related to anti-money laundering/Bank Secrecy Act compliance, fair lending laws, fair housing laws, consumer protection laws, unfair, deceptive or abusive acts or practices regulations, or the Community Reinvestment Act;
- retain employees and customers of the Company or the businesses that we acquire or merge with;
- attract sufficient deposits and capital to fund anticipated loan growth;
- maintain adequate common equity and regulatory capital;
- avoid diversion or disruption of our management and existing operations as well as those of the acquired or merged institution;
- maintain adequate management personnel and systems to oversee such growth;
- maintain adequate internal audit, risk management, loan review and compliance functions; and
- implement additional policies, procedures and operating systems required to support such growth.

Operating Results. There is no assurance that existing branches or future branches will maintain or achieve deposit levels, loan balances or other operating results necessary to avoid losses or produce profits. Our growth may entail an increase in overhead expenses as we add new branches and staff. There are considerable costs involved in opening branches, and new branches generally do not generate sufficient revenues to offset their costs until they have been in operation for at least a year or more. Accordingly, any new branches we establish can be expected to negatively impact our earnings for some period of time until they reach certain economies of scale. Our historical results may not be indicative of future results or results that may be achieved, particularly if we continue to expand. Failure to successfully address these and other issues related to our expansion could have a material adverse effect on our business, financial condition and results of operations, including short-term and long-term liquidity, and could adversely affect our ability to successfully implement our business strategy.

We may be exposed to difficulties in combining the operations of acquired or merged businesses into our own operations, which may prevent us from achieving the expected benefits from our merger and acquisition activities.

We may not be able to fully achieve the strategic objectives and operating efficiencies that we anticipate in our merger and acquisition activities. Inherent uncertainties exist in integrating the operations of an acquired or merged business. We may lose our customers or the customers of acquired or merged entities as a result of an acquisition. We may also lose key personnel from the acquired entity as a result of an acquisition. We may not discover all known and unknown factors when examining a company for acquisition or merger during the due diligence period. These factors could produce unintended and unexpected consequences for us. Undiscovered factors as a result of an acquisition or merger could bring civil, criminal, and financial liabilities against us, our management, and the management of those entities we acquire or merge with. In addition, if difficulties arise with respect to the integration process, the economic benefits expected to result from acquisitions and mergers might not occur. Failure to successfully integrate businesses that we acquire or merge with could have an adverse effect on our profitability, return on equity, return on assets, or our ability to implement our strategy, any of which in turn could have a material adverse effect on our business, financial condition and results of operations. These factors could contribute to our not achieving the expected benefits from our mergers and acquisitions within desired time frames, if at all.

New lines of business, products, product enhancements or services may subject us to additional risks.

From time to time, we may implement new lines of business or offer new products, and product enhancements as well as new services within our existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances

in which the markets are not fully developed. In implementing, developing or marketing new lines of business, products, product enhancements or services, we may invest significant time and resources, although we may not assign the appropriate level of resources or expertise necessary to make these new lines of business, products, product enhancements or services successful or to realize their expected benefits. Further, initial timetables for the introduction and development of new lines of business, products, product enhancements or services may not be achieved, and price and profitability targets may not prove feasible. The introduction of such new products requires continued innovative efforts on the part of our management and may require significant time and resources as well as ongoing support and investment. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also affect the ultimate implementation of a new line of business or offerings of new products, product enhancements or services. Furthermore, any new line of business, product, product enhancement or service or system conversion could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or offerings of new products, product enhancements or services could have a material adverse effect on our business, financial condition or results of operations.

Industry-Related Risks

The phase-out of LIBOR could negatively impact our net interest income and require significant operational work.

The United Kingdom's Financial Conduct Authority, which regulates the London Interbank Offered Rate ("LIBOR"), has announced that it will not compel panel banks to contribute to LIBOR after 2021. The discontinuance of LIBOR has resulted in significant uncertainty regarding the transition to suitable alternative reference rates and could adversely impact our business, operations, and financial results.

The Federal Reserve, in conjunction with the Alternative Reference Rates Committee, a steering committee comprised of large U.S. financial institutions, has endorsed replacing the U.S. dollar LIBOR with a new index calculated by short-term repurchase agreements, backed by Treasury securities ("SOFR"). SOFR is observed and backward looking, which stands in contrast with LIBOR under the current methodology, which is an estimated forward-looking rate and relies, to some degree, on the expert judgment of submitting panel members. Given that SOFR is a secured rate backed by government securities, it will be a rate that does not take into account bank credit risk (as is the case with LIBOR). In November 2020, the federal banking agencies issued a statement that says that banks may use any reference rate for its loans that the bank determines to be appropriate for its funding model and customer needs.

We have substantial exposure to LIBOR-based products, including loans, securities, derivatives and hedges, and we are preparing to transition away from the widespread use of LIBOR to alternative rates. During the fourth quarter of 2019, we began the process of incorporating fallback language in legacy LIBOR-based commercial loans, and we plan to begin indexing new retail adjustable rate mortgages to SOFR in the second quarter of 2021. We continue to monitor market developments and regulatory updates, including recent announcements from the ICE Benchmark Administrator to extend the cessation date for several USD LIBOR tenors to June 30, 2023, as well as collaborate with regulators and industry groups on the transition. The manner and impact of this transition, as well as the effect of these developments on our funding costs, loan and investment and trading securities portfolios, asset-liability management, and business, is uncertain.

Our estimate of fair values for our investments may not be realizable if we were to sell these securities today.

Our available-for-sale securities are carried at fair value. The determination of fair value for securities categorized in Level 3 involves significant judgment due to the complexity of the factors contributing to the valuation, many of which are not readily observable in the market. Recent market disruptions and the resulting fluctuations in fair value have made the valuation process even more difficult and subjective. If the valuations are incorrect, it could harm our financial results and financial condition.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Our deposit insurance premiums could be substantially higher in the future, which could have a material adverse effect on our future earnings.

The FDIC insures deposits at FDIC-insured depository institutions, such as the Bank, up to \$250,000 per insured depositor category. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based

assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. As a result of recent FDIC assessment charges, banks are now assessed deposit insurance premiums based on the bank's average consolidated total assets less the sum of its average tangible equity, and the FDIC has modified certain risk-based adjustments, which increase or decrease a bank's overall assessment rate. In addition to ordinary assessments described above, the FDIC has the ability to impose special assessments in certain instances. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay higher FDIC premiums than the recent levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums could reduce our profitability, may limit our ability to pursue certain business opportunities or otherwise negatively impact our operations.

Legal, Accounting, Regulatory and Compliance Risks

We face a risk of noncompliance with the Bank Secrecy Act and other anti-money laundering statutes and regulations and corresponding enforcement proceedings.

The federal Bank Secrecy Act, the PATRIOT Act, and other laws and regulations require financial institutions, among our other duties, to institute and maintain effective anti-money laundering programs and to file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. Federal and state bank regulators also focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

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

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

The Company and the Bank also undergo periodic examinations by their regulators, who have extensive discretion and authority to prevent or remedy unsafe or unsound practices or violations of law. Failure to comply with applicable laws, regulations or policies could also result in heightened regulatory scrutiny and in sanctions by regulatory agencies (such as a memorandum of understanding, a written supervisory agreement or a cease and desist order), civil money penalties and/or reputation damage. Any of these consequences could restrict our ability to expand our business or could require us to raise additional capital or sell assets on terms that are not advantageous to us or our stockholders and could have a material adverse effect on our business, financial condition and results of operations.

A more detailed description of the primary federal banking laws and regulations that affect the Company and the Bank is included in this Form 10-K under the section captioned "Supervision and Regulation" in Item 1. Since the 2008 financial crisis, federal and state banking laws and regulations, as well as interpretations and implementations of these laws and regulations, have undergone substantial review and change. In particular, the Dodd-Frank Act drastically revised the laws and regulations under which we operate. The burden of regulatory compliance has increased under the Dodd-Frank Act and has increased our costs of doing business and, as a result, may create an advantage for our competitors who may not be subject to similar legislative and regulatory requirements.

We face risks related to the adoption of future legislation and potential changes in federal regulatory agency leadership, policies, and priorities.

With a new Congress taking office in January 2021, Democrats have retained control of the U.S. House of Representatives, and have gained control of the U.S. Senate, albeit with a majority found only in the tie-breaking vote of Vice President Harris. However slim the majorities, though, the net result is unified Democratic control of the White House and both chambers of Congress, and consequently Democrats will be able to set the agenda both legislatively and in the Administration. We expect that Democratic-led Congressional committees will pursue greater oversight and will also pay increased attention to the banking sector's role in providing COVID-19-related assistance. The prospects for the enactment of major banking reform legislation under the new Congress are unclear at this time.

Moreover, the turnover of the presidential administration has produced, and likely will continue to produce, certain changes in the leadership and senior staffs of the federal banking agencies, the CFPB, SEC, and the Treasury Department. These changes could impact the rulemaking, supervision, examination and enforcement priorities and policies of the agencies. Of note, promptly after taking office,

President Biden issued an Executive Order instituting a “freeze” of certain recently-finalized and pending regulations to allow for review by incoming Administration officials. As a result of this Executive Order, recently-adopted regulations may be subject to further notice-and-comment rulemaking and, more broadly, agency rulemaking agendas may be disrupted. The potential impact of any changes in agency personnel, policies and priorities on the financial services sector, including the Bank, cannot be predicted at this time. Regulations and laws may be modified at any time, and new legislation may be enacted that will affect us. Any future changes in federal and state laws and regulations, as well as the interpretation and implementation of such laws and regulations, could affect us in substantial and unpredictable ways, including those listed above or other ways that could have a material adverse effect on our business, financial condition or results of operations.

Our accounting estimates and risk management processes and controls rely on analytical and forecasting techniques and models and assumptions, which may not accurately predict future events.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with GAAP and reflect management’s judgment of the most appropriate manner in which to report our financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet which may result in our reporting materially different results than would have been reported under a different alternative.

Certain accounting policies are critical to presenting our financial condition and results of operations. They require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include the allowance for credit losses and fair value methodologies. Because of the uncertainty of estimates involved in these matters, we may be required to significantly increase the ACL or sustain loan losses that are significantly higher than the reserve provided, reduce the carrying value of an asset measured at fair value, or significantly increase liabilities measured at fair value. Any of these could have a material adverse effect on our business, financial condition or results of operations.

Our internal controls, disclosure controls, processes and procedures, and corporate governance policies and procedures are based in part on certain assumptions and can provide only reasonable (not absolute) assurances that the objectives of the system are met. Any failure or circumvention of our controls, processes and procedures or failure to comply with regulations related to controls, processes and procedures could necessitate changes in those controls, processes and procedures, which may increase our compliance costs, divert management attention from our business or subject us to regulatory actions and increased regulatory scrutiny. Any of these could have a material adverse effect on our business, financial condition or results of operations.

As a participating lender in the SBA Paycheck Protection Program (“PPP”), we are subject to additional risks of litigation from our customers or other parties regarding our processing of loans for the PPP and risks that the SBA may not fund some or all PPP loan guaranties.

On March 27, 2020, President Trump signed the CARES Act, which created a guaranteed, unsecured loan program, the Paycheck Protection Program, or PPP, to fund operational costs of eligible businesses, organizations and self-employed persons during COVID-19. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Bank is participating as a lender in the PPP. The PPP commenced on April 3, 2020, and was available to qualified borrowers through August 8, 2020, and an additional stimulus package was approved on December 28, 2020, authorizing an additional \$284.5 billion of PPP funds. Since the opening of the PPP, several other larger banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP. We may be exposed to the risk of litigation, from both customers and non-customers that approached us regarding PPP loans, regarding our process and procedures used in processing applications for the PPP. If any such litigation is filed against us and is not resolved in a manner favorable to us, it may result in significant financial liability or adversely affect our reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP-related litigation could have a material adverse impact on our business, financial condition and results of operations.

We also have credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced by us, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the PPP. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by us, the SBA may deny our liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, the CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution’s

performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the Community Reinvestment Act and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

We could be subject to changes in tax laws, regulations, and interpretations or challenges to our income tax provision.

We compute our income tax provision based on enacted tax rates in the jurisdictions in which we operate. Any change in enacted tax laws, rules or regulatory or judicial interpretations, or any change in the pronouncements relating to accounting for income taxes could adversely affect our effective tax rate, tax payments and results of operations. The taxing authorities in the jurisdictions in which we operate may challenge our tax positions, which could increase our effective tax rate and harm our financial position and results of operations. We are subject to audit and review by U.S. federal and state tax authorities. Any adverse outcome of such a review or audit could have a negative effect on our financial position and results of operations.

In addition, deferred tax assets are reported as assets on our balance sheet and represent the decrease in taxes expected to be paid in the future because of net operating losses (“NOLs”) and tax credit carryforwards and because of future reversals of temporary differences in the bases of assets and liabilities as measured by enacted tax laws and their bases as reported in the financial statements. As of December 31, 2020, we had net deferred tax assets of \$8.1 million, which included no remaining federal net operating loss carryforward. Realization of deferred tax assets is dependent upon the generation of sufficient future taxable income during the periods in which existing deferred tax assets are expected to become deductible for income tax purposes. Changes in enacted tax laws, such as adoption of a lower income tax rate in any of the jurisdictions in which we operate, could impact our ability to obtain the future tax benefits represented by our deferred tax assets. Our deferred tax asset may be further reduced in the future if estimates of future income or our tax planning strategies do not support the amount of the deferred tax asset. Charges to establish a valuation allowance with respect to our deferred tax asset could have a material adverse effect on our financial condition and results of operations.

In addition, the determination of our provision for income taxes and other liabilities requires significant judgment by management. Although we believe that our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and could have a material adverse effect on our financial results in the period or periods for which such determination is made.

We could become subject to claims and litigation pertaining to our fiduciary responsibility.

Some of the services we provide, such as wealth management services through River Street Advisors, LLC, require us to act as fiduciaries for our customers and others. Customers make claims and on occasion take legal action pertaining to our performance of our fiduciary responsibilities. Whether customer claims and legal action related to our performance of our fiduciary responsibilities are founded or unfounded, if such claims and legal action are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services as well as impact customer demand for those products and services. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse impact on our financial condition and results of operations.

We are defendants in a variety of litigation and other actions.

Currently, there are certain other legal proceedings pending against the Company and our subsidiaries in the ordinary course of business. While the outcome of any legal proceeding is inherently uncertain, based on information currently available, the Company’s management believes that any liabilities arising from pending legal matters would not have a material adverse effect on us or our consolidated financial statements. However, if actual results differ from management’s expectations, it could have a material adverse effect on our financial condition, results of operations, or cash flows.

From time to time we are, or may become, involved in suits, legal proceedings, information-gatherings, investigations and proceedings by governmental and self-regulatory agencies that may lead to adverse consequences.

Many aspects of the banking business involve a substantial risk of legal liability. From time to time, we are, or may become, the subject of information-gathering requests, reviews, investigations and proceedings, and other forms of regulatory inquiry, including by bank regulatory agencies, self-regulatory agencies, the SEC and law enforcement authorities. The results of such proceedings could lead to significant civil or criminal penalties, including monetary penalties, damages, adverse judgements, settlements, fines, injunctions, restrictions on the way we conduct our business or reputational harm.

Capital and Liquidity Risks

Our business needs and future growth may require us to raise additional capital, but that capital may not be available or may be dilutive.

We may need to raise additional capital, in the form of debt or equity securities, in the future to have sufficient capital resources to meet our commitments and fund our business needs and future growth, particularly if the quality of our assets or earnings were to deteriorate significantly. In addition, the Company and the Bank are each required by federal regulatory authorities to maintain adequate levels of capital to support their operations.

Our ability to raise capital will depend on, among other things, conditions in the capital markets, which are outside of our control, and our financial performance. Accordingly, we cannot provide assurance that such capital will be available on terms acceptable to us or at all. Any occurrence that limits our access to capital, may adversely affect our capital costs and our ability to raise capital and, in turn, our liquidity. Further, if we need to raise capital in the future we may have to do so when many other financial institutions are also seeking to raise capital and would then have to compete with those institutions for investors. Any inability to raise capital on acceptable terms when needed could have a material adverse effect on our business, financial condition and results of operations and could be dilutive to both tangible book value and our share price.

In addition, an inability to raise capital when needed may subject us to increased regulatory supervision and the imposition of restrictions on our growth and business. These restrictions could negatively affect our ability to operate or further expand our operations through loan growth, acquisitions or the establishment of additional branches. These restrictions may also result in increases in operating expenses and reductions in revenues that could have a material adverse effect on our financial condition, results of operations and share price.

We could experience an unexpected inability to obtain needed liquidity.

Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits, and to take advantage of interest rate market opportunities and is essential to a financial institution's business. The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets and its access to alternative sources of funds. We seek to ensure that our funding needs are met by maintaining an appropriate level of liquidity through asset and liability management. In 2020, the Bank experienced ample liquidity due to customer deposits received related to federal stimulus programs responding to the COVID-19 pandemic, as well as funds received as PPP loans were forgiven, and short-term borrowing facilities were not required to be significantly utilized. However, if funds were needed, we could seek to secure liquidity under the advance program provided under terms offered by the FHLBC. If we are unable to obtain funds when needed, it could have a material adverse effect on our business, financial condition and results of operations.

We may not be able to maintain a strong core deposit base or access other low-cost funding sources.

We rely on bank deposits to be a low cost and stable source of funding. In addition, our future growth will largely depend on our ability to maintain and grow a strong deposit base. If we are unable to continue to attract and retain core deposits, to obtain third party financing on favorable terms, or to have access to interbank or other liquidity sources, we may not be able to grow our assets as quickly. We compete with banks and other financial services companies for deposits. If our competitors raise the rates they pay on deposits in response to interest rate changes initiated by the FRBC Open Market Committee or for other reasons of their choice, our funding costs may increase, either because we raise our rates to avoid losing deposits or because we lose deposits and must rely on more expensive sources of funding. Higher funding costs could reduce our net interest margin and net interest income. Any decline in available funding could adversely affect our ability to continue to implement our business strategy which could have a material adverse effect on our liquidity, business, financial condition and results of operations.

Risks Related to an Investment in Our Common Stock

Our future ability to pay dividends is subject to restrictions.

We currently conduct substantially all of our operations through our subsidiaries, and a significant part of our income is attributable to dividends from the Bank. We principally rely on the profitability of the Bank to conduct operations and satisfy obligations. As is the case with all financial institutions, the profitability of the Bank is subject to the fluctuating cost and availability of money, changes in interest rates, and in economic conditions in general.

Holders of our common stock are only entitled to receive such cash dividends as our board of directors may declare out of funds legally available for such payments. Any declaration and payment of dividends on common stock will depend upon our earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, our ability to service any equity or debt obligations senior to the common stock, and other factors deemed relevant by the board of directors. Furthermore, consistent with our business plans, growth initiatives, capital availability, projected liquidity needs, and other factors, we have made, and will continue to make, capital management decisions and policies that could adversely impact the amount of dividends, if any, paid to our stockholders.

Although we currently expect to continue to pay quarterly dividends, any future determination relating to our dividend policy will be made by our board of directors and will depend on a number of factors. We are subject to certain restrictions on the payment of cash dividends as a result of banking laws, regulations and policies. Finally, our ability to pay dividends to our stockholders depends on our receipt of dividends from the Bank, which is also subject to restrictions on dividends as a result of banking laws, regulations and policies. See Part II, Item 5. "Dividends."

The trading volumes in our common stock may not provide adequate liquidity for investors.

Shares of our common stock are listed on the NASDAQ Global Select Market; however, the average daily trading volume in our common stock is less than that of larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of a sufficient number of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the current daily average trading volume of our common stock, significant sales of our common stock in a brief period of time, or the expectation of these sales, could cause a significant decline in the price of our common stock.

The trading price of our common stock may be subject to continued significant fluctuations and volatility.

The market price of our common stock could be subject to significant fluctuations due to, among other things:

- actual or anticipated quarterly fluctuations in our operating and financial results, particularly if such results vary from the expectations of management, securities analysts and investors, including with respect to further credit losses on loans or unfunded commitments we may incur;
- announcements regarding significant transactions in which we may engage;
- market assessments regarding such transactions;
- changes or perceived changes in our operations or business prospects;
- legislative or regulatory changes affecting our industry generally or our businesses and operations;
- a weakening of general market and economic conditions, particularly with respect to economic conditions in Illinois;
- the operating and share price performance of companies that investors consider to be comparable to us;
- future offerings by us of debt, preferred stock or trust preferred securities, each of which would be senior to our common stock upon liquidation and for purposes of dividend distributions;
- actions of our current stockholders, including future sales of common stock by existing stockholders and our directors and executive officers; and
- other changes in U.S. or global financial markets, economies and market conditions, such as interest or foreign exchange rates, stock, commodity, credit or asset valuations or volatility.

As a result, the market price of our common stock may continue to be subject to similar market fluctuations that may or may not be related to our operating performance or prospects. Increased volatility could result in a decline in the market price of our common stock.

Shares of our common stock are subject to dilution, which could cause our common stock price to decline.

We are generally not restricted from issuing additional shares of our common stock up to the number of shares authorized in our Certificate of Incorporation. We may issue additional shares of our common stock (or securities convertible into common stock) in the future for a number of reasons, including to finance our operations and business strategy (including mergers and acquisitions), to adjust our ratio of debt to equity, to address regulatory capital concerns, or to satisfy our obligations upon the exercise of outstanding stock awards. We may issue equity securities in transactions that generate cash proceeds, transactions that free up regulatory capital but do not immediately generate or preserve substantial amounts of cash, and transactions that generate regulatory or balance sheet capital only and do not generate or preserve cash. If we choose to raise capital by selling shares of our common stock or securities convertible into common stock for any reason, the issuance would have a dilutive effect on the holders of our common stock and could have a material negative effect on the market price of our common stock.

Certain banking laws and our governing documents may have an anti-takeover effect and may make it difficult and expensive to remove current management.

Certain federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to our stockholders. In addition, certain provisions in our certificate of incorporation and bylaws could make it more difficult for a third party to acquire control of the Company, even if such event was perceived by you to be beneficial to your interests. These include, among others, (a) provisions that empower our board of directors, without stockholder approval, to issue preferred stock, the terms of which, including voting power, are set by the board of directors, (b) we have a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board, and (c) the approval of certain business combinations require the affirmative vote of at least 75% of our outstanding shares of common stock. The combination of these laws and provisions in our certificate of incorporation may inhibit certain business combinations, including a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock. These provisions in our certificate of incorporation could also discourage proxy contests and make it more difficult

and expensive for holders of our common stock to elect directors other than the candidates nominated by our board of directors or otherwise remove existing directors and management, even if current management is not performing adequately.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We conduct our business primarily at 29 banking locations in various communities throughout the greater western and southern Chicago metropolitan area. The principal business office of the Company is located at 37 South River Street, Aurora, Illinois. We own 26 of our properties and lease three of our locations. Our three leased locations are under agreement through March 31, 2021, March 1, 2022, and June 30, 2030. We believe that all of our properties and equipment are well maintained, in good operating condition and adequate for all of our present and anticipated needs.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market for the Company’s Common Stock

Our common stock trades on the NASDAQ Global Select Market under the symbol “OSBC.” As of December 31, 2020, we had 815 stockholders of record for our common stock. The following table sets forth the high and low trading prices of our common stock on the NASDAQ Global Select Market, and information about declared dividends during each quarter for 2020 and 2019.

	<u>2020</u>			<u>2019</u>		
	<u>High</u>	<u>Low</u>	<u>Dividend</u>	<u>High</u>	<u>Low</u>	<u>Dividend</u>
First quarter	\$ 13.33	\$ 6.09	\$ 0.01	\$ 14.80	\$ 12.01	\$ 0.01
Second quarter	9.18	5.96	0.01	13.64	11.43	0.01
Third quarter	8.97	6.95	0.01	13.60	11.24	0.01
Fourth quarter	10.78	7.38	0.01	13.77	11.72	0.01

Dividends

The Company’s stockholders are entitled to receive dividends when, as and if declared by the board of directors out of funds legally available therefor. The Company’s ability to pay dividends to stockholders is largely dependent upon the dividends it receives from the Bank; however, certain regulatory restrictions and the terms of its debt and equity securities, limit the amount of cash dividends it may pay. See “Supervision and Regulation—Regulation and Supervision of the Bank.”

Although we currently expect to continue to pay quarterly dividends, any future determination relating to our dividend policy will be made by our board of directors and will depend on a number of factors, including: (1) our historic and projected financial condition, liquidity and results of operations, (2) our capital levels and needs, (3) tax considerations, (4) any acquisitions or potential acquisitions that we may examine, (5) statutory and regulatory prohibitions and other limitations, (6) the terms of any credit agreements or other borrowing arrangements that restrict our ability to pay cash dividends, (7) general economic conditions and (8) other factors deemed relevant by our board of directors. We are not obligated to pay dividends on our common stock and are subject to restrictions on paying dividends on our common stock.

As a Delaware corporation, we are subject to certain restrictions on dividends under the DGCL. Generally, a Delaware corporation may only pay dividends either out of surplus or out of the current or the immediately preceding year’s net profits. Surplus is defined as the excess, if any, at any given time, of the total assets of a corporation over its total liabilities and statutory capital. The value of a corporation’s assets can be measured in a number of ways and may not necessarily equal their book value.

In addition, we are subject to certain restrictions on the payment of cash dividends as a result of banking laws, regulations and policies. See “Supervision and Regulation—Regulation and Supervision of the Company.”

Stock Repurchases

In September 2019, our board of directors authorized the repurchase of up to 1,494,826 shares of our common stock (the “Repurchase Program”). The Repurchase Program expired on September 19, 2020. However, on October 20, 2020, the Company received notice of non-objection from the Federal Reserve Bank of Chicago to extend the Repurchase Program through October 20, 2021. As of December 31, 2020, 775,553 shares remained available to be repurchased under the Repurchase Program. Repurchases by the Company under the Repurchase Program may be made from time to time through open market purchases, trading plans established in accordance with SEC rules, privately negotiated transactions, or by other means.

The actual means and timing of any repurchases, quantity of purchased shares and prices will be, subject to certain limitations, at the discretion of management and will depend on a number of factors, including, without limitation, market prices of our common stock, general market and economic conditions, and applicable legal and regulatory requirements. Repurchases under the Repurchase Program may be initiated, discontinued, suspended or restarted at any time provided that repurchases under the Repurchase Program after October 20, 2021, would require Federal Reserve non-objection or approval. We are not obligated to repurchase any shares under the Repurchase Program.

<i>(Dollars in thousands, except for per share amounts)</i>	Total Number of Shares Purchased (a)	Average Price Paid per Share (b)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (c)⁽¹⁾	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (d)
October 1, 2020 - October 31, 2020	58,486	\$ 9.06	58,486	839,929
November 1, 2020 - November 30, 2020	64,376	9.13	64,376	775,553
December 1, 2020 - December 31, 2020	-	-	-	775,553
Total	122,862	\$ 9.10	122,862	775,553

⁽¹⁾ We publicly announced the extension of our Repurchase Program, which will expire on October 20, 2021 unless further extended as described above, in our Current Report on Form 8-K filed on October 21, 2020, and 898,415 shares remained available for repurchase under the Repurchase Program as of October 20, 2020.

Recent Sales of Unregistered Securities

None.

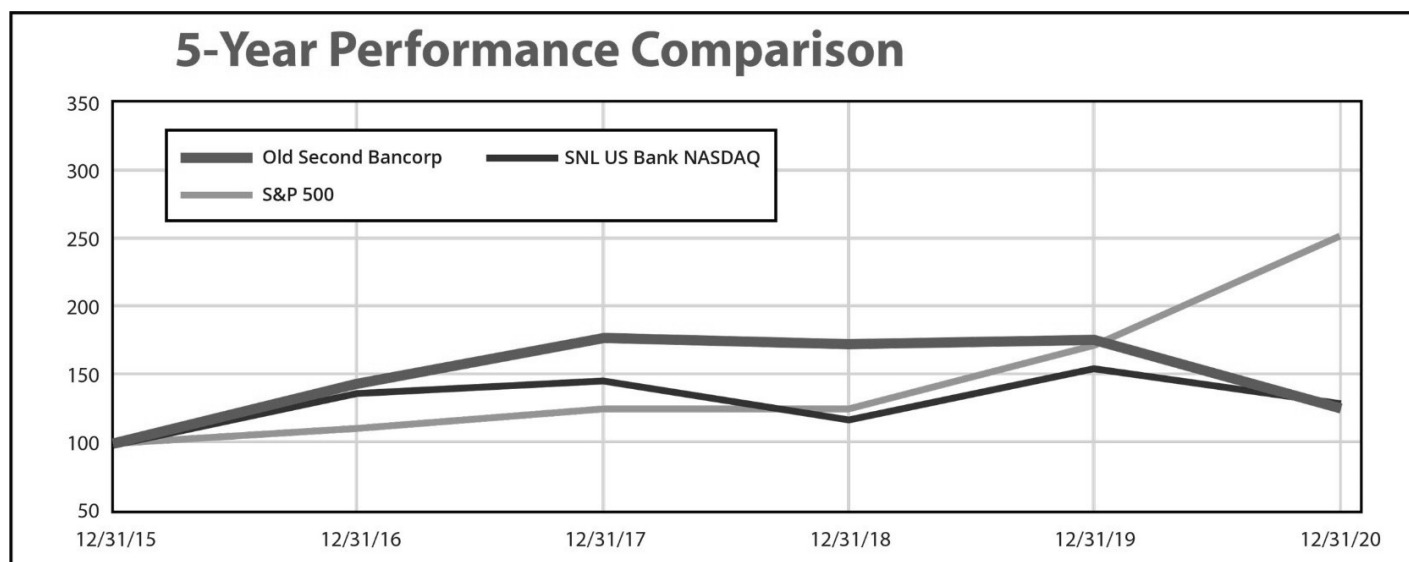
Form 10-K and Other Information

Transfer Agent/Stockholder Services

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

Old Second Bancorp, Inc.
c/o Shirley Cantrell,
Stockholder Relations Department
37 South River Street
Aurora, Illinois 60507
(630) 906-2303
scantrell@oldsecond.com

Stockholder Return Performance Graph. The following graph indicates, for the period commencing December 31, 2015, and ending December 31, 2020, a comparison of cumulative total returns for the Company, S&P 500 and the SNL U.S. Bank NASDAQ. The information assumes that \$100 was invested at the closing price at December 31, 2015, in the common stock of the Company and each index and that all dividends were reinvested.



<i>Index</i>	<i>Period Ending</i>					
	12/31/2015	12/30/2016	12/31/2017	12/31/2018	12/31/2019	12/30/2020
Old Second Bancorp, Inc.	100.00	141.51	175.39	167.50	174.10	131.10
S&P 500	100.00	111.96	136.40	130.42	171.49	203.04
SNL U.S. Bank NASDAQ	100.00	138.65	145.97	123.04	154.47	132.56

Item 6. Selected Financial Data

Old Second Bancorp, Inc. and Subsidiaries Financial Highlights (Dollars in thousands, except per share data)

	2020	2019	2018	2017	2016
Balance sheet items at year-end					
Total assets	\$ 3,040,837	\$ 2,635,545	\$ 2,676,003	\$ 2,383,429	\$ 2,251,188
Total earning assets	2,859,154	2,444,974	2,471,328	2,191,685	2,037,012
Average assets	2,860,770	2,623,443	2,547,806	2,318,798	2,142,748
Loans, gross	2,034,851	1,930,812	1,897,027	1,617,622	1,478,809
Allowance for credit losses on loans	33,855	19,789	19,006	17,461	16,158
Deposits	2,537,073	2,126,749	2,116,673	1,922,925	1,866,785
Securities sold under agreement to repurchase	66,980	48,693	46,632	29,918	25,715
Other short-term borrowings	-	48,500	149,500	115,000	70,000
Junior subordinated debentures	25,773	57,734	57,686	57,639	57,591
Senior notes	44,375	44,270	44,158	44,058	43,998
Notes payable and other borrowings	23,393	6,673	15,379	-	-
Stockholders' equity	307,087	277,864	229,081	200,350	175,210
Results of operations for the year ended					
Interest and dividend income	\$ 104,215	\$ 115,594	\$ 107,617	\$ 87,505	\$ 73,379
Interest expense	12,464	18,835	16,678	12,626	9,938
Net interest and dividend income	91,751	96,759	90,939	74,879	63,441
Provision for credit losses	10,413	1,600	1,228	1,800	750
Noninterest income	37,487	35,800	31,353	30,372	28,574
Noninterest expense	81,417	79,102	77,128	69,149	66,761
Income before taxes	37,408	51,857	43,936	34,302	24,504
Provision for income taxes	9,583	12,402	9,924	19,164	8,820
Net income available to common stockholders	\$ 27,825	\$ 39,455	\$ 34,012	\$ 15,138	\$ 15,684
Performance ratio					
Return on average total assets	0.97 %	1.50 %	1.33 %	0.65 %	0.73 %
Return on average equity	9.67	15.37	16.08	7.89	9.43
Average equity to average assets	10.06	9.78	8.30	8.28	7.76
Dividend payout ratio	4.26	3.03	3.51	7.84	5.66
Per share data					
Basic earnings	\$ 0.94	\$ 1.32	\$ 1.14	\$ 0.51	\$ 0.53
Diluted earnings	0.92	1.30	1.12	0.50	0.53
Common book value per share	10.47	9.28	7.70	6.76	5.93
Weighted average diluted shares outstanding	30,174,072	30,416,348	30,308,935	30,038,417	29,838,931
Weighted average basic shares outstanding	29,623,333	29,891,046	29,728,308	29,600,702	29,532,510
Shares outstanding at year-end	29,328,723	29,931,809	29,763,078	29,627,086	29,556,216
Loan quality ratios					
Allowance for credit losses on loans to total loans at end of the year	1.66 %	1.02 %	1.00 %	1.08 %	1.09 %
Provision for credit losses on loans to total loans	0.45 %	0.08 %	0.06 %	0.11 %	0.05 %
Net loans charged-off to average total loans	0.05 %	0.04 %	(0.02)%	0.03 %	0.07 %
Nonaccrual loans to total loans at end of the year	1.09 %	0.64 %	0.72 %	0.89 %	1.03 %
Nonperforming assets to total assets at end of the year	0.84 %	0.79 %	0.88 %	1.01 %	1.24 %
Allowance for credit losses on loans to nonaccrual loans	151.95 %	159.18 %	138.32 %	121.36 %	105.73 %

Old Second Bancorp, Inc. and Subsidiaries
Quarterly Financial Information
(Dollars in thousands, except per share data)

	2020				2019			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st
Interest income	\$ 26,006	\$ 25,046	\$ 25,712	\$ 27,451	\$ 27,668	\$ 29,444	\$ 29,586	\$ 28,896
Interest expense	2,129	2,537	3,005	4,793	4,479	4,664	4,832	4,860
Net interest income	23,877	22,509	22,707	22,658	23,189	24,780	24,754	24,036
Provision for credit losses	-	300	2,129	7,984	150	550	450	450
Securities gains, net	-	(1)	-	(24)	35	3,463	986	27
Income (loss) before taxes	11,409	13,628	12,377	(6)	12,453	16,209	12,321	10,874
Net income	8,047	10,265	9,238	275	9,536	12,173	9,278	8,468
Basic earnings per share	0.27	0.35	0.31	0.01	0.32	0.41	0.31	0.28
Diluted earnings per share	0.27	0.34	0.31	0.01	0.31	0.40	0.31	0.28
Dividends paid per share	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01

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

The following discussion provides additional information regarding our operations for the twelve-month periods ending December 31, 2020, 2019 and 2018, and financial condition at December 31, 2020 and 2019, and should be read in conjunction with our consolidated financial statements and the related notes. Historical results of operations and the percentage relationships among any amounts included, and any trends that may appear, may not indicate trends in operations or results of operations for any future periods.

We have made, and will continue to make, various forward-looking statements with respect to financial and business matters. Comments regarding our business that are not historical facts are considered forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in these forward-looking statements. For additional information regarding our cautionary disclosures, see the “Cautionary Note Regarding Forward-Looking Statements” at the beginning of this annual report.

Business overview

We provide a wide range of financial services through our 29 banking locations located in Cook, DeKalb, DuPage, Kane, Kendall, LaSalle and Will counties in Illinois. These banking centers offer access to a full range of traditional retail and commercial banking services including treasury management operations as well as fiduciary and wealth management services. We focus our business on establishing and maintaining relationships with our clients while maintaining a commitment to providing for the financial services needs of the communities in which we operate through our retail branch network. We emphasize relationships with individual customers as well as small to medium-sized businesses throughout our market area. Our market area includes a mix of commercial and industrial, real estate, and consumer related lending opportunities, and provides a stable, loyal core deposit base. We also offer extensive wealth management services, which include a registered investment advisory platform in addition to trust administration and trust services related to personal and corporate trusts, including employee benefit plan administration services.

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

On April 20, 2018, we closed on our acquisition of Greater Chicago Financial Corp. and its wholly-owned subsidiary, ABC Bank. As a result of this transaction, we acquired \$227.6 million of loans, net of fair value adjustments, and \$248.5 million of deposits, net of fair value adjustments. The purchase resulted in us increasing our presence in the near west Chicago area and metropolitan Chicago, as four branches were acquired with a retail and commercial client mix of loans and deposits.

COVID-19 Pandemic

The COVID-19 pandemic continues to create extensive disruptions to the global economy and financial markets and to businesses and the lives of individuals throughout the world. In particular, the COVID-19 pandemic has severely restricted the level of economic activity in our markets. Federal and state governments have taken, and may continue to take, unprecedented actions to contain the spread of the disease, including quarantines, travel bans, shelter-in-place orders, closures of businesses and schools, fiscal stimulus, and legislation designed to deliver monetary aid and other relief to businesses and individuals impacted by the pandemic. Although in various locations certain activity restrictions have been relaxed and businesses and schools have reopened with some level of success, in many states and localities the number of individuals diagnosed with COVID-19 has increased significantly, which may cause a freezing or, in certain

cases, a reversal of previously announced relaxation of activity restrictions and may prompt the need for additional aid and other forms of relief.

The impact of the COVID-19 pandemic is fluid and continues to evolve, adversely affecting many of our clients. The unprecedented and rapid spread of COVID-19 and its associated impacts on trade (including supply chains and export levels), travel, employee productivity, unemployment, consumer spending, and other economic activities has resulted in less economic activity, lower equity market valuations and significant volatility and disruption in financial markets. In addition, due to the COVID-19 pandemic, market interest rates have declined significantly, with the 10-year Treasury bond falling below 1.00% on March 3, 2020, for the first time, although bond yields have recently begun to rise, nearing where they were before the pandemic in February 2020. In March 2020, the Federal Open Market Committee reduced the targeted federal funds interest rate range to 0% to 0.25% percent. These reductions in interest rates and the other effects of the COVID-19 pandemic have had, and are expected to continue to have, possibly materially, an adverse effect on our business, financial condition and results of operations. For instance, the pandemic has had negative effects on our interest income, ACL, and certain transaction-based line items of noninterest income. The ultimate extent of the impact of the COVID-19 pandemic on our business, financial condition and results of operations is currently uncertain and will depend on various developments and other factors, including the effect of governmental and private sector initiatives, the effect of the recent rollout of vaccinations for the virus, whether such vaccinations will be effective against any resurgence of the virus, including any new strain, and the ability for customers and businesses to return to their pre-pandemic routine.

In response to the pandemic, we have taken a number of steps to protect our employees, customers and communities. In March 2020, as part of our efforts to exercise social distancing, we closed all of our banking lobbies (other than by appointment) and conducted most of our business through drive-thru tellers and through electronic and online means. At this time, our lobbies have been reopened, but we encourage customers to use drive-thru or electronic means to conduct their banking, and are following social distancing and personal protective protocols as directed by the Center for Disease Control and Prevention. In addition, a majority of our workforce has been working from home since mid-March 2020, and we expect this to continue through at least the first quarter of 2021, or until vaccines are more widely available.

Results of Operation and Financial Condition

We are monitoring the impact of the COVID-19 pandemic on our results of operation and financial condition. To date, the COVID-19 pandemic has not significantly impacted the health of the overall real estate industry in our markets, which have reflected relative stability over the past three years. In addition, we have not experienced significant incurred losses on loans or received communications from our borrowers that significant losses were imminent. While management does not currently expect the next year to result in the precipitous decline in the value of certain real estate assets similar to the declines seen in 2009 to 2010, our forecast includes assumptions for certain loss scenarios that may occur due to the exhaustion of federal stimulus funds or a decrease in market valuations. Accordingly, in 2020, we determined it prudent to increase our provision for credit losses in anticipation of continued market risk and uncertainty at this time. Our provision for credit losses was \$10.4 million for the year ended December 31, 2020, which was unchanged from the quarter ended September 30, 2020. Our allowance for credit losses increased \$14.1 million during 2020, which was impacted by both our adoption of the new CECL methodology and the expected impact of the COVID-19 pandemic and market interest rate reductions. Although we did not record additional provision for credit losses in the fourth quarter of 2020, we continue to monitor the impact of COVID-19, as periods ending after December 31, 2020 may also be materially impacted by the COVID-19 pandemic.

We also adjust our investment securities portfolio to fair value each period end and review for any impairment that would require a provision for credit losses. At this time, we have determined there is no need for a provision for credit losses related to our investment securities portfolio. Because of changing economic and market conditions affecting issuers, we may be required to recognize impairments in the future on the securities we hold as well as experience reductions in other comprehensive income. We cannot currently determine the ultimate impact of the pandemic on the long-term value of our portfolio.

As of December 31, 2020, we had \$18.6 million of goodwill. As of March 31, June 30, and September 30, 2020, we considered whether a quantitative assessment of our goodwill was required because of the significant economic disruption caused by the COVID-19 pandemic, but ultimately determined that a quantitative assessment was not required at those period ends. At November 30, 2020, we performed our recurring annual review for any goodwill impairment. At the end of each of these periods, we determined no goodwill impairment existed. However, further delayed recovery or further deterioration in market conditions related to the general economy, financial markets, and the associated impacts on our customers, employees and vendors, among other factors, could significantly impact the impairment analysis and may result in future goodwill impairment charges that, if incurred, could have a material adverse effect on our results of operations and financial condition.

Lending Operations and Accommodations to Borrowers

To more fully support our customers during the pandemic, we established client assistance programs, including offering commercial, consumer, and mortgage loan payment deferrals for certain clients. During 2020, we executed 499 of these deferrals on loan balances of \$231.3 million. In accordance with interagency guidance issued in March 2020, these short term deferrals were not considered troubled debt restructurings. As of December 31, 2020, 448 loans previously in deferral status, representing loan balances of \$198.6 million, had resumed payments or paid off, and 51 loans totaling \$32.7 million remained in active deferral status, of which only \$4.4 million were in

nonaccrual status. We also suspended late fees for consumer loans through June 30, 2020, and, although consumer late fees have been reinstated, we will continue to evaluate any late fee suspension based on the borrower's financial situation and prior payment history. In addition, we paused new foreclosure and repossession actions through December 31, 2020, and will continue to re-evaluate these activities based on the ongoing COVID-19 pandemic. These programs may negatively impact our revenue and other results of operations in the near term and, if not effective in mitigating the effect of COVID-19 on our customers, may adversely affect our business and results of operations more substantially over a longer period of time. Future governmental actions may require these and other types of customer-related responses.

We are also participating in the CARES Act. During 2020, as part of the "first round" of the SBA PPP program, we processed 746 PPP loan applications, representing a total of \$136.7 million. In early October, we started the application process for PPP loan forgiveness, and expect this process to continue through the first quarter of 2021, with funds to be received from the SBA for the forgiven loans well into the second quarter of 2021. In addition, as of December 31, 2020, we had originated two loans for \$305,000 under the Main Street Lending Program. We recorded \$2.4 million of net fee income on PPP loans in 2020, and as of December 31, 2020, unearned net fee income on PPP loans totaled \$420,000. Finally, with the governmental authorization of the "second round" of the SBA PPP in late 2020, we are now originating additional PPP loans, and anticipate filing for forgiveness of these loans with the SBA in the latter half of 2021.

Capital and Liquidity

As of December 31, 2020, all of our capital ratios were in excess of all regulatory requirements. While we believe that we have sufficient capital to withstand an extended economic recession brought about by the COVID-19 pandemic, our reported and regulatory capital ratios could be adversely impacted by credit losses.

We believe there could be potential stresses on liquidity management as a result of the COVID-19 pandemic. For instance, as customers manage their own liquidity stress, we could experience an increase in the utilization of existing lines of credit.

We have developed new processes to monitor our liquidity on a daily basis, and have run stress testing based on various economic assumptions under stress and severe stress scenarios. In addition, management continues to communicate each week in structured meetings with key staff to ensure all current events related to the COVID-19 pandemic, such as; federal government stimulus check receipt, PPP loan fundings and the forgiveness application process, are managed appropriately.

Financial overview

In 2020, we recorded net income of \$27.8 million, or \$0.92 per fully diluted share, which compares with \$39.5 million, or \$1.30 per fully diluted share, in 2019, and \$34.0 million, or \$1.12 per fully diluted share, in 2018. Our basic earnings per share for the periods presented were \$0.94 in 2020, \$1.32 in 2019 and \$1.14 in 2018. Our 2020 net income decreased primarily due to \$10.4 million of provision for credit losses recorded in 2020, compared to a provision for loan and lease losses of \$1.6 million in 2019 and \$1.2 million in 2018. The increase in provision expense in 2020 was primarily driven by the COVID-19 pandemic and market interest rate reductions, and the adoption of the CECL methodology, which requires provision to be recorded based on future expected credit losses, as compared to the prior methodology of provision expense based on historically incurred losses. Net loan charge-offs were \$979,000 in 2020 and \$817,000 in 2019, compared to net loan recoveries of \$317,000 in 2018. The reduction of interest rates by the Federal Reserve in 2020 also impacted our net interest income, which decreased \$5.0 million in 2020 compared to 2019, but increased \$812,000 over 2018, due primarily to higher volumes on earning assets and decreases in the cost of funds. Our 2020 net income was favorably impacted by \$10.0 million of growth in our residential mortgage banking revenues, compared to 2019, and \$9.4 million of growth, compared to 2018. The low interest rate environment in 2020 resulted in a significant increase in mortgage loan refinancing and new mortgage originations.

Net interest and dividend income decreased \$5.0 million, or 5.2%, for 2020 compared to 2019. Average loans, including loans held-for-sale, increased \$122.0 million, or 6.4%, in 2020 compared to 2019. Contributing to this growth was average PPP loans of \$83.3 million in 2020, as well as organic loan growth in our commercial, leases, construction, and commercial real estate-investor loan portfolios. Offsetting our loan growth in 2020, compared to 2019, was an 88 basis point decrease in average rates earned on interest earning assets. Average interest bearing deposits increased \$78.8 million, or 5.4%, for 2020 compared to 2019, while average deposit rates decreased 23 basis points over the same period. The decrease in rates was primarily due to the falling interest rate environment in 2020, due to the Federal Reserve rate reductions in March 2020, and deposit accounts repricing to the lower rates as the year progressed, which impacted all interest-bearing deposit categories. Average noninterest bearing deposits increased by \$181.8 million, or 27.9%, from 2019 to 2020, as a result of commercial demand deposit growth which correlated with federal stimulus funds received due to COVID-19 and the CARES Act, as well as growth in our commercial, leases, construction, and commercial real estate loans.

Net interest and dividend income increased \$5.8 million, or 6.4%, for 2019 compared to 2018. Average loans, including loans held-for-sale, increased \$118.9 million, or 6.7%, in 2019 compared to 2018, resulting from organic loan growth in our commercial, leases, and commercial real estate loan portfolios. Average interest bearing deposits decreased \$17.1 million, or 1.2%, for 2019 compared to 2018, while average rates increased 12 basis points. This increase in rates was primarily due to the rising interest rate environment in the first half of 2019 compared to 2018, which impacted interest rates on all interest-bearing deposit categories. Average noninterest bearing deposits increased by \$41.6 million, or 6.8%, from 2018 to 2019, a result of commercial demand deposit growth which correlated with growth in our commercial, leases and commercial real estate loans.

We continued to reposition our balance sheet in 2020 to provide appropriate funding for loan growth, ensure adequate liquidity during the COVID-19 pandemic, reduce asset quality risk, and decrease our cost of funds through organic deposit growth. In 2020, our available-for-sale securities portfolio increased \$11.5 million, compared to 2019, primarily from purchases in the fourth quarter of 2020 of short duration, high credit quality bonds, net of securities paydowns and calls, to utilize a portion of our excess liquidity on hand. In 2019, our available-for-sale securities portfolio decreased \$56.6 million, compared to 2018, primarily from sales in the third quarter of 2019 due to interest rate reductions and the tightening of credit spreads, which resulted in a \$1.2 million decrease to interest income for 2019, compared to 2018. Net securities losses of \$25,000 were recorded in 2020, compared to net securities gains of \$4.5 million and \$360,000 recorded in 2019 and 2018, respectively, related to sales and calls during those years. Average interest bearing liabilities increased \$10.8 million, to \$1.70 billion in 2020 from \$1.69 billion in 2019, as funding needs in 2020 were also met by an increase in average noninterest bearing deposits year over year.

Management also continued to emphasize credit quality and maintained our capital ratios with continued strong liquidity. In 2020, we experienced loan growth of \$104.0 million, or 5.4%, over 2019. The growth was driven by PPP loan originations, which totaled \$74.1 million as of year end 2020, as well as an active commercial lending team in new and existing markets, and the continued development of a lease lending team. Asset quality levels have remained steady over the last few years in comparison to total loans, as nonperforming assets, increased to \$25.5 million for 2020, compared to \$20.9 million for 2019 and \$23.5 million for 2018. We also continued to take steps to control operating expenses and increase net income. A decline in other real estate owned holdings of \$2.5 million in 2020 resulted in an increase of \$228,000 in net other real estate owned expenses for 2020 compared to 2019, and a decline in other real estate owned holdings of \$2.2 million in 2019 compared to 2018 resulted in a minimal increase of \$27,000 in the like period. As we focused on reducing all noninterest expenses, we were able to maintain our profitable wealth management business and secondary residential real estate originations and sales as important sources of noninterest income.

Critical accounting policies

Our consolidated financial statements are prepared based on the application of accounting policies in accordance with generally accepted accounting principles (“GAAP”) and follow general practices within the banking industry. These policies require the reliance on estimates, assumptions and judgements, which may prove inaccurate or are subject to variations. Changes in underlying factors, estimates, assumptions or judgements could have a material impact on our future financial condition and results of operations.

Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. We have identified the determination of the allowance for credit losses and fair value measurements to be the accounting areas that require the most subjective or complex judgments and, as such, could be most subject to revision as new or additional information becomes available or circumstances change, including overall changes in the economic climate and/or market interest rates. Therefore, we consider these policies, discussed below, to be critical accounting estimates and discuss them directly with the Audit Committee of our board of directors.

Significant accounting policies are presented in Note 1 of the financial statements included in this annual report. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Recent accounting pronouncements and standards that have impacted or could potentially affect us are also discussed in Note 1 of the consolidated financial statements.

Allowance for credit losses

Determining the allowance for loan and lease losses has historically been identified as a critical accounting policy. On January 1, 2020, we adopted the new CECL accounting methodology which requires entities to estimate and recognize an allowance for lifetime expected credit losses for loans and other financial assets measured at amortized cost. Previously, an allowance for loan and lease losses was recognized based on probable incurred losses. The accounting estimates relating to the allowance for credit losses is also a “critical accounting policy” as:

- changes in the provision for credit losses can materially affect our financial results;
- estimates relating to the allowance for credit losses require us to project future borrower performance, including cash flows, delinquencies and charge-offs, along with, when applicable, collateral values, based on a reasonable and supportable forecast period utilizing forward-looking economic scenarios in order to estimate probability of default and loss given default; and
- the allowance for credit losses is influenced by factors outside of our control such as industry and business trends, geopolitical events and the effects of laws and regulations as well as economic conditions such as trends in housing prices, interest rates, GDP, inflation, energy prices and unemployment; and
- considerable judgment is required to determine whether the models used to generate the allowance for credit losses produce an estimate that is sufficient to encompass the current view of lifetime expected credit losses.

Because our estimates of the allowance for credit losses involve judgment and are influenced by factors outside our control, there is uncertainty inherent in these estimates. Our estimate of lifetime expected credit losses is inherently uncertain because it is highly sensitive to changes in economic conditions and other factors outside of our control. Changes in such estimates could significantly impact our allowance and provision for credit losses. See Note 1 – *Basis of Presentation and Changes in Significant Accounting Policies* in the accompanying notes to the consolidated financial statements included elsewhere in this annual report for a discussion of our Allowance for Credit Losses.

As a result of management’s modeling, an allowance for credit losses on loans totaling \$33.9 million was recorded as of December 31, 2020; in addition, an allowance for credit losses on unfunded commitments of \$3.0 million was recorded as of December 31, 2020, within other liabilities. There was no allowance for credit losses on securities determined to be required per management’s review at year end 2020. A provision for credit losses of \$10.4 million was recorded in 2020, comprised of a \$9.2 million provision for credit losses on loans and a \$1.2 million provision for credit losses on unfunded commitments, compared to \$1.6 million and \$1.2 million of loan and lease loss provision recorded in 2019 and 2018, respectively. In addition, a discussion of the factors driving changes in the amount of the ACL is included in the “Allowances for Credit Losses” section below.

Fair Value Measurements

The use of fair values is required in determining the carrying values of certain assets and liabilities, as well as for specific disclosures. Fair value is an estimate of the exchange price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction (i.e., not a forced transaction, such as a liquidation or distressed sale) between market participants at the measurement date and is based on the assumptions market participants would use when pricing an asset or liability.

In determining the fair value of financial instruments, market prices of the same or similar instruments are used whenever such prices are available. If observable market prices are unavailable or impracticable to obtain, we are required to make judgments about assumptions market participants would use in estimating the fair value of the financial instrument. Fair value is estimated using modeling techniques and incorporates assumptions about interest rates, duration, prepayment speeds, risks inherent in a particular valuation technique and the risk of nonperformance. These assumptions are inherently subjective as they require material estimates, all of which may be susceptible to significant change. In 2018, we adopted ASU 2016-01, which, among other topics addressed, required business entities to use the exit price notion, as defined in ASC 820, for the measurement of the fair value of financial instruments. Adoption of this standard resulted in our use of an exit price rather than an entrance price to determine the fair value of loans and deposits not already measured at fair value on a non-recurring basis in the consolidated balance sheet disclosures. See Note 16 “Fair Value Measurements” and Note 17 “Fair Values of Financial Instruments,” to the consolidated financial statements which include information about the extent to which fair value is used to measure assets and liabilities, and the valuation methodologies and key inputs used for further information regarding the valuation processes.

Non-GAAP Financial Measures

This annual report contains references to financial measures that are not defined in GAAP. Such non-GAAP financial measures include the presentation of net interest income and net interest income to interest earning assets on a tax equivalent (“TE”) basis and our tangible common equity to tangible assets ratio. Management believes that the presentation of these non-GAAP financial measures (a) provides important supplemental information that contributes to a proper understanding of our operating performance, (b) enables a more complete understanding of factor and trends affecting our business, and (c) allows investors to evaluate our performance in a manner similar to management, the financial services industry, bank stock analysts, and bank regulators. Management uses non-GAAP measures as follows:

in the preparation of our operating budgets, monthly financial performance reporting, and in our presentation to investors of our performance. However, we acknowledge that these non-GAAP financial measures have a number of limitations. Limitations associated with non-GAAP financial measures include the risk that persons might disagree as to the appropriateness of items comprising these measures and that different companies might calculate these measures differently. These disclosures should not be considered an alternative to our GAAP results. A reconciliation of non-GAAP financial measures to the most directly comparable GAAP financial measures is presented below or alongside the first instance where each non-GAAP financial measure is used.

Results of operations

Net interest income

Net interest income, which is our primary source of earnings, is the difference between interest income earned on interest-earning assets, such as loans and investment securities, as well as accretion income on purchased loans, and interest incurred on interest-bearing liabilities, such as deposits and borrowings. Net interest income depends upon the relative mix of interest-earning assets and interest-bearing liabilities, the ratio of interest-earning assets to total assets and of interest-bearing liabilities to total funding sources, and movements in market interest rates. Our net interest income can be significantly influenced by a variety of factors, including overall loan demand, economic conditions, credit risk, the amount of nonearning assets including nonperforming loans, the amounts of and rates at which assets and liabilities reprice, variances in prepayment of loans and securities, early withdrawal of deposits, exercise of call options on borrowings or securities, a general rise or decline in interest rates, changes in the slope of the yield-curve, and balance sheet growth or contraction. Our asset and liability committee (“ALCO”) seeks to manage interest rate risk under a variety of rate environments by structuring our balance sheet and off-balance sheet positions. This process is discussed in more detail in the section entitled “Interest rate risk” in “Quantitative and Qualitative Disclosures about Market Rate Risk.”

Our net interest income decreased \$5.0 million, or 5.2%, to \$91.8 million for 2020, from \$96.8 million for 2019. The decrease in 2020 was primarily driven by the reduction in market interest rates on loans and securities, and was partially offset by decreases in interest rates on deposits and reductions in short and long-term borrowings. Our net interest margin, which is net interest income divided by total interest-earning assets, was 3.43% for the year ended 2020, compared to 3.98% for the year ended 2019, a decrease of 55 basis points. Our net interest margin on a taxable equivalent (TE) basis, was 3.48% for the year ended 2020, compared to 4.06% for the year ended 2019, a decrease of 58 basis points. Although average interest earning assets increased \$241.3 million during 2020, the market rate reductions were more impactful than the volume growth of lower yielding assets. The decrease in interest expense in 2020 compared to 2019 was due primarily to lower rates paid on all interest bearing deposits, as well as a reduction of our short-term funding needs, as our excess liquidity on hand allowed us to utilize minimal short-term borrowings for the majority of 2020.

Our net interest income increased \$5.8 million, or 6.4%, to \$96.8 million for 2019, from \$90.9 million for 2018. The increase in 2019 was primarily driven by a full year impact of our acquisition of ABC Bank, and was partially offset by increases in interest expense. Our net interest margin was 3.98% for the year ended 2019, compared to 3.87% for the year ended 2018, an increase of 11 basis points. Our net interest margin on a taxable equivalent (TE) basis, which is net interest income divided by total interest-earning assets, was 4.06% for the year ended 2019, compared to 3.96% for the year ended 2018, an increase of ten basis points. The growth in our net interest margin was due to higher loan volumes in 2019, coupled with \$2.1 million of discount accretion on loans acquired in our ABC Bank acquisition in 2018 and Talmer branch purchase in late 2016. The increase in interest expense in 2019 compared to 2018 was due primarily to higher rates paid on all interest bearing deposits, as well as additional short-term funding needs, which increased due to our loan growth and was financed by FHLBC borrowings, which reprice daily.

Our average earning assets increased \$241.3 million, or 9.9%, to \$2.67 billion in 2020, from \$2.43 billion in 2019. The increase was primarily attributable to growth in our interest earning assets with financial institutions of \$158.7 million stemming from federal stimulus funds received, as well as an increase in our loan portfolio, primarily due to PPP loans originated, in addition to organic commercial, lease financing, construction, and commercial real estate loan growth. Our average earning assets increased \$81.5 million, or 3.5%, to \$2.43 billion in 2019, from \$2.35 billion in 2018. The increase was primarily attributable to a full year of average impact of our April 2018 acquisition of ABC Bank, as well as organic commercial, lease financing, and commercial real estate loan growth.

Our average interest bearing liabilities increased \$10.8 million, or 0.6%, from \$1.69 billion in 2019 to \$1.70 billion in 2020, due primarily to an increase in all deposit categories, excluding time deposits. Deposit growth was driven by federal stimulus funds received by depositors, as well as growth in commercial deposit accounts stemming from new commercial loans. Our other short-term borrowings declined due to our excess liquidity on hand, while our average junior subordinated debentures decreased due to our March 2020 redemption of the Old Second Capital Trust I trust preferred securities and related junior subordinated debentures totaling \$32.6 million. Our average interest bearing liabilities decreased \$17.3 million, or 1.0%, from \$1.71 billion in 2018 to \$1.69 billion in 2019, due primarily to a reduction in average NOW, money market, savings and time deposits, as well as growth in commercial demand deposit accounts commensurate with growth in our commercial loan clients, and a modest increase in short-term borrowings used to fund loan growth.

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

**Analysis of Average Balances,
Tax Equivalent Income / Expense and Rates
(Dollars in thousands - unaudited)**

	2020			2019			2018		
	Average Balance	Income / Expense	Rate %	Average Balance	Income / Expense	Rate %	Average Balance	Income / Expense	Rate %
Assets									
Interest earning deposits with financial institutions	\$ 180,439	\$ 258	0.14	\$ 21,783	\$ 459	2.11	\$ 17,540	\$ 334	1.90
Securities:									
Taxable	265,312	6,773	2.55	253,260	9,256	3.65	268,791	9,577	3.56
Non-taxable (TE) ¹	199,386	6,926	3.47	249,976	9,399	3.76	277,555	10,558	3.80
Total securities (TE) ¹	464,698	13,699	2.95	503,236	18,655	3.71	546,346	20,135	3.69
Dividends from FHLBC and FRBC	9,917	484	4.88	10,730	602	5.61	9,305	469	5.04
Loans and loans held-for-sale ^{1,2}	2,019,903	91,241	4.52	1,897,909	97,866	5.16	1,778,996	88,922	5.00
Total interest earning assets	2,674,957	105,682	3.95	2,433,658	117,582	4.83	2,352,187	109,860	4.67
Cash and due from banks	31,143	-	-	34,027	-	-	34,021	-	-
Allowance for credit losses on loans	(29,771)	-	-	(19,548)	-	-	(18,930)	-	-
Other noninterest bearing assets	184,441	-	-	175,306	-	-	180,528	-	-
Total assets	<u>\$ 2,860,770</u>			<u>\$ 2,623,443</u>			<u>\$ 2,547,806</u>		
Liabilities and Stockholders' Equity									
NOW accounts	\$ 456,284	\$ 564	0.12	\$ 432,028	\$ 1,386	0.32	\$ 436,702	\$ 978	0.22
Money market accounts	296,398	497	0.17	289,745	1,086	0.37	307,259	843	0.27
Savings accounts	363,331	508	0.14	308,847	488	0.16	291,611	335	0.11
Time deposits	424,831	5,033	1.18	431,377	6,736	1.56	443,520	5,829	1.31
Interest bearing deposits	1,540,844	6,602	0.43	1,461,997	9,696	0.66	1,479,092	7,985	0.54
Securities sold under repurchase agreements	53,808	202	0.38	43,698	577	1.32	44,122	462	1.05
Other short-term borrowings	11,255	179	1.59	73,757	1,755	2.38	71,041	1,429	2.01
Junior subordinated debentures	31,101	2,215	7.12	57,710	3,724	6.45	57,663	3,716	6.44
Senior notes	44,323	2,692	6.07	44,212	2,699	6.10	44,109	2,688	6.09
Notes payable and other borrowings	22,812	574	2.52	12,008	384	3.20	14,696	398	2.71
Total interest bearing liabilities	1,704,143	12,464	0.73	1,693,382	18,835	1.11	1,710,723	16,678	0.97
Noninterest bearing deposits	832,180	-	-	650,400	-	-	608,762	-	-
Other liabilities	36,758	-	-	22,984	-	-	16,742	-	-
Stockholders' equity	287,689	-	-	256,677	-	-	211,579	-	-
Total liabilities and stockholders' equity	<u>\$ 2,860,770</u>			<u>\$ 2,623,443</u>			<u>\$ 2,547,806</u>		
Net interest income (GAAP)		<u>\$ 91,751</u>			<u>\$ 96,759</u>			<u>\$ 90,939</u>	
Net interest margin (GAAP)			<u>3.43</u>			<u>3.98</u>			<u>3.87</u>
Net interest income (TE) ¹		<u>\$ 93,218</u>			<u>\$ 98,747</u>			<u>\$ 93,182</u>	
Net interest margin (TE) ¹			<u>3.48</u>			<u>4.06</u>			<u>3.96</u>
Core net interest margin (TE - excluding PPP loans) ¹			<u>3.48</u>			<u>4.06</u>			<u>3.96</u>
Interest bearing liabilities to earning assets	<u>63.71 %</u>			<u>69.58 %</u>			<u>72.73 %</u>		

¹ Tax equivalent basis is calculated using a marginal tax rate of 21% in 2020, 2019 and 2018. See the discussion entitled "Non-GAAP Presentations" below and the table on page 43 that provides a reconciliation of each non-GAAP measure to the most comparable GAAP equivalent.

² Interest income from loans is shown on a tax equivalent basis, which is a non-GAAP financial measure, discussed below, and includes fees of \$4.3 million for 2020, and \$1.1 million for both 2019 and 2018. Nonaccrual loans are included in the above stated average balances.

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

(In thousands)	Effect of Tax Equivalent Adjustment		
	2020	2019	2018
Interest income (GAAP)	\$ 104,215	\$ 115,594	\$ 107,617
Taxable equivalent adjustment - loans	12	14	26
Taxable equivalent adjustment - securities	1,455	1,974	2,217
Interest income (TE)	105,682	117,582	109,860
Less: interest expense (GAAP)	12,464	18,835	16,678
Net interest income (TE)	\$ 93,218	\$ 98,747	\$ 93,182
PPP loan - interest and net fee income	\$ 3,116	\$ N/A	\$ N/A
Net interest income (TE - excluding PPP loans)	\$ 90,102	\$ 98,747	\$ 93,182
Net interest income (GAAP)	\$ 91,751	\$ 96,759	\$ 90,939
Average interest earning assets	\$ 2,674,957	\$ 2,433,658	\$ 2,352,187
Average PPP loans	\$ 83,251	N/A	N/A
Average interest earning assets - excluding PPP loans	\$ 2,591,706	\$ 2,433,658	\$ 2,352,187
Net interest margin (GAAP)	3.43 %	3.98 %	3.87 %
Net interest margin (TE)	3.48 %	4.06 %	3.96 %
Core net interest margin (TE - excluding PPP loans)	3.48 %	4.06 %	3.96 %

The following table allocates the changes in net interest income to changes in either average balances or average rates for interest earning assets and interest bearing liabilities. Interest income is measured on a tax-equivalent basis using a 21% marginal rate for all periods presented. Interest income not yet received on nonaccrual loans is reversed upon transfer to nonaccrual status; future receipt of interest income is a reduction to principal while in nonaccrual status.

Analysis of Year-to-Year Changes in Net Interest Income¹

(In thousands)	2020 Compared to 2019			2019 Compared to 2018		
	Change Due to			Change Due to		
	Average Balance	Average Rate	Total Change	Average Balance	Average Rate	Total Change
Interest and dividend income						
Interest earning deposits	\$ (230)	\$ 29	\$ (201)	\$ 87	\$ 38	\$ 125
Securities:						
Taxable	465	(2,948)	(2,483)	(579)	258	(321)
Tax-exempt	(1,797)	(676)	(2,473)	(1,038)	(121)	(1,159)
Dividends from FHLBC and FRBC	(43)	(75)	(118)	76	57	133
Loans and loans held-for-sale	7,130	(13,755)	(6,625)	6,071	2,873	8,944
Total interest and dividend income	5,525	(17,425)	(11,900)	4,617	3,105	7,722
Interest expense						
NOW accounts	83	(905)	(822)	(10)	418	408
Money market accounts	26	(615)	(589)	(45)	288	243
Savings accounts	58	(38)	20	21	132	153
Time deposits	(101)	(1,602)	(1,703)	(154)	1,061	907
Securities sold under repurchase agreements	179	(554)	(375)	(4)	119	115
Other short-term borrowings	(1,133)	(443)	(1,576)	56	270	326
Junior subordinated debentures	(1,947)	438	(1,509)	3	5	8
Senior notes	7	(14)	(7)	6	5	11
Notes payable and other borrowings	250	(60)	190	(1,216)	1,202	(14)
Total interest expense	(2,578)	(3,793)	(6,371)	(1,343)	3,500	2,157
Net interest and dividend income	\$ 8,103	\$ (13,632)	\$ (5,529)	\$ 5,960	\$ (395)	\$ 5,565

¹ The changes in net interest income are created by changes in both interest rates and volumes. In the table above, volume variances are computed using the change in volume multiplied by previous year’s rate. Rate variances are computed using the change in rate multiplied by the previous year’s volume. The change in interest due to both rate and volume has been allocated between factors in proportion to the relationship of absolute dollar amounts of the change in each.

Provision for credit losses

We recorded a provision for credit losses in 2020 of \$10.4 million, comprised of \$9.2 million related to loans and leases, and \$1.2 million related to unfunded commitments, compared to \$1.6 million in 2019 and \$1.2 million in 2018. For additional discussion of the credit provision and allowance for credit losses, see the section below “Allowance for Credit Losses” in Item 7. Management’s Discussion and Analysis of Financial Condition.

Noninterest income

(Dollars in thousands)	Noninterest Income for the Twelve Months ending December 31,			Percent Change From	
	2020	2019	2018	2020-2019	2019-2018
Trust income	\$ 6,409	\$ 6,655	\$ 6,417	(3.7)	3.7
Service charges on deposits	5,512	7,715	7,328	(28.6)	5.3
Residential mortgage banking revenue					
Secondary mortgage fees	1,654	772	696	114.2	10.9
Mortgage servicing rights mark to market loss	(3,999)	(2,662)	(734)	(50.2)	(262.7)
Mortgage servicing income	1,950	1,881	1,939	3.7	(3.0)
Net gain on sales of mortgage loans	15,519	5,112	3,791	203.6	34.8
Total residential mortgage banking revenue	15,124	5,103	5,692	196.4	(10.3)
Securities gains (losses), net	(25)	4,511	360	(100.6)	N/M
Increase in cash surrender value of BOLI	1,233	1,415	984	(12.9)	43.8
Death benefit realized on bank-owned life insurance	57	872	1,026	(93.5)	(15.0)
Card related income	5,532	5,861	5,663	(5.6)	3.5
Other income	3,645	3,668	3,883	(0.6)	(5.5)
Total noninterest income	\$ 37,487	\$ 35,800	\$ 31,353	4.7	14.2

N/M - Not meaningful

Our total noninterest income increased \$1.7 million, or 4.7%, to \$37.5 million for 2020, compared to \$35.8 million for 2019. This increase was due to growth in total residential mortgage banking revenues, primarily attributable to net gain on sales of mortgage loans. Originations of residential loans held-for-sale increased by 133.4 % in 2020 over 2019, and net gain on the sales of mortgage loans increased by over 200% year over year, due to the low market interest rates for the majority of 2020. Secondary mortgage service fees and mortgage servicing income also increased in 2020 compared to 2019. These positive variances were partially offset by growth in mark to market losses on mortgage servicing rights, which increased \$1.3 million, or 50.2%, in 2020, compared to 2019. Service charges on deposits decreased \$2.2 million, or 28.6%, and card-related income decreased \$329,000, or 5.6%, in 2020, compared to 2019, as consumer spending was muted as a result of the COVID-19 pandemic. We had net losses on securities of \$25,000 in 2020, primarily due to sales of \$18.0 million, compared to a net gain of \$4.5 million in 2019, due to portfolio sales of \$191.3 million in 2019. Security sales in 2019 were executed to take advantage of the tightening credit spreads in the falling interest rate environment. Finally, BOLI death benefit proceeds of \$57,000 were realized in 2020, compared to \$872,000 of BOLI death benefit proceeds realized in 2019, and the increase in cash surrender value of BOLI declined by \$182,000 for the year ended December 31, 2020, compared to the 2019 like period.

Our total noninterest income increased \$4.4 million to \$35.8 million in 2019, compared to \$31.4 million in 2018. In 2019, we continued to implement our strategy to grow trust income and service charges on deposits, subject to applicable bank regulations. Trust income increased \$238,000 in 2019 from 2018, due primarily to growth in agent fees, IRA management fees, and management emphasis on advisory fee growth. Average assets under management by our wealth management department totaled \$1.21 billion for 2019, reflecting growth of \$33.0 million, or 2.8%, from \$1.18 billion for 2018. Service charges on deposits increased \$387,000 in 2019 from 2018 due primarily to growth in commercial demand related account fees, as a result of increases in commercial demand deposit balances commensurate with management’s focus on growing commercial loans. Residential mortgage banking revenue declined \$589,000 in 2019 from 2018, due primarily to a rising interest rate environment in the first half of 2019 and the negative impact of the rate changes to mortgage servicing rights, which were partially offset by an increase of \$30.8 million in mortgage loans originated for sale in 2019. Security gains, net, of \$4.5 million were recorded in 2019, relating to security sales of \$191.3 million, compared to security gains, net, of \$360,000 in 2018 related to \$94.7 million of securities sales in 2018. We recorded a death benefit of \$872,000 on bank owned life insurance, or BOLI, in 2019, in addition to the \$431,000 increase in cash surrender value of BOLI compared to 2018. Finally, other income decreased \$215,000 in 2019 compared to 2018 due to a decrease in interest rate swap fee income on commercial swaps.

Noninterest expense

(Dollars in thousands)	Noninterest Expense for the Twelve Months ending December 31,			Percent Change From	
	2020	2019	2018	2020-2019	2019-2018
Salaries	\$ 38,058	\$ 36,413	\$ 34,031	4.5	7.0
Officers incentive	3,574	3,378	3,131	5.8	7.9
Benefits and other	7,915	7,078	6,999	11.8	1.1
Total salaries and employee benefits	<u>49,547</u>	<u>46,869</u>	<u>44,161</u>	5.7	6.1
Occupancy, furniture and equipment	8,498	8,289	6,915	2.5	19.9
Computer and data processing	5,143	5,631	6,745	(8.7)	(16.5)
FDIC insurance	597	176	653	239.2	(73.0)
General bank insurance	1,030	1,002	1,040	2.8	(3.7)
Amortization of core deposit intangible	494	539	387	(8.3)	39.3
Advertising expense	298	1,225	1,567	(75.7)	(21.8)
Card related expense	2,195	1,956	1,985	12.2	(1.5)
Legal fees	761	675	835	12.7	(19.2)
Other real estate owned expense, net	651	423	396	53.9	6.8
Other expense	12,203	12,317	12,444	(0.9)	(1.0)
Total noninterest expense	<u>\$ 81,417</u>	<u>\$ 79,102</u>	<u>\$ 77,128</u>	2.9	2.6

N/M - Not meaningful

Our total noninterest expense increased by \$2.3 million, or 2.9%, in 2020 compared to 2019. The increase was primarily attributable to a \$2.7 million increase in salaries and employee benefits, due primarily to an increase in salary costs as 2020 reflected a full year of the commercial lending team hires in mid-year 2019, annual merit increases in early 2020, growth in mortgage commissions paid due to an increase in residential loan origination volumes, higher employee insurance costs and an increase in company matches on 401k deferrals due to the earlier eligibility allowed to enter our 401k plan. In addition, occupancy, furniture and equipment expense increased \$209,000 due to planned building repairs at various branch locations in 2020. FDIC insurance expense increased \$421,000, due to assessment credits received in 2019 after the FDIC reached its required reserve ratio, that were not repeated in 2020; see “Supervision and Regulation Deposit Insurance” for further discussion of these assessment credits. Partially offsetting these increases to noninterest expense were reductions in computer and data processing, advertising expense, and other expense. Advertising expense decreased in 2020, as we continued to assess our marketing strategy and opportunities for future promotion of our 150th anniversary in 2021.

Our total noninterest expense increased by \$2.0 million, or 2.6%, in 2019 compared to 2018. The increase was primarily attributable to a full year of costs related to our acquisition of ABC Bank in the second quarter of 2018, which increased salaries and employee benefits, and occupancy, furniture and equipment expense. In addition to the acquisition-related expense, as part of our strategic plan, we also made significant improvements, repairs and maintenance in 2019 on our various bank locations. Computer and data processing and legal fees decreased in 2019 compared to 2018, as the 2018 expenses included acquisition related costs. FDIC insurance expense decreased \$477,000, or 73.0%, in 2019 from 2018 due to assessment credits received in 2019 after the FDIC reached its required reserve ratio. Amortization of core deposit intangibles increased \$152,000, or 39.0%, in 2019, reflecting a full year of expense of the ABC Bank acquired deposit premium. Advertising expense decreased in 2019, as we began to assess our marketing strategy and opportunities for future promotion of our 150th anniversary in 2021. Our other real estate owned expenses, net, increased marginally by \$27,000 due to continued low levels of other real estate held, and reductions in valuation reserves taken in 2019.

Our number of full-time equivalent employees was 533 as of December 31, 2020, compared to 535 as of December 31, 2019 and 518 as of December 31, 2018. Staffing levels remained stable in 2020 as our team converted to primarily remote work due to the COVID-19 pandemic. The increase in staffing levels from 2018 to 2019 of 17 employees was primarily driven by growth in our specialty commercial lending teams in mid-year 2019 and our compliance team. Management continues to be diligent in controlling the hiring of additional personnel, even as positions become open, as we seek to efficiently utilize our current staff and control expenses.

Income taxes

Our provision for income taxes includes both federal and state income tax expense (benefit). An analysis of the provision for income taxes for the three years ended December 31, 2020, is detailed in Note 10 of the consolidated financial statements and our income tax accounting policies are described in Note 1 to the consolidated financial statements.

Our income tax expense totaled \$9.6 million for 2020 compared to an income tax expense of \$12.4 million for 2019 and \$9.9 million for 2018. Income tax expense reflected all relevant statutory tax rates and GAAP accounting. Our effective tax rate was 25.6% for 2020, 23.9% for 2019, and 22.6% for 2018. Any changes in tax rates will be recorded in the period enacted.

The determination of whether we will be able to realize our deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, available tax planning strategies, and assessments of both current and future economic and business conditions. Management considered both positive and negative evidence regarding our ability to ultimately realize the deferred tax assets, which is largely dependent on our ability to derive benefits based on future taxable income. For all periods presented, management determined that the realization of the deferred tax asset was "more likely than not" as required by GAAP.

Financial condition

General

Our total assets were \$3.04 billion at December 31, 2020, an increase of \$405.3 million, or 15.4%, from December 31, 2019. Our total cash and cash equivalents increased \$279.3 million, driven by an increase in interest earning deposits with financial institutions, primarily due to stimulus payments our customers received from the federal government, as well as decreased consumer spending related to the COVID-19 pandemic. Our loans increased by \$104.0 million, or 5.4%, to \$2.03 billion for the year ended December 31, 2020, compared to 2019. We experienced loan growth due to \$136.7 million of PPP loan originations during 2020, \$74.1 million of which were outstanding as of December 31, 2020. In addition, we also had organic loan growth in 2020, primarily in our commercial, leases, construction and commercial real estate investor loan portfolios. Total securities increased by \$11.5 million, or 2.4%, for the year ended December 31, 2020. Our portfolio mix remained static overall, but we were able to benefit from tight credit spreads and executed sales, primarily in the first quarter of 2020 just prior to the decline in interest rates, recording pretax net security losses of \$25,000 in 2020. In 2020, management emphasized a desire for excess liquidity due to the unknown needs stemming from the COVID-19 pandemic, as well as short duration investments and credit quality in all investing and lending decisions. We also continued to experience a high level of competition for loans in our target markets. The balance of our other real estate owned decreased to \$2.5 million as of December 31, 2020, from \$5.0 million as of December 31, 2019.

Our total liabilities were \$2.73 billion at December 31, 2020, an increase of \$376.1 million, or 16.0%, from December 31, 2019. Total deposits increased by \$410.3 million, or 19.3%, to \$2.54 billion for the year ended December 31, 2020, compared to \$2.13 billion for the year ended December 31, 2019, primarily due to growth in commercial demand deposits commensurate with our commercial and commercial real estate loan growth. Management continued to fund new lending with deposit growth and securities sold under repurchase agreements, and we were able to reduce our short term borrowings from the Federal Home Loan Bank of Chicago (the "FHLBC") due to our liquidity on hand.

At December 31, 2020, total stockholders' equity was \$307.1 million, compared to \$277.9 million at December 31, 2019.

Investments

As shown below, we experienced minimal changes in the overall composition of our securities portfolio from 2019 to 2020. However, the size of the portfolio increased in 2020 compared to 2019 primarily due to an increase in unrealized mark to market gains of \$14.7 million in 2020.

Securities Available-for-Sale Portfolio

(Dollars in thousands)	2020			2019			2018		
	Amortized Cost	Fair Value	% of Total	Amortized Cost	Fair Value	% of Total	Amortized Cost	Fair Value	% of Total
Securities available-for-sale									
U.S. Treasury	\$ 4,014	\$ 4,117	0.8	\$ 4,010	\$ 4,036	0.8	\$ 4,006	\$ 3,923	0.7
U.S. government agencies	6,811	6,657	1.3	8,502	8,337	1.7	11,112	10,951	2.0
U.S. government agency mortgage-backed	16,098	17,209	3.5	16,164	16,588	3.4	14,407	14,075	2.6
States and political subdivisions	229,352	249,259	50.2	240,399	249,175	51.4	277,112	274,067	50.6
Collateralized mortgage obligations	53,999	56,585	11.4	57,059	57,984	12.0	66,494	64,429	11.9
Asset-backed securities	130,959	131,818	26.6	82,114	81,844	16.9	108,574	109,514	20.3
Collateralized loan obligations	30,728	30,533	6.2	66,898	66,684	13.8	65,162	64,289	11.9
Total securities available-for-sale	\$ 471,961	\$ 496,178	100.0	\$ 475,146	\$ 484,648	100.0	\$ 546,867	\$ 541,248	100.0

Our investment portfolio serves as both an important source of liquidity and as a source of income. Accordingly, the size and composition of the portfolio reflects our liquidity needs, loan demand and interest income objectives. We will adjust the size and composition of the portfolio from time to time. While a significant portion of the portfolio consists 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.

Our total securities as of December 31, 2020, reflected a net increase of \$11.5 million, or 2.4%, from December 31, 2019. We executed security sales in 2020 to take advantage of the tightening credit spreads in the declining interest rate environment, recording \$18.0 million of sales in collateralized loan obligations, as well as recording \$48.1 million of maturities, paydowns and calls primarily in states and political subdivisions and collateralized loan obligations. We recorded net securities losses of \$25,000 in 2020 related to sales and calls during the year. We executed securities purchases in the latter half of 2020 to use a portion of our excess liquidity, with investments primarily in asset-backed securities.

Our total securities as of December 31, 2019, reflected a net decrease of \$56.6 million, or 10.5%, from December 31, 2018. We executed security sales in 2019 to take advantage of the tightening credit spreads in the falling interest rate environment, with the reduction occurring primarily in states and political subdivisions, collateralized mortgage obligations (“CMOs”), and asset-backed securities. In addition, net paydowns and calls totaled \$41.8 million in 2019, primarily due to the falling interest rate environment. We recorded net securities gains of \$4.5 million in 2019 related to sales and calls during the year.

Some of our holdings of U.S. government agency MBS and CMOs are issuances of government-sponsored enterprises, such as Fannie Mae and Freddie Mac, which are not backed by the full faith and credit of the U.S. government. Some holdings of MBS and CMOs are issued by Ginnie Mae, which do carry the full faith and credit of the U.S. government. We also hold some MBS and CMOs that were not issued by U.S. government agencies and are typically credit-enhanced via over-collateralization and/or subordination. Holdings of ABS were largely comprised of securities backed by student loans issued under the U.S. Department of Education’s (“DOE”) FFEL program, which generally provides a minimum 97% U.S. DOE guarantee of principal. These ABS securities also have added credit enhancement through over-collateralization and/or subordination. The majority of holdings issued by states and political subdivisions are general obligation or revenue bonds that have S&P or Moody’s ratings of AA- or higher. Other state and political subdivision issuances are unrated and generally consist of smaller investment amounts that involve issuers in our markets. The credit quality of these issuers is monitored and none have been identified as posing a material risk of loss. We also hold collateralized loan obligation (“CLO”) securities that are generally backed by a pool of debt issued by multiple middle-sized and large businesses. Our CLO S&P or Moody’s ratings distribution consists of 58% rated A, 26% rated AA and 14% rated AAA. CLO credit enhancement is achieved through over-collateralization and/or subordination.

The following table presents the expected maturities or call dates and weighted average yield (nontax equivalent) of securities by major category as of December 31, 2020. Securities not due at a single maturity date are shown only in the total column.

Securities Portfolio Maturity and Yields

(Dollars in thousands)	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale										
U.S. Treasury	\$ -	-	\$ 4,117	1.85 %	\$ -	-	\$ -	-	\$ 4,117	1.85 %
U.S. government agencies	-	-	-	-	6,657	1.28 %	-	-	6,657	1.80
States and political subdivisions	427	2.09 %	1,945	2.67	22,370	2.66	224,517	3.02 %	249,259	2.98
	427	2.09	6,062	2.11	29,027	2.33	224,517	3.02	260,033	2.92
Mortgage-backed securities and collateralized mortgage obligations	-	-	-	-	-	-	-	-	73,794	2.95
Asset-backed securities	-	-	-	-	-	-	-	-	131,818	1.37
Collateralized loan obligations	-	-	-	-	-	-	-	-	30,533	2.04
Total securities available-for-sale	\$ 427	2.09 %	\$ 6,062	2.11 %	\$ 29,027	2.33 %	\$ 224,517	3.02 %	\$ 496,178	2.44 %

As of December 31, 2020, net unrealized gains on available-for-sale securities totaled \$24.2 million, which offset by deferred income taxes resulted in an overall increase to equity capital of \$17.4 million. As of December 31, 2019, net unrealized losses on available-for-sale securities totaled \$9.5 million, which offset by deferred income taxes resulted in an overall increase to equity capital of \$6.8 million.

At December 31, 2020, there was one issuer of CMOs where the book value of our holdings were greater than 10% of our stockholders' equity, as follows:

Issuer	December 31, 2020	
	Amortized Cost	Fair Value
Towd Point Mortgage Trust	\$ 33,198	\$ 35,479

Loans

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

Loan Portfolio

(Dollars in thousands)	2020		2019		2018		2017		2016	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commercial	\$ 407,159	20.0	\$ 332,842	17.2	\$ 314,323	16.6	\$ 272,851	16.9	\$ 228,113	15.4
Leases	141,601	7.0	119,751	6.2	78,806	4.2	68,325	4.2	55,451	3.7
Commercial real estate - Investor	582,042	28.6	520,095	26.9	449,109	23.7	418,749	25.9	406,009	27.5
Commercial real estate - Owner occupied	333,070	16.4	345,504	17.9	371,832	19.6	332,242	20.5	330,238	22.3
Construction	98,486	4.8	69,617	3.6	108,390	5.7	85,162	5.3	64,720	4.4
Residential real estate - Investor	56,137	2.8	71,105	3.7	70,458	3.7	55,620	3.4	56,097	3.8
Residential real estate - Owner occupied	116,388	5.7	136,023	7.0	140,382	7.4	128,005	7.9	123,626	8.4
Multifamily	189,040	9.3	189,773	9.8	196,228	10.3	129,772	8.0	96,502	6.5
HELOC	80,908	4.0	91,605	4.7	95,046	5.0	98,638	6.1	101,626	6.9
HELOC - Purchased	19,487	1.0	31,852	1.6	45,396	2.4	14,195	0.9	-	-
Other ¹	10,533	0.4	12,258	0.9	14,439	0.7	13,383	0.9	15,210	1.0
Total loans, excluding deferred loans costs and PCI loans²	2,034,851	100.0	1,920,425	99.5	1,884,409	99.3	1,616,942	100.0	1,477,592	99.9
Net deferred loans costs	-	-	1,786	0.1	1,653	0.1	680	-	1,217	0.1
Total loans, excluding PCI loans²	2,034,851	100.0	1,922,211	99.6	1,886,062	99.4	1,617,622	100.0	1,478,809	100.0
PCI loans	-	-	8,601	0.4	10,965	0.6	-	-	-	-
Total loans, including deferred loan costs and PCI loans²	\$ 2,034,851	100.0	\$ 1,930,812	100.0	\$ 1,897,027	100.0	\$ 1,617,622	100.0	\$ 1,478,809	100.0

¹ The "Other" class includes consumer loans and overdrafts.

² As noted in the paragraph below, for periods before the Company's adoption of CECL on January 1, 2020, PCI loans and their related deferred loan costs (now PCD loans) were excluded from nonperforming loan disclosures and were therefore separately reported. After the adoption of CECL, all PCD loans are now included within each relevant loan type and are not separately reported as PCI loans, because such loans are now included within the Company's nonperforming loan disclosures, if such loans otherwise meet the definition of a nonperforming loan.

Our total loans were \$2.03 billion as of December 31, 2020, an increase of \$104.0 million from \$1.93 billion as of December 31, 2019. Growth in the year over year period was primarily due to PPP loan originations of \$136.7 million, recorded within commercial loans, with \$74.1 million of PPP loans outstanding as of December 31, 2020. In addition, we experienced organic growth primarily in our commercial, leases, commercial real estate—investor and construction loan portfolios. Total loan originations and renewals of \$1.11 billion were recorded in 2020, which were largely offset by accelerated paydowns experienced in 2020. We strive to serve customers in and around our geographic locations and continue to seek opportunities in our primary lending markets; however, our markets remain very competitive for new loan business.

Our total loans were \$1.93 billion as of December 31, 2019, an increase of \$33.8 million from \$1.90 billion as of December 31, 2018. In 2019, we continued our focus on identifying commercial and industrial loan prospects that conform to our loan policies, and we increased commercial loans by \$18.5 million, leases by \$40.9 million, and commercial real estate—investor loans by \$71.0 million, compared to 2018. Our loan growth in 2018 was driven by our ABC Bank acquisition of \$227.6 million of loans, net of purchase accounting adjustments, as well as organic loan and lease financing growth and two HELOC purchases from a third party of \$41.6 million.

We worked diligently to build loan origination pipelines in a competitive marketplace during the past four years, as evidenced by our loan growth of 5.4% in 2020, 1.8% in 2019, 17.3% in 2018 and 9.4% in 2017. Management continues to emphasize loan portfolio quality, which was evidenced by the stable nonperforming loan metrics discussed in the “Asset Quality” section below. As a result, we recorded net loan charge-offs of \$979,000 in 2020, net loan charge-offs of \$817,000 in 2019, and \$317,000 of net loan recoveries in 2018.

The quality of our loan portfolio is in large part a reflection of the economic health of the communities in which we operate. Our local communities have been relatively stable in the past five years, as reflected in our loan growth and declines in classified assets, as discussed in the “Asset Quality” section below. Real estate lending categories comprised the largest group in the portfolio for all years presented. In addition, our lending exposure is diversified across our commercial, leasing, commercial real estate, residential real estate, construction loan, multifamily and HELOC portfolios, with total loan portfolio growth increasing in each of the five years presented. We remain committed to overseeing and managing our loan portfolio to avoid unnecessarily high credit concentrations in accordance with the general interagency guidance on risk management. Consistent with those commitments, management monitors our asset diversification and anticipates that the percentage of real estate lending in relation to the overall portfolio will decrease in the future.

The following table sets forth the remaining contractual maturities for loan categories at December 31, 2020:

Maturity and Rate Sensitivity of Loans to Changes in Interest Rate

(In thousands)	Over 1 Year						Total
	One Year or Less	Through 5 Years		Over 5 Years			
		Fixed Rate	Floating Rate	Fixed Rate	Floating Rate		
Commercial Loans	\$ 185,947	\$ 120,626	\$ 74,079	\$ 11,089	\$ 15,418	\$ 407,159	
Leases	2,737	112,115	588	26,161	-	141,601	
Commercial real estate - Investor	105,819	218,215	132,168	38,934	86,906	582,042	
Commercial real estate - Owner Occupied	39,751	200,099	25,273	12,464	55,483	333,070	
Construction	47,578	8,474	34,779	6,798	857	98,486	
Real estate - Investor	9,470	22,941	10,474	888	12,364	56,137	
Real estate - Owner Occupied	26,399	10,971	34,013	15,903	29,102	116,388	
Multifamily	38,967	106,042	38,523	3,784	1,724	189,040	
HELOC	2,449	1,266	15,259	8,904	53,030	80,908	
HELOC - Purchased	-	-	-	19,487	-	19,487	
Other ¹	4,796	2,040	3,417	30	250	10,533	
Total	\$ 463,913	\$ 802,789	\$ 368,573	\$ 144,442	\$ 255,134	\$ 2,034,851	

¹ The “Other” class includes consumer loans and overdrafts; column one includes demand notes.

While there are no significant concentrations of loans where the customers’ ability to honor loan terms is dependent upon a single economic sector, the real estate related categories represented 72.5% and 75.4% of the portfolio at December 31, 2020 and 2019, respectively. We had no concentration of loans exceeding 10% of total loans that were not otherwise disclosed as a category of loans at December 31, 2020.

Our ACL on loans was \$33.9 million at year-end 2020, compared to \$19.8 million at year-end 2019, and \$19.0 million at year-end 2018. One measure of the adequacy of the ACL is the ratio of the allowance for credit losses on loans to total loans. The ACL as a percentage of total loans was 1.7% as of December 31, 2020 and 1.0% as of December 31, 2019. In management’s judgment, an adequate allowance for estimated losses has been established; however, there can be no assurance that losses will not exceed the estimated amounts in the future.

Commercial real estate values have generally stabilized in the greater metro Chicago area with increased competition for the financing investor and multifamily transactions. While we continue to adhere to rigorous underwriting standards, we could experience increased levels of delinquencies, problem loans and losses in future periods if an economic recession or politically triggered economic instability develops.

Asset Quality

Beginning on January 1, 2020, we calculated our ACL using the CECL methodology. The provision for credit losses, which includes a provision for losses on unfunded commitments, is a charge to earnings to maintain the ACL at a level consistent with management's assessment of expected losses over the expected life of the loan portfolio as well as considering changes in macroeconomic conditions. Before January 1, 2020, we calculated an allowance for loan losses using the incurred losses methodology.

Based on our portfolio composition at December 31, 2019, and the economic environment at that time, we recorded an overall increase in our ACL for loans and leases of \$5.9 million and an ACL for unfunded commitments of \$1.7 million as of January 1, 2020, the date we adopted CECL. Approximately \$2.5 million of the increase to the ACL on loans resulted from the transfer of the non-accretable purchase accounting adjustments on purchased credit impaired loans. There was no impact from adoption of CECL on securities available-for sale. As a result of the adoption of CECL, we recorded a reduction to retained earnings of approximately \$3.8 million, which was net of the \$1.4 million deferred tax asset impact stemming from adoption.

During 2020, we recorded \$9.2 million of provision for credit losses on loans and \$1.2 million of provision for credit losses on unfunded commitments, compared to \$1.6 million of provision for loan and lease losses recorded for 2019, and \$1.2 million for 2018. The increase in the provision for credit losses was due to the COVID-19 pandemic and market interest rate reductions, as our assumptions under the newly adopted CECL methodology, which requires a provision based on expected credit losses over the life of the loans, as compared to the previously used incurred loss model.

Nonperforming loans consist of nonaccrual loans, performing restructured accruing loans and loans 90 days or greater past due still accruing interest. Remediation work continues in all segments. Management believes that the full impacts of the COVID-19 pandemic are not yet known. The fiscal stimulus and relief programs appear to have delayed any materially adverse financial impact to the Bank. Once these stimulus programs have been exhausted, however, we believe our credit metrics could worsen and loan losses could ultimately materialize. Any potential loan losses will be contingent upon a number of factors beyond our control, such as the resurgence of the virus, including any new strains, offset by the potency of vaccines along with their extensive distribution, and the ability for customers and businesses to return to their pre-pandemic routines.

Nonperforming loans increased by \$7.2 million to \$23.0 million at December 31, 2020, from \$15.8 million at December 31, 2019. Nonperforming assets, which includes nonperforming loans plus other real estate owned, totaled \$25.5 million as of December 31, 2020, compared to \$20.9 million as of December 31, 2019. Purchased credit deteriorated loans, or PCD loans, are purchased loans that, as of the date of acquisition, the Company determined had experienced a more-than-insignificant deterioration in credit quality since origination. As of the date of CECL adoption, \$2.5 million of the credit related component of the purchase accounting adjustment on PCI loans was reclassified to the ACL upon reclassification to PCD status, which contributed to the \$4.7 million increase in nonperforming assets since December 31, 2019. Credit metrics, excluding the impact of this reclassification, continue to be relatively stable regarding nonperforming loan levels, and management is carefully monitoring loans considered to be in a classified status. Nonperforming loans as a percent of total loans increased to 1.1% as of December 31, 2020, from 0.8% as of December 31, 2019, and 0.9% December 31, 2018. The distribution of our nonperforming loans is shown in the following table.

Risk Elements

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

(Dollars in thousands)	2020	2019	2018	2017	2016
Nonaccrual loans	\$ 22,280	\$ 12,432	\$ 13,741	\$ 14,388	\$ 15,283
Performing troubled debt restructured loans accruing interest	331	872	1,683	988	718
Loans past due 90 days or more and still accruing interest	434	2,545	917	248	-
Total nonperforming loans	23,045	15,849	16,341	15,624	16,001
Other real estate owned	2,474	5,004	7,175	8,371	11,916
Total nonperforming assets	\$ 25,519	\$ 20,853	\$ 23,516	\$ 23,995	\$ 27,917
PCI loans, net of purchase accounting adjustments ⁽¹⁾	\$ -	\$ 8,601	\$ 10,965	\$ -	\$ -
Other real estate owned ("OREO") as % of nonperforming assets, excluding PCI loans	9.7 %	24.0 %	30.5 %	34.9 %	42.7 %

1 In 2020, due to the adoption of CECL, PCD loans (formerly PCI loans) are now included in total nonperforming assets, if their risk rating at period end so indicates. For all periods before 2020, PCI loans were not included within total nonperforming assets since we were accruing interest income over the expected life of the loan.

Total past due loans, including accruing and nonaccrual loans, totaled \$22.9 million at year-end 2020, a \$6.4 million decrease from year end 2019, resulting in the rate of past due loans to total loans decreasing to 1.13% at year-end 2020 compared to 1.33% at year-end 2019, and 0.97% at year-end 2018. Refer to Note 4, "Loans", in our consolidated financial statements, below, for further detail of past due loans by classification for 2020 and 2019.

Accrual of interest is discontinued on a loan when principal or interest is 90 days or more past due, unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual status, interest previously accrued but not collected in the current period is reversed against current period interest income. Interest income of approximately \$70,000, \$347,000 and \$335,000 was recorded and collected during 2020, 2019 and 2018, respectively, on loans that subsequently went to nonaccrual status by year-end. Interest income, which would have been recognized during 2020, 2019 and 2018, had these loans been on an accrual basis throughout the year, was approximately \$461,000, \$1.3 million and \$952,000, respectively. There were approximately \$1.3 million and \$4.5 million in restructured residential mortgage loans that were still accruing interest based upon their prior performance history at December 31, 2020 and 2019, respectively. Additionally, the nonaccrual loans above include \$2.7 million and \$3.4 million in restructured loans for the years ending December 31, 2020 and 2019.

Classified Assets

(Dollars in thousands)	Classified assets as of December 31,			Percent Change From	
	2020	2019	2018	2020-2019	2019-2018
Commercial	\$ 2,679	\$ 11,688	\$ 137	(77.1)	N/M
Leases	3,222	329	-	879.3	N/M
Commercial real estate - Investor	5,117	4,926	13,248	3.9	(62.8)
Commercial real estate - Owner occupied	11,187	7,956	10,635	40.6	(25.2)
Construction	5,192	262	2,610	N/M	(90.0)
Residential real estate - Investor	1,516	1,390	1,216	9.1	14.3
Residential real estate - Owner occupied	4,040	3,631	4,524	11.3	(19.7)
Multifamily	7,558	503	979	N/M	(48.6)
HELOC	1,540	1,789	1,889	(13.9)	(5.3)
HELOC - Purchased	-	180	-	(100.0)	N/M
Other ¹	4	359	31	(98.9)	N/M
Total classified loans, excluding PCI loans ²	42,055	33,013	35,269	27.4	(6.4)
Other real estate owned	2,474	5,004	7,175	(50.6)	(30.3)
Total classified assets, excluding PCI loans ²	44,529	38,017	42,444	17.1	(10.4)
PCI, net of purchase accounting adjustments ²	-	8,601	10,965	(100.0)	(21.6)
Total classified assets	\$ 44,529	\$ 46,618	\$ 53,409	(4.5)	(12.7)

N/M - Not meaningful

¹ The "Other" class includes consumer loans and overdrafts.

² In 2020, due to the adoption of CECL, PCD loans (formerly PCI loans) are now included in total classified loans, if their risk rating at period end so indicates. For all periods before 2020, PCI loans were not included within total classified loans since we were accruing interest income over the expected life of the loan.

Classified loans include nonaccrual, performing troubled debt restructurings and all other loans considered substandard. Classified assets include both classified loans and OREO. Loans classified as substandard are inadequately protected by either the current net worth and ability to meet payment obligations of the obligor, or by the collateral pledged to secure the loan, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt and carry the distinct possibility that we will sustain some loss if deficiencies remain uncorrected.

Total classified loans increased in 2020 compared to 2019 but decreased in 2019 compared to 2018. The increase in classified loans in 2020 was primarily attributable to our adoption of CECL on January 1, 2020 and the allocation of PCD loans, formerly PCI loans, to the appropriate segment classification if the risk rating so indicated. Total classified assets decreased in 2020 compared to both 2019 and 2018. Classified assets, which includes classified loans and OREO, was favorably impacted by a \$2.5 million decrease in our OREO portfolio, in 2020 from 2019, and a \$2.2 million decrease in our OREO portfolio in 2019 from 2018. Management monitors a metric of

classified assets to the sum of Bank Tier 1 capital and the ACL, which is referred to as the “classified assets ratio.” Our classified assets ratio increased to 12.64% at December 31, 2020, compared to 11.11% at December 31, 2019, from 13.49% at December 31, 2018.

Potential Problem Loans

We utilize an internal asset classification system as a means of reporting problem and potential problem assets. At the scheduled board of directors meetings of the Bank, loan listings are presented, which show significant loan relationships listed as “Special Mention,” “Substandard,” and “Doubtful.” Loans classified as Substandard include those that have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent as those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets that do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management’s close attention, are deemed to be Special Mention.

Management defines potential problem loans as performing loans rated Substandard that do not meet the definition of a nonperforming loan. These potential problem loans carry a higher probability of default and require additional attention by management. A more detailed description of these loans can be found in Note 4 to the Consolidated Financial Statements, as listed in the credit quality indicators discussion.

Allowance for Credit Losses

Upon adoption of CECL on January 1, 2020, (Day One), we recognized an increase in our ACL on outstanding loans of \$5.9 million and an increase in our ACL on unfunded commitments of \$1.7 million as a cumulative effect adjustment from change in accounting policies. Approximately \$2.5 million of the increase to the ACL resulted from the transfer of the non-accretable purchase accounting adjustments on PCD loans. The Day One adjusting entries resulted in a \$3.8 million reduction to retained earnings, and a deferred tax asset adjustment of \$1.4 million. At December 31, 2020, the ACL on loans totaled \$33.9 million, and the ACL on unfunded commitments, included in other liabilities, totaled \$3.0 million, compared to the allowance for loan and lease losses of \$19.8 million as of December 31, 2019, under the incurred loss model, with no allowance for unfunded commitments. This increase in the ACL during 2020 was driven by forecast assumptions due to the COVID-19 pandemic, primarily related to unemployment and GDP expectations over the remaining life of the loans, as well as the following:

- An initial forecast period of one year for all portfolio segments and off-balance-sheet credit exposures. This period reflects management’s expectation of losses based on forward-looking economic scenarios over that time.
- A historical reversion loss forecast period covering the remaining contractual life, adjusted for prepayments, by portfolio segment based on the historical loss rate of loans within those segments.
- The initial loss forecast period and historical reversion loss rate is based on economic conditions at the measurement date.
- We primarily utilized the static pool and migration analysis methods to estimate credit losses. Such methods would obtain estimated life-time credit losses using the conceptual components described above.

See Note 1 – *Basis of Presentation and Changes in Significant Accounting Policies* in the accompanying notes to the consolidated financial statements in this annual report for discussion of our ACL methodology on loans.

Summary of Loan Loss Experience

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

Analysis of Allowance for Credit Losses

(Dollars in thousands)	2020	2019	2018	2017	2016
Average total loans (exclusive of loans held-for-sale)	<u>\$ 2,009,774</u>	<u>\$ 1,894,745</u>	<u>\$ 1,776,230</u>	<u>\$ 1,534,673</u>	<u>\$ 1,214,804</u>
Allowance at beginning of year	19,789	19,006	17,461	16,158	16,223
Charge-offs:					
Commercial	39	109	41	25	95
Leases	206	49	13	215	23
Commercial real estate - Investor	512	303	1,376	309	1,622
Commercial real estate - Owner occupied	1,763	716	172	-	11
Construction	60	9	(16)	23	23
Real estate - Investor	8	7	(13)	88	166
Real estate - Owner occupied	43	111	(10)	880	284
Multifamily	-	-	(22)	141	-
HELOC	127	109	147	238	622
HELOC - Purchased	66	229	-	-	-
Other ¹	244	409	409	387	344
Total charge-offs	<u>3,068</u>	<u>2,051</u>	<u>2,097</u>	<u>2,306</u>	<u>3,190</u>
Recoveries:					
Commercial	56	74	157	30	32
Leases	98	-	-	-	5
Commercial real estate - Investor	165	679	440	149	447
Commercial real estate - Owner occupied	697	5	7	12	193
Construction	172	1	35	377	96
Real estate - Investor	57	11	109	69	50
Real estate - Owner occupied	287	77	847	181	366
Multifamily	-	15	190	51	70
HELOC	387	172	364	679	845
HELOC - Purchased	-	-	-	-	-
Other ¹	170	200	265	261	271
Total recoveries	<u>2,089</u>	<u>1,234</u>	<u>2,414</u>	<u>1,809</u>	<u>2,375</u>
Net charge-offs / (recoveries)	979	817	(317)	497	815
Adoption of ASU 326	5,879	-	-	-	-
Provision for credit losses on loans	9,166	1,600	1,228	1,800	750
Allowance at end of year	<u>\$ 33,855</u>	<u>\$ 19,789</u>	<u>\$ 19,006</u>	<u>\$ 17,461</u>	<u>\$ 16,158</u>
Net charge-offs / (recoveries) to average loans	0.05 %	0.04 %	(0.02)%	0.03 %	0.07 %
ACL on loans at year end to average loans	1.68 %	1.04 %	1.07 %	1.14 %	1.33 %

¹ The "Other" class includes consumer loans and overdrafts.

The provision for credit losses on loans is based upon management's estimate of future expected credit losses in the loan and lease portfolio and its evaluation of the adequacy of the ACL. Provision for credit losses expense recorded in 2020 totaled \$10.4 million, compared to provision for loan and lease losses of \$1.6 million and \$1.2 million recorded in 2019 and 2018, respectively. Net charge-offs recorded in 2020 totaled \$979,000, compared to net charge-offs of \$817,000 recorded in 2019, and net recoveries of \$317,000 in 2018. The total increase in the ACL reflects forecasted credit deterioration due to the COVID-19 pandemic and the resultant recession. Our ACL on loans to average loans was 1.68% as of December 31, 2020, compared to 1.04% at both December 31, 2019 and 1.07% at December 31, 2018.

The following table shows our allocation of the ACL by loan type at December 31 for the years indicated, and, for each category of loans, the percent of total loans represented by that category:

Allocation of the Allowance for Credit Losses

(Dollars in thousands)	2020		2019		2018		2017		2016	
	Loan Type to Total		Loan Type to Total		Loan Type to Total		Loan Type to Total		Loan Type to Total	
	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans
Commercial	\$ 2,812	20.0 %	\$ 3,015	17.2 %	\$ 2,832	16.6 %	\$ 2,453	16.9 %	\$ 1,629	15.4 %
Leases	3,888	7.0	1,262	6.2	734	4.2	692	4.2	633	3.7
Commercial real estate - Investor	9,205	28.6	6,218	26.9	6,339	23.7	5,020	25.9	5,184	27.5
Commercial real estate - Owner occupied	2,251	16.4	3,678	17.9	3,515	19.6	3,157	20.5	3,156	22.3
Construction	4,054	4.8	513	3.6	969	5.7	923	5.3	389	4.4
Real estate - Investor	1,740	2.8	601	3.7	554	3.7	542	3.4	449	3.8
Real estate - Owner occupied	2,714	5.7	1,257	7.0	1,377	7.4	1,304	7.9	1,729	8.4
Multifamily	3,625	9.3	1,444	9.8	616	10.3	1,345	8.0	1,207	6.5
HELOC	1,749	4.0	1,161	4.7	1,449	5.0	1,446	6.1	1,331	6.9
HELOC - Purchased	199	1.0	-	1.6	-	2.4	-	0.9	-	-
Other ¹	1,618	0.4	640	1.4	621	1.4	579	0.9	451	1.1
Total	\$ 33,855	100.0 %	\$ 19,789	100.0 %	\$ 19,006	100.0 %	\$ 17,461	100.0 %	\$ 16,158	100.0 %

¹ The "Other" class includes consumer loans, overdrafts and the unallocated allowance balance for each year presented.

Allocations of the allowance may be made for specific loans, but the entire allowance is available for losses in the loan portfolio. In addition, the OCC, as part of their examination process, periodically reviews the ACL. Regulators can require management to record adjustments to the allowance level based upon their assessment of the information available to them at the time of examination. The OCC, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the ACL. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that (1) institutions have effective systems and controls to identify, monitor and address asset quality problems; (2) management has analyzed all significant factors that affect the collectability of the portfolio in a reasonable manner; and (3) management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Management believes it has established an adequate estimated allowance for expected credit losses over the estimated life of our loan portfolio. Management reviews its process quarterly using an extensive and detailed loan review process, makes changes as needed, and reports those results at meetings of our Board of Directors and Audit Committee. Although management believes the ACL is sufficient to cover expected losses over the estimated life of our loan portfolio, there can be no assurance that the allowance will prove sufficient to cover actual loan and lease losses or that regulators, in reviewing the loan portfolio, would not request us to materially adjust our ACL at the time of their examination.

Based on these quarterly assessments, management determined that a provision for credit losses on loans of \$9.2 million, \$1.6 million and \$1.2 million was required for 2020, 2019 and 2018, respectively. When measured as a percentage of average loans outstanding, the total ACL decreased from 1.1% of total loans as of December 31, 2018, to 1.0% of total loans at December 31, 2019, but increased to 1.7% of total loans at December 31, 2020.

The provision for credit losses on unfunded commitments totaled \$1.2 million in 2020, and the allowance for unfunded commitments totaled \$3.0 million as of December 31, 2020. Management reviewed the securities portfolio for credit loss exposure, and determined that no allowance for credit losses on securities was required for 2020. See Note 3 to the consolidated financial statements for more detail on the ACL for securities analysis performed.

Other Real Estate Owned

Other real estate owned ("OREO") decreased to \$2.5 million as of December 31, 2020, compared to \$5.0 million as of December 31, 2019, reflecting a \$2.5 million decline. Of the 11 properties we held as of year-end 2020, the largest net book value property was comprised of one industrial zoned property carried at \$576,000. Reductions in our OREO balance during 2020 included the sale of twelve properties resulting in proceeds of \$3.0 million. Net gains on the sale of OREO properties during 2020 totaled \$204,000,

compared to net gains on sale of \$264,000 in 2019 and \$792,000 in 2018. The trend of year over year reductions in valuation adjustments continued but at decreasing levels in 2018 through 2020.

(Dollars in thousands)	OREO Properties by Type as of December 31,			Percent Change From	
	2020	2019	2018	2020-2019	2019-2018
Single family residence	\$ 430	\$ 174	\$ 1,137	147.3	(84.7)
Lots (single family and commercial)	1,387	3,945	4,310	(64.8)	(8.5)
Vacant land	352	41	470	758.5	(91.3)
Commercial property	305	844	1,258	(63.8)	(32.9)
Total OREO properties	\$ 2,474	\$ 5,004	\$ 7,175	(50.6)	(30.3)

Other real estate assets acquired in settlement of loans are recorded at the fair value of the property when acquired, less estimated costs to sell, establishing a new cost basis. The OREO valuation reserve for the year ended 2020 was \$1.6 million, which was 39.9% of gross OREO, at year-end 2020. This compares to \$6.7 million, or 57.3%, of gross OREO, net of participations, at year-end 2019.

Deposits

We grew total deposits by \$410.3 million, or 19.3%, to a total of \$2.54 billion at year-end 2020 compared to year-end 2019 primarily due to the federal stimulus funds received by our customers from the U.S. government in response to the COVID-19 pandemic. Total deposits grew by \$10.1 million, or 0.5%, from \$2.12 billion at year-end 2018 to \$2.13 billion at year-end 2019. We had no brokered certificates of deposit as of December 31, 2020, compared to \$249,000 in brokered certificates of deposit as of December 31, 2019, due to scheduled runoff of brokered deposits acquired with the ABC Bank acquisition.

YTD Average Balances and Interest Rates

(Dollars in thousands)	2020		2019		2018	
	Average Balance	Rate %	Average Balance	Rate %	Average Balance	Rate %
Noninterest bearing demand	\$ 832,180	-	\$ 650,400	-	\$ 608,762	-
Interest bearing:						
NOW and money market	752,682	0.14	721,773	0.34	743,961	0.24
Savings	363,331	0.14	308,847	0.16	291,611	0.11
Time	424,831	1.18	431,377	1.56	443,520	1.31
Total deposits	\$ 2,373,024		\$ 2,112,397		\$ 2,087,854	

The following table sets forth the amounts and maturities of time deposits of \$100,000 or more at December 31 of the year indicated:

Maturities of Time Deposits of \$100,000 or More

(\$ in thousands)	2020	2019
3 months or less	\$ 88,435	\$ 54,234
Over 3 months through 6 months	41,608	56,362
Over 6 months through 12 months	70,917	72,119
Over 12 months	24,367	31,376
	\$ 225,327	\$ 214,091

Borrowings

In addition to deposits, we used other liquidity sources for our funding needs in 2020, such as repurchase agreements and other short-term borrowings with the FHLBC. Our borrowings at the FHLBC require the Bank to be a member and invest in the stock of the FHLBC, and total borrowings are generally limited to the lower of 35% of total assets or 60% of the book value of certain mortgage-backed loans. We primarily use these borrowings as a source of short-term funding; however, our excess liquidity on hand during 2020 allowed us to reduce our short-term borrowing levels with the FHLBC throughout the majority of the year. Our other short-term borrowings decreased by \$48.5 million in 2020 compared to 2019, with no outstanding balances as of December 31, 2020.

We recorded long-term FHLBC borrowings in our ABC Bank acquisition in April 2018 of \$23.4 million, net of purchase accounting adjustments. These borrowings were issued at favorable rates compared to the overnight borrowing rate as of the date of ABC Bank acquisition, and matured over a seven year period. As of December 31, 2020, the balance of these borrowings consists of one remaining advance in long-term status which totaled \$6.4 million and matures in February 2026. In addition, we have an unused line of credit of \$20.0 million available with a third-party bank, which can be used for the Company's operating needs at the holding company level. This line of credit renews every February and must be repaid within 360 days, if drawn. This line of credit had an outstanding balance of \$4.0 million as of year-end 2018, but was repaid in January 2019 and has not been used since that time.

Short-term and Long-term Borrowings

(Dollars in thousands)	2020		2019		2018	
	Amount	Weighted Average Rate %	Amount	Weighted Average Rate %	Amount	Weighted Average Rate %
At period-end:						
Securities sold under repurchase agreements	\$ 66,980	0.20	\$ 48,693	1.19	\$ 46,632	1.28
Other short-term borrowings	-	-	48,500	1.78	149,500	2.50
Junior subordinated debentures ⁽¹⁾	25,773	4.40	57,734	6.37	57,686	6.36
Senior notes ⁽¹⁾	44,375	5.75	44,270	5.84	44,158	5.86
Notes payable and other borrowings	23,393	2.16	6,673	2.83	15,379	2.42
Total borrowed funds	\$ 160,521	2.72	\$ 205,870	3.79	\$ 313,355	3.50

Average for the year-to-date period:

Securities sold under repurchase agreements	\$ 53,808	0.38	\$ 43,698	1.32	\$ 44,122	1.05
Other short-term borrowings	11,255	1.59	73,757	2.38	71,041	2.01
Junior subordinated debentures	31,101	7.12	57,710	6.45	57,663	6.44
Senior notes	44,323	6.07	44,212	6.10	44,109	6.09
Notes payable and other borrowings	22,812	2.51	12,008	3.20	14,696	2.71
Total borrowed funds	\$ 163,299	3.59	\$ 231,385	3.95	\$ 231,631	3.75

Maximum amount outstanding at the end of any month-end during the period:

Securities sold under repurchase agreements	\$ 69,842	\$ 54,166	\$ 54,037
Other short-term borrowings	38,500	120,000	149,500
Junior subordinated debentures	25,773	57,734	57,686
Senior notes	44,375	44,270	44,158
Notes payable and other borrowings	26,652	15,363	26,037

¹ Period end rates listed for long term borrowings are stated rates per contract, and do not include adjustments for deferred issuance costs.

There were no other categories of short-term borrowings that had an average balance greater than 30% of our stockholders' equity as of December 31, 2020, 2019 or 2018.

The average junior subordinated debentures included two issuances of trust preferred securities by our subsidiaries, Old Second Capital Trust I ("Trust I") which totaled \$32.0 million as of December 31, 2019, and Old Second Capital Trust II ("Trust II"), which totaled \$25.0 million as of December 31, 2019. On March 2, 2020, we redeemed all of the subordinated debentures due June 30, 2033, relating to the outstanding 7.80% cumulative trust preferred securities (the "Trust Securities") issued by Trust I. Also on March 2, 2020, we redeemed all of the outstanding Trust Securities at a redemption price of \$10.00 per Trust Security, which reflects 100% of the liquidation amount, plus accrued and unpaid distributions through the redemption date. In connection with the redemption, the Trust Securities were delisted from The Nasdaq Stock Market. See Note 11 to the consolidated financial statements *Junior Subordinated Debentures* for further discussion of the Capital Trusts I and II. The junior subordinated debentures outstanding at December 31, 2020 consists of \$25.8 million of the Trust II issuance.

In December 2016, we completed the retirement of \$45.0 million of subordinated debt with the proceeds of a \$45.0 million senior notes issuance and cash on hand. The senior notes mature in ten years, and terms include interest payable semiannually at 5.75% for five years. Beginning December 31, 2021, the senior debt will pay interest at a floating rate, with interest payable quarterly at three month LIBOR plus 385 basis points. As of December 31, 2020, we had \$44.4 million of senior debt outstanding, net of deferred issuance costs. At December 31, 2020, we were in compliance with all of the financial covenants contained within the senior debt agreement.

Capital

As of December 31, 2020, we had total stockholders' equity of \$307.1 million, an increase of \$29.2 million, or 10.5%, from \$277.9 million as of December 31, 2019. This increase was largely attributable to net income of \$27.8 million in 2020, and a favorable fair value adjustment on securities available for sale, within accumulated other comprehensive income. At December 31, 2020, accumulated other comprehensive income, net of deferred taxes, was \$14.8 million, compared to \$4.6 million accumulated other comprehensive income, net of tax, as of year-end 2019. Equity in 2020 was reduced for the payment of dividends to common stockholders, which totaled \$1.2 million for the year, as well as treasury stock purchases pursuant to our stock repurchase plan, which totaled \$5.5 million for the year. Our total stockholders' equity increased in 2019, ending at \$277.9 million, compared to \$229.1 million at year end 2018, due primarily to net income of \$39.5 million in 2019.

We issued \$32.6 million of cumulative trust preferred securities through our consolidated subsidiary, Trust I, in July 2003. As noted above, we redeemed all of the outstanding Trust Securities on March 2, 2020, at a redemption price of \$10.00 per Trust Security, which reflects 100% of the liquidation amount, plus accrued and unpaid distributions through the redemption date.

We issued an additional \$25.8 million of cumulative trust preferred securities through a private placement completed by a second unconsolidated subsidiary, Trust II, in April 2007. These trust preferred securities mature in 30 years, but subject to regulatory approval, can also now be called in whole or in part. The quarterly cash distributions on the securities were fixed at 6.77% through June 15, 2017, and converted to a floating rate at 150 basis points over the three-month LIBOR rate thereafter. We entered into a forward starting interest rate swap on August 18, 2015, with an effective date of June 15, 2017. This transaction had a notional amount totaling \$25.8 million as of December 31, 2015, and was designated as a cash flow hedge of certain junior subordinated debentures and continues to be fully effective during the period presented. As such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swap is recorded in other liabilities with changes in fair value recorded in other comprehensive income, net of tax. The amount included in other comprehensive income would be reclassified to current earnings should all or a portion of the hedge no longer be considered effective. We expect the hedge to remain fully effective during the remaining term of the swap. We will pay the counterparty a fixed rate and receive a floating rate based on three month LIBOR. Management concluded that it would be advantageous to enter into this transaction given that our trust preferred securities issued in 2007 changed from a fixed to floating rate on June 15, 2017. The cash flow hedge has a maturity date of June 15, 2037.

We are currently paying interest on the Trust II preferred securities as that interest comes due. As of December 31, 2020, and December 31, 2019, total trust preferred proceeds of \$25.0 million and \$56.6 million, respectively, qualified as Tier 1 regulatory capital at the bank holding company level.

In January 2009, we issued and sold (i) 73,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series B (the "Series B Stock") and (ii) a warrant to purchase 815,339 shares of its common stock at an exercise price of \$13.43 per share to the U.S. Treasury. The total liquidation value of the Series B Stock and the warrant was \$73.0 million at issuance. As of December 31, 2015, the Series B Stock was fully redeemed. The warrant had a carrying value of \$4.8 million and was included within additional paid-in capital as of December 31, 2018. On January 16, 2019, the warrant was fully exercised; see further disclosures in Note 12 - Earnings Per Share, in the accompanying notes to the consolidated financial statements.

In the third quarter of 2019, our Board of Directors authorized a stock repurchase program, under which we were authorized to repurchase up to approximately 1.5 million shares (or approximately 5%) of our outstanding common stock through open market purchases, trading plans established in accordance with U.S. Securities and Exchange Commission rules, privately negotiated transactions, or by other means. The stock repurchase program expired on September 19, 2020; however, we received a notice of non-objection from the Federal Reserve Bank of Chicago to extend the previously authorized stock repurchase program through October 20, 2021. The actual means and timing of any repurchases, quantity of purchased shares and prices will be, subject to certain limitations, at the discretion of management and will depend on a number of factors, including, without limitation, market prices of our common stock, general market and economic condition, and applicable legal and regulatory requirements. These share purchases are anticipated to be funded by our cash on hand. No shares were repurchased in 2019, and during 2020, we repurchased 719,273 shares of our common stock at a weighted average price of \$7.65 per share pursuant to our stock repurchase program. 775,553 shares remain available to be repurchased under the plan as of December 31, 2020.

We withheld 33,765 shares for \$423,000 to satisfy RSU vesting tax withholding obligations in 2020, and repurchased 719,273 shares for \$5.5 million under our stock repurchase program, which increased treasury stock. This increase was offset by issuances of 46,325 shares for RSU vestings, which totaled \$431,000. The net impact was an increase to treasury stock of 706,713 shares, to 5,628,661 shares totaling \$101.4 million as of December 31, 2020. The increase in treasury stock decreased stockholders' equity, and also increased earnings per share by decreasing the number of shares outstanding.

We withheld 49,959 shares for \$667,000 to satisfy stock award tax withholding obligations in 2019, which increased treasury stock. This increase was offset by issuances of 38,614 shares for nonqualified stock option exercises and RSU vestings, which totaled \$526,000, and the exercise of stock warrants of 45,836 shares, which totaled \$313,000. The net impact was a reduction to treasury stock of 34,491 shares, to 4,921,948 shares totaling \$95.9 million as of December 31, 2019. The decrease in treasury stock increased stockholders'

equity, and also decreased earnings per share by increasing the number of shares outstanding. There were 4,500 stock options exercised in 2019 and in 2018; no stock options remained outstanding as of December 31, 2019 or 2020.

Regulatory capital rules adopted in July 2013 and fully-phased in as of January 1, 2019, which we refer to as the Basel III rules, impose minimum capital requirements for bank holding companies and banks. The Basel III rules apply to all national and state banks and savings associations regardless of size and bank holding companies and savings and loan holding companies other than “small bank holding companies” which are generally holding companies with consolidated assets of less than \$3 billion. In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a “capital conservation buffer” on top of our minimum risk-based capital requirements. This buffer must consist solely of CET1, but the buffer applies to all three measurements (CET1, Tier 1 capital and total capital). The capital conservation buffer consists of an additional amount of common equity equal to 2.5% of risk-weighted assets.

The following table shows the regulatory capital ratios and the current minimum and well capitalized regulatory requirements at the dates indicated:

Risk Based Capital Ratios

	Minimum Capital Adequacy with Capital Conservation Buffer, if applicable ¹	Well Capitalized Under Prompt Corrective Action Provisions ²	December 31, 2020	December 31, 2019	December 31, 2018
The Company					
Common equity tier 1 capital ratio	7.00 %	N/A	11.94 %	11.14 %	9.29 %
Total risk-based capital ratio	10.50 %	N/A	14.26 %	14.53 %	12.63 %
Tier 1 risk-based capital ratio	8.50 %	N/A	13.01 %	13.65 %	11.78 %
Tier 1 leverage ratio	4.00 %	N/A	10.21 %	11.93 %	10.08 %
The Bank					
Common equity tier 1 capital ratio	7.00 %	6.50 %	13.75 %	14.35 %	13.29 %
Total risk-based capital ratio	10.50 %	10.00 %	15.00 %	15.23 %	14.14 %
Tier 1 risk-based capital ratio	8.50 %	8.00 %	13.75 %	14.35 %	13.29 %
Tier 1 leverage ratio	4.00 %	5.00 %	10.74 %	12.50 %	11.36 %

¹ Amounts are shown inclusive of a capital conservation buffer of 2.50%. Under the Federal Reserve’s Small Bank Holding Company Policy Statement, the Company is not subject to the minimum capital adequacy and capital conservation buffer capital requirements at the holding company level, unless otherwise advised by the Federal Reserve (such capital requirements are applicable only at the Bank level). Although the minimum regulatory capital requirements are not applicable to the Company or the Tier 1 Leverage ratio, we calculate these ratios for our own planning and monitoring purposes.

² Prompt corrective action provisions are only applicable at the Bank level.

The Company, on a consolidated basis, exceeded the minimum capital ratios to be deemed “well capitalized” at December 31, 2020, pursuant to the capital requirements in effect at that time. All ratios conform to the regulatory calculation requirements in effect as of the date noted.

In addition to the above regulatory ratios, our common equity to total assets ratio decreased from 10.54% to 10.10%, while our tangible common equity to tangible assets ratio (non-GAAP), decreased from 9.83% at December 31, 2019 to 9.49% at December 31, 2020. The declines in these ratios was primarily due to an increase in each denominator due to growth in assets in 2020, due to interest earning deposits with financial institutions and loans, stemming from the COVID-19 pandemic. Management considers this non-GAAP measure a valuable performance measurement for capital analysis. The following table provides a reconciliation of the GAAP tangible common equity to tangible assets ratio to the non-GAAP ratio for the periods indicated:

	December 31, 2020		December 31, 2019	
	GAAP	Non-GAAP	GAAP	Non-GAAP
Tangible common equity (Dollars in thousands)				
Total Equity	\$ 307,087	\$ 307,087	\$ 277,864	\$ 277,864
Less: Goodwill and intangible assets	20,781	20,781	21,275	21,275
Add: Limitation of exclusion of core deposit intangible (80%)	N/A	435	N/A	534
Adjusted goodwill and intangible assets	20,781	20,346	21,275	20,741
Tangible common equity	\$ 286,306	\$ 286,741	\$ 256,589	\$ 257,123
Tangible assets				
Total assets	\$ 3,040,837	\$ 3,040,837	\$ 2,635,545	\$ 2,635,545
Less: Adjusted goodwill and intangible assets	20,781	20,346	21,275	20,741
Tangible assets	\$ 3,020,056	\$ 3,020,491	\$ 2,614,270	\$ 2,614,804
Common equity to total assets	10.10 %	10.10 %	10.54 %	10.54 %
Tangible common equity to tangible assets	9.48 %	9.49 %	9.81 %	9.83 %

The non-GAAP intangible asset exclusion reflects the 80% core deposit limitation per Basel III guidelines within risk based capital calculations, and is useful for the Company when reviewing risk based capital ratios and equity performance metrics.

Liquidity

Liquidity is our ability to fund operations, to meet depositor withdrawals, to provide for customer's credit needs, and to meet maturing obligations and existing commitments. Our liquidity principally depends on cash flows from net operating activities, including pledging requirements, investment in, and both maturity and repayment of assets, changes in balances of deposits and borrowings, and our ability to borrow funds. In addition, the Company's liquidity depends on the Bank's ability to pay dividends, which is subject to certain regulatory requirements. See "Supervision and Regulation Dividend Payments." We continually monitor our cash position and borrowing capacity as well as perform stress tests of contingency funding no less frequently than quarterly as part of our liquidity management process. Stress testing of liquidity for contingency funding purposes includes tests that outline scenarios for specifically identified liquidity risk events, which are then aggregated into a Bank-wide assessment of liquidity risk stress levels. The outcomes of these tests are reviewed by management monthly and our Board of Directors quarterly. Cash and cash equivalents at the end of 2020 totaled \$329.9 million, compared to \$50.6 million as of December 31, 2019, and \$55.2 million as of December 31, 2018.

Net cash inflows from operating activities were \$26.0 million during 2020, compared with inflows of \$52.6 million in 2019 and inflows of \$54.9 million in 2018. Proceeds from sales of loans held-for-sale, net of funds used to originate loans held-for-sale, was a source of inflows for 2020, 2019 and 2018. Interest received, net of interest paid, combined with changes in other assets and liabilities were a source of outflows in 2020, and inflows in 2019 and 2018. Management of investing and financing activities, as well as market conditions, determines the level and the stability of net interest cash flows in 2020. Management's policy is to mitigate the impact of changes in market interest rates to the extent possible as part of our balance sheet management process.

Net cash outflows from investing activities were \$103.8 million in 2020, compared to \$42.2 million of inflows in 2019, and \$25.8 million of outflows in 2018. Loan growth resulted in \$103.9 million of cash outflows for 2020, compared to \$34.4 million of cash outflows in 2019 and \$52.7 million of cash outflows in 2018. In 2020, securities transactions accounted for net inflows of \$831,000, and proceeds from the sales of OREO assets accounted for inflows of \$3.3 million. In 2019, securities transactions accounted for net inflows of \$77.0 million, whereas proceeds from the sale of OREO assets accounted for inflows of \$2.8 million. The ABC Bank acquisition in April 2018 resulted in net cash outflows of \$35.7 million in 2018.

Net cash inflows from financing activities in 2020 were \$357.1 million, primarily due to deposit growth, compared to net cash outflows for financing activities of \$99.5 million in 2019, and net cash outflows of \$29.7 million in 2018. Significant cash outflows from financing activities in 2020 also included a reduction in other short-term borrowings of \$48.5 million, and redemption of the OSBC Capital Trust I junior subordinated debentures of \$32.6 million. Significant cash outflows from financing activities in 2019 included decreases of \$101.0 million in other short-term borrowings with the FHLBC and the US Bank line of credit payoff. Significant cash outflows in 2018 included deposit run-off associated with the ABC Bank acquisition in 2018, primarily related to non-core deposits.

Contractual Obligations

We have various financial obligations that may require future cash payments. The following table presents, as of December 31, 2020, significant fixed and determinable contractual obligations to third parties by payment date:

(In thousands)	Within	One to	Three to	Over	Total
	One Year	Three Years	Five Years	Five Years	
Deposits without a stated maturity	\$ 2,111,639	\$ -	\$ -	\$ -	\$ 2,111,639
Certificates of deposit	349,003	48,603	27,828	-	425,434
Securities sold under repurchase agreements	66,980	-	-	-	66,980
Junior subordinated debentures	-	-	-	25,773	25,773
Senior notes	-	-	-	44,375	44,375
Notes payable and other borrowings	4,000	13,000	-	6,393	23,393
Purchase obligations	4,442	5,120	3,748	103	13,413
Automatic teller machine leases	28	16	4	-	48
Operating leases	734	1,222	1,267	3,297	6,520
Nonqualified voluntary deferred compensation plan	61	135	246	3,220	3,662
Total	\$ 2,536,887	\$ 68,096	\$ 33,093	\$ 83,161	\$ 2,721,237

Purchase obligations represent obligations under agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The purchase obligation amounts presented above primarily relate to certain contractual payments for services provided for information technology, capital expenditures, and the outsourcing of certain operational activities. We routinely enter into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for early termination. In this disclosure, we have made an effort to estimate such payments, where applicable. Additionally, where necessary, all data reflects reasonable management estimates as to certain purchase obligations as of December 31, 2020. Management has used the information available to make the estimations necessary to value the related purchase obligations.

Commitments, Contingent Liabilities, and Off-balance sheet arrangements

Derivative contracts, which include contracts under which we either receive cash from, or pay cash to, counterparties reflecting changes in interest rates are carried at fair value on our Consolidated Balance Sheet as disclosed in Note 18 of the Notes to the Consolidated Financial Statements provided in Part II, Item 8, "Financial Statements and Supplementary Data". Because the fair value of derivative contracts changes daily as market interest rates change, the derivative assets and liabilities recorded on the balance sheet at December 31, 2020, do not necessarily represent the amounts that may ultimately be paid. As a result, these assets and liabilities are not included in the table of contractual obligations presented above.

Assets under management and assets under custody are held in fiduciary or custodial capacity for clients. In accordance with GAAP, these assets are not included on our balance sheet.

Financial instruments with off-balance sheet risk address the financing needs of our clients. These instruments include commitments to extend credit as well as performance, standby and commercial letters of credit. Further discussion of these commitments is included in Note 13 – Commitments in the accompanying notes to the consolidated financial statements.

The following table details the amounts and expected maturities of significant commitments to extend credit as of December 31, 2020:

(In thousands)	Within	One to	Three to	Over	Total
	One Year	Three Years	Five Years	Five Years	
Commercial secured by real estate	\$ 23,601	\$ 21,517	\$ 13,859	\$ 6,848	\$ 65,825
Revolving open end residential	7,108	11,909	19,216	80,102	118,335
Other unused loan commitments, including commercial and industrial	165,603	49,515	1,299	4,604	221,021
Financial standby letters of credit (borrowers)	9,370	10	-	-	9,380
Performance standby letters of credit (borrowers)	4,863	-	10	-	4,873
Performance standby letters of credit (others)	67	-	-	-	67
Total	\$ 210,612	\$ 82,951	\$ 34,384	\$ 91,554	\$ 419,501

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

As part of our normal operations, we are subject to interest-rate risk on the assets we invest in (primarily loans and securities) and the liabilities we fund (primarily customer deposits and borrowed funds). Fluctuations in interest rates may result in changes in the fair market values our financial instruments, cash flows, and net interest income. Like most financial institutions, we have an exposure to changes in both short-term and long-term interest rates.

In the first quarter of 2020 the Federal Reserve cut the Fed Funds rate three times down to a target range of 0% to 0.25%. Additionally, the Federal Reserve has been aggressively purchasing various assets since March 2020 in an effort to stabilize the economy from the continuing effects of the COVID-19 pandemic. Overall, the Federal Reserve's balance sheet has increased from about \$4.2 trillion in early March 2020 to about \$7.4 trillion as of December 31, 2020. However, the pace of asset purchases has slowed in the second half of 2020. The Federal Reserve has indicated that it expects the Fed Funds rate to remain in the 0% to 0.25% range through 2023 and possibly even longer. We manage interest rate risk within guidelines established by policy which are intended to limit the amount of rate exposure. In practice, we seek to manage our interest rate risk exposure well within our guidelines so that such exposure does not pose a material risk to our future earnings.

We manage various market risks in the normal course of our operations, including credit, liquidity risk, and interest-rate risk. Other types of market risk, such as foreign currency exchange risk and commodity price risk, do not arise in the normal course of our business activities and operations. In addition, since we do not hold a trading portfolio, we are not exposed to significant market risk from trading activities. Our interest rate risk exposures at December 31, 2020 and December 31, 2019 are outlined in the table below.

Our net income can be significantly influenced by a variety of external factors, including: overall economic conditions, policies and actions of regulatory authorities, the amounts of and rates at which assets and liabilities reprice, variances in prepayment of loans and securities other than those that are assumed, early withdrawal of deposits, exercise of call options on borrowings or securities, competition, a general rise or decline in interest rates, changes in the slope of the yield-curve, changes in historical relationships between indices (such as LIBOR and prime), and balance sheet growth or contraction. Our asset-liability committee seeks to manage interest rate risk under a variety of rate environments by structuring our balance sheet and off-balance sheet positions, which includes interest rate swap derivatives as discussed in Note 18 of our consolidated financial statements included in this annual report. We seek to monitor and manage interest rate risk within approved policy guidelines and limits.

We use simulation analysis to quantify the impact of various rate scenarios on our net interest income. Specific cash flows, repricing characteristics, and embedded options of the assets and liabilities held by us are incorporated into the simulation model, such as interest rate floors on our loans. Earnings at risk are calculated by comparing the net interest income of a stable interest rate environment to the net interest income of a different interest rate environment in order to determine the percentage change. As of December 31, 2019, we had modest amounts of earnings gains (in both dollars and percentage) should interest rates rise, and limited earnings reductions should interest rates fall. The projected increases in income across all up rate interest rate shock scenarios as of December 31, 2020 were considerably higher than those in December 31, 2019. This was primarily the result of updated assumptions in our asset liability management model in 2020 associated with an updated deposit decay study, deposit beta study, and loan prepayment study. Additionally, large growth in non-maturity deposits since the beginning of the year has elevated our level of interest rate risk relative to December 31, 2019.

The following table summarizes the effect on annual income before income taxes based upon an immediate increase or decrease in interest rates of 0.5%, 1%, and 2% and no change in the slope of the yield curve. Due to relatively low current market interest rates, it was not possible to calculate any down rate scenarios because many of the market interest rates would fall below zero in that scenario.

	Analysis of Net Interest Income Sensitivity					
	Immediate Changes in Rates					
	(2.0)%	(1.0)%	(0.5)%	0.5 %	1.0 %	2.0 %
December 31, 2020						
Dollar change	N/M	N/M	N/M	\$ 3,405	\$ 6,879	\$13,145
Percent change	N/M	N/M	N/M	3.9 %	7.8 %	14.9 %
December 31, 2019						
Dollar change	N/M	\$ (6,229)	\$ (2,670)	\$ 993	\$ 2,016	\$ 3,856
Percent change	N/M	(6.6)%	(2.8)%	1.1 %	2.1 %	4.1 %

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

Effects of Inflation

In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not change at the same rate or in the same magnitude as the inflation rate. Rather, interest rate volatility is based on changes in the expected rate of inflation, as well as on changes in monetary and fiscal policies. A financial institution's ability to be relatively unaffected by changes in interest rates is a good indicator of its capability to perform in today's volatile economic environment. We seek to insulate the Company from interest rate volatility by using our best efforts to ensure that rate sensitive assets and rate sensitive liabilities respond to changes in interest rates in a similar time frame and to a similar degree.

Item 8. Financial Statements and Supplementary Data

Old Second Bancorp, Inc. and Subsidiaries Consolidated Balance Sheets December 31, 2020 and 2019 (In thousands, except per share data)

	<u>December 31, 2020</u>	<u>December 31, 2019</u>
Assets		
Cash and due from banks	\$ 24,306	\$ 34,096
Interest earning deposits with financial institutions	305,597	16,536
Cash and cash equivalents	329,903	50,632
Securities available-for-sale, at fair value	496,178	484,648
Federal Home Loan Bank Chicago ("FHLBC") and Federal Reserve Bank Chicago ("FRBC") stock	9,917	9,917
Loans held-for-sale	12,611	3,061
Loans	2,034,851	1,930,812
Less: allowance for credit losses on loans	33,855	19,789
Net loans	2,000,996	1,911,023
Premises and equipment, net	45,477	44,354
Other real estate owned	2,474	5,004
Mortgage servicing rights, net	4,224	5,935
Goodwill and core deposit intangible	20,781	21,275
Bank-owned life insurance ("BOLI")	63,102	61,763
Deferred tax assets, net	8,121	11,459
Other assets	47,053	26,474
Total assets	<u>\$ 3,040,837</u>	<u>\$ 2,635,545</u>
Liabilities		
Deposits:		
Noninterest bearing demand	\$ 909,505	\$ 669,795
Interest bearing:		
Savings, NOW, and money market	1,202,134	1,015,285
Time	425,434	441,669
Total deposits	2,537,073	2,126,749
Securities sold under repurchase agreements	66,980	48,693
Other short-term borrowings	-	48,500
Junior subordinated debentures	25,773	57,734
Senior notes	44,375	44,270
Notes payable and other borrowings	23,393	6,673
Other liabilities	36,156	25,062
Total liabilities	2,733,750	2,357,681
Stockholders' Equity		
Common stock	34,957	34,854
Additional paid-in capital	122,212	120,657
Retained earnings	236,579	213,723
Accumulated other comprehensive income	14,762	4,562
Treasury stock	(101,423)	(95,932)
Total stockholders' equity	307,087	277,864
Total liabilities and stockholders' equity	<u>\$ 3,040,837</u>	<u>\$ 2,635,545</u>

	<u>December 31, 2020</u>	<u>December 31, 2019</u>
	<u>Common Stock</u>	<u>Common Stock</u>
Par value	\$ 1.00	\$ 1.00
Shares authorized	60,000,000	60,000,000
Shares issued	34,957,384	34,853,757
Shares outstanding	29,328,723	29,931,809
Treasury shares	5,628,661	4,921,948

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries
Consolidated Statements of Income
Years Ended December 31, 2020, 2019 and 2018
(In thousands, except per share data)

	Year Ended December 31,		
	2020	2019	2018
Interest and dividend income			
Loans, including fees	\$ 90,923	\$ 97,719	\$ 88,769
Loans held-for-sale	306	133	127
Securities:			
Taxable	6,773	9,256	9,577
Tax exempt	5,471	7,425	8,341
Dividends from FHLBC and FRBC stock	484	602	469
Interest bearing deposits with financial institutions	258	459	334
Total interest and dividend income	<u>104,215</u>	<u>115,594</u>	<u>107,617</u>
Interest expense			
Savings, NOW, and money market deposits	1,569	2,960	2,156
Time deposits	5,033	6,736	5,829
Securities sold under repurchase agreements	202	577	462
Other short-term borrowings	179	1,755	1,429
Junior subordinated debentures	2,215	3,724	3,716
Senior notes	2,692	2,699	2,688
Notes payable and other borrowings	574	384	398
Total interest expense	<u>12,464</u>	<u>18,835</u>	<u>16,678</u>
Net interest and dividend income	91,751	96,759	90,939
Provision for credit losses	10,413	1,600	1,228
Net interest and dividend income after provision for credit losses	<u>81,338</u>	<u>95,159</u>	<u>89,711</u>
Noninterest income			
Trust income	6,409	6,655	6,417
Service charges on deposits	5,512	7,715	7,328
Secondary mortgage fees	1,654	772	696
Mortgage servicing rights mark to market loss	(3,999)	(2,662)	(734)
Mortgage servicing income	1,950	1,881	1,939
Net gain on sales of mortgage loans	15,519	5,112	3,791
Securities (losses) gains, net	(25)	4,511	360
Change in cash surrender value of BOLI	1,233	1,415	984
Death benefit realized on BOLI	57	872	1,026
Card related income	5,532	5,861	5,663
Gains on disposal and transfer of fixed assets, net	-	32	-
Other income	3,645	3,636	3,883
Total noninterest income	<u>37,487</u>	<u>35,800</u>	<u>31,353</u>
Noninterest expense			
Salaries and employee benefits	49,547	46,869	44,161
Occupancy, furniture and equipment	8,498	8,289	6,915
Computer and data processing	5,143	5,631	6,745
FDIC insurance	597	176	653
General bank insurance	1,030	1,002	1,040
Amortization of core deposit intangible	494	539	387
Advertising expense	298	1,225	1,567
Card related expense	2,195	1,956	1,985
Legal fees	761	675	835
Other real estate expense, net	651	423	396
Other expense	12,203	12,317	12,444
Total noninterest expense	<u>81,417</u>	<u>79,102</u>	<u>77,128</u>
Income before income taxes	37,408	51,857	43,936
Provision for income taxes	9,583	12,402	9,924
Net income	<u>\$ 27,825</u>	<u>\$ 39,455</u>	<u>\$ 34,012</u>
Basic earnings per share	\$ 0.94	\$ 1.32	\$ 1.14
Diluted earnings per share	0.92	1.30	1.12
Dividends declared per share	0.04	0.04	0.04

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2020, 2019 and 2018
(In thousands)

	(unaudited)		
	Year Ended December 31,		
	2020	2019	2018
Net Income	\$ 27,825	\$ 39,455	\$ 34,012
Unrealized holding gains (losses) on available-for-sale securities arising during the period	14,690	19,630	(9,053)
Related tax (expense) benefit	(4,122)	(5,521)	2,554
Holding gains (losses) after tax on available-for-sale securities	10,568	14,109	(6,499)
Less: Reclassification adjustment for the net (losses) gains realized during the period			
Net realized (losses) gains	(25)	4,511	360
Related tax benefit (expense)	7	(1,267)	(100)
Net realized (losses) gains after tax	(18)	3,244	260
Other comprehensive income (loss) on available-for-sale securities	10,586	10,865	(6,759)
Changes in fair value of derivatives used for cash flow hedges	(533)	(3,092)	1,230
Related tax benefit (expense)	147	868	(348)
Other comprehensive (loss) income on cash flow hedges	(386)	(2,224)	882
Total other comprehensive income (loss)	10,200	8,641	(5,877)
Total comprehensive income	\$ 38,025	\$ 48,096	\$ 28,135

	Accumulated Unrealized Gain (Loss) on Securities Available-for-Sale	Accumulated Unrealized Gain (Loss) on Derivative Instruments	Total Accumulated Other Comprehensive Income/(Loss)
Balance, December 31, 2017	\$ 2,239	\$ (760)	\$ 1,479
Reclassification of stranded tax effects	482	(163)	319
Other comprehensive (loss) income, net of tax	(6,759)	882	(5,877)
Balance, December 31, 2018	\$ (4,038)	\$ (41)	\$ (4,079)
Balance, December 31, 2018	\$ (4,038)	\$ (41)	\$ (4,079)
Other comprehensive income (loss), net of tax	10,865	(2,224)	8,641
Balance, December 31, 2019	\$ 6,827	\$ (2,265)	\$ 4,562
Balance, December 31, 2019	\$ 6,827	\$ (2,265)	\$ 4,562
Other comprehensive income (loss), net of tax	10,586	(386)	10,200
Balance, December 31, 2020	\$ 17,413	\$ (2,651)	\$ 14,762

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2020, 2019 and 2018
(In thousands)

	Year Ended December 31,		
	2020	2019	2018
Cash flows from operating activities			
Net income	\$ 27,825	\$ 39,455	\$ 34,012
Adjustments to reconcile net income to net cash provided by operating activities:			
Net premium / discount from amortization on securities	2,329	2,726	2,969
Securities losses (gains), net	25	(4,511)	(360)
Provision for credit losses	10,413	1,600	1,228
Originations of loans held-for-sale	(384,379)	(164,696)	(133,930)
Proceeds from sales of loans held-for-sale	388,538	168,472	137,622
Net gains on sales of mortgage loans	(15,519)	(5,112)	(3,791)
Mortgage servicing rights mark to market loss	3,999	2,662	734
Net discount from accretion on loans	(911)	(1,025)	(1,703)
Net change in cash surrender value of BOLI	(1,233)	(1,415)	(984)
Net gains on sale of other real estate owned	(204)	(264)	(792)
Provision for other real estate owned valuation losses	357	519	581
Depreciation of fixed assets and amortization of leasehold improvements	2,798	2,462	2,423
Amortization of core deposit intangibles	494	539	387
Change in current income taxes receivable	811	1,546	1,678
Deferred tax (benefit) expense	(646)	6,436	9,840
Change in accrued interest receivable and other assets	(17,692)	(6,350)	1,218
Accretion of purchase accounting adjustment on time deposits	-	(38)	(100)
Amortization of purchase accounting adjustment on notes payable and other borrowings	27	92	81
Amortization of junior subordinated debentures issuance costs	643	48	47
Amortization of senior notes issuance costs	105	112	100
Change in accrued interest payable and other liabilities	6,118	6,863	1,390
Stock based compensation	2,089	2,516	2,257
Net cash provided by operating activities	<u>25,987</u>	<u>52,637</u>	<u>54,907</u>
Cash flows from investing activities			
Proceeds from maturities and calls, including pay down of securities available-for-sale	48,054	41,752	40,641
Proceeds from sales of securities available-for-sale	18,006	191,298	94,663
Purchases of securities available-for-sale	(65,229)	(159,544)	(75,044)
Proceeds from sales of FHLBC/FRBC stock	-	6,875	6,754
Purchases of FHLBC/FRBC stock	-	(3,359)	(8,470)
Net change in loans	(103,887)	(34,440)	(52,706)
Purchases of BOLI policies	(590)	-	-
Proceeds from claims on BOLI, net of claims receivable	484	1,196	1,204
Proceeds from sales of other real estate owned, net of participations and improvements	3,275	2,779	4,723
Net purchases of premises and equipment	(3,921)	(4,345)	(1,895)
Cash paid for acquisition, net of cash and cash equivalents retained	-	-	(35,711)
Net cash (used in) provided by investing activities	<u>(103,808)</u>	<u>42,212</u>	<u>(25,841)</u>
Cash flows from financing activities			
Net change in deposits	410,324	10,114	(54,650)
Net change in securities sold under repurchase agreements	18,287	2,061	11,091
Net change in other short-term borrowings	(48,500)	(101,000)	23,625
Redemption of junior subordinated debentures	(32,604)	-	-
Issuance of term note	20,000	-	-
Repayment of term note	(3,000)	-	-
Net change in notes payable and other borrowings, excluding term note	(307)	(8,798)	(8,069)
Proceeds from exercise of stock options	-	32	33
Dividends paid on common stock	(1,186)	(1,195)	(1,189)
Purchase of treasury stock	(5,922)	(666)	(505)
Net cash provided by (used in) financing activities	<u>357,092</u>	<u>(99,452)</u>	<u>(29,664)</u>
Net change in cash and cash equivalents	279,271	(4,603)	(598)
Cash and cash equivalents at beginning of period	50,632	55,235	55,833
Cash and cash equivalents at end of period	<u>\$ 329,903</u>	<u>\$ 50,632</u>	<u>\$ 55,235</u>

Old Second Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows – Continued
Years Ended December 31, 2020, 2019 and 2018

Supplemental cash flow information	Year Ended December 31,		
	2020	2019	2018
Income taxes paid, net	\$ 7,922	\$ 4,425	\$ 20
Interest paid for deposits	7,255	9,686	7,644
Interest paid for borrowings	5,093	9,073	8,323
Non-cash transfer of loans to other real estate owned	898	863	2,915

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2020, 2019 and 2018
(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2017	\$ 34,626	\$ 117,742	\$ 142,959	\$ 1,479	\$ (96,456)	\$ 200,350
Net income			34,012			34,012
Other comprehensive loss, net of tax				(5,877)		(5,877)
Dividends declared and paid, (\$0.04 per share)			(1,189)			(1,189)
Vesting of restricted stock	91	(926)			835	-
Reclassification of stranded tax effects			(319)	319		-
Stock option exercised	3	8			22	33
Stock based compensation		2,257				2,257
Purchase of treasury stock from taxes withheld on stock awards					(505)	(505)
Balance, December 31, 2018	<u>\$ 34,720</u>	<u>\$ 119,081</u>	<u>\$ 175,463</u>	<u>\$ (4,079)</u>	<u>\$ (96,104)</u>	<u>\$ 229,081</u>
Balance, December 31, 2018	\$ 34,720	\$ 119,081	\$ 175,463	\$ (4,079)	\$ (96,104)	\$ 229,081
Net income			39,455			39,455
Other comprehensive income, net of tax				8,641		8,641
Dividends declared and paid, (\$0.04 per share)			(1,195)			(1,195)
Vesting of restricted stock	132	(634)			502	-
Stock option exercised	2	7			23	32
Stock warrants exercised		(313)			313	-
Stock based compensation		2,516				2,516
Purchase of treasury stock from taxes withheld on stock awards					(666)	(666)
Balance, December 31, 2019	<u>\$ 34,854</u>	<u>\$ 120,657</u>	<u>\$ 213,723</u>	<u>\$ 4,562</u>	<u>\$ (95,932)</u>	<u>\$ 277,864</u>
Balance, December 31, 2019	\$ 34,854	\$ 120,657	\$ 213,723	\$ 4,562	\$ (95,932)	\$ 277,864
Adoption of ASU 2016-13 (CECL)			(3,783)			(3,783)
Net income			27,825			27,825
Other comprehensive income, net of tax				10,200		10,200
Dividends declared and paid, (\$0.04 per share)			(1,186)			(1,186)
Vesting of restricted stock	103	(534)			431	-
Stock based compensation		2,089				2,089
Purchase of treasury stock from taxes withheld on stock awards					(423)	(423)
Purchase of treasury stock from stock repurchase program					(5,499)	(5,499)
Balance, December 31, 2020	<u>\$ 34,957</u>	<u>\$ 122,212</u>	<u>\$ 236,579</u>	<u>\$ 14,762</u>	<u>\$ (101,423)</u>	<u>\$ 307,087</u>

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020, 2019 and 2018

(Table amounts in thousands, except per share data)

Note 1: Summary of Significant Accounting Policies

Nature of Operations - Old Second Bancorp, Inc. (the “Company”) is a corporation organized under the laws of the State of Delaware in 1981 that serves as the bank holding company for its wholly-owned subsidiary bank, Old Second National Bank. Old Second National Bank (the “Bank”) is a national banking association headquartered in Aurora, Illinois, that operates through 29 banking centers located in Cook, DeKalb, DuPage, Kane, Kendall, LaSalle and Will counties in Illinois. The Bank is a full-service banking business, offering a broad range of deposit products, trust and wealth management services, and lending services, including commercial, residential and consumer loans. We also offer a full complement of electronic banking services, such as online and mobile banking and corporate cash management products.

The consolidated financial statements of the Company include the financial statements of the Bank and its wholly-owned subsidiaries, River Street Advisors, LLC, an investment advisory/management service company, Old Second Affordable Housing Fund, L.L.C., which provides down payment assistance for home ownership to qualified individuals, and Station I, LLC, which holds property acquired by the Bank through foreclosure or in the ordinary course of collecting a debt previously contracted with borrowers. The Company uses the accrual basis of accounting for financial reporting purposes. Certain amounts in prior year financial statements have been reclassified to conform to the 2020 presentation.

Use of Estimates – The preparation of consolidated financial statements in conformity with generally accepted accounting principles (“GAAP”) and following general practices within the banking industry requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Although these estimates and assumptions are based on the best available information, actual results could differ from those estimates.

Principles of Consolidation – The accompanying consolidated financial statements include the accounts and results of operations of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions. Assets held in a fiduciary or agency capacity are not assets of the Company or its subsidiaries and are not included in the consolidated financial statements.

Segment Reporting – The Company has one operating segment, which is community banking. While our management monitors the revenue streams of our various products and services, the Company’s operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, all of the Company’s operations are considered to be aggregated in one reportable segment.

Concentration of Credit Risk – Most of the Company’s business activity is with customers located within Cook, DeKalb, DuPage, Kane, Kendall, LaSalle and Will counties in Illinois. These banking centers surround or are within the Chicago metropolitan area. Therefore, the Company’s exposure to credit risk is significantly affected by changes in the economy in that market area since the Bank generally makes loans within this market. There are no significant concentrations of loans where the customers’ ability to honor loan terms is dependent upon a single economic sector.

Cash and Cash Equivalents – For purposes of the Consolidated Statements of Cash Flows, management has defined cash and cash equivalents to include cash and due from banks, interest-earning deposits in other financial institutions, and other short-term investments, such as federal funds sold and securities purchased under agreements to resell. The classification of cash and cash equivalents includes those assets held in the form of cash or liquid instruments with an original maturity of 90 days or less.

Securities – All of the Company’s securities are classified as available-for-sale, and are carried at fair value, with unrealized gains or losses, net of tax, recorded in stockholders’ equity as a separate component of accumulated other comprehensive income (loss).

Realized securities gains or losses, which are reported in securities gains (losses), net, in the Consolidated Statements of Income, are recognized on a trade date basis and are determined using the specific identification method. Discounts are accreted into interest income over the estimated life of the related security and premiums are amortized into income to the earlier of the call date or estimated life of the related security using the level yield method.

The Company has made a policy election to exclude accrued interest income from the amortized cost basis of available-for-sale debt securities and report accrued interest separately in other assets in the Consolidated Balance Sheets. A debt security is placed on nonaccrual status at the time we no longer expect to receive all contractual amounts due, which is generally at 90 days past due. Accrued interest for a security placed on nonaccrual is reversed against interest income. Accordingly, we do not recognize an allowance for credit loss against accrued interest receivable.

For available-for-sale debt securities in an unrealized loss position, we first assess whether we intend to sell, or it is more likely than not that we will be required to sell the security, prior to the recovery of its amortized cost basis. If either of the above criteria is met, the security's amortized cost basis is written down to fair value through earnings. When the criteria above is not met, we evaluate whether the decline in fair value is the result of credit losses or other factors. In making this assessment, we review changes to the rating of the security by a rating agency, an increase in defaults on the underlying collateral, and the extent to which the securities are issued by the federal government or its agencies, including the amount of the guarantee issued by those agencies, among other factors. If this assessment indicates that a credit loss exists, we compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis for the security, a credit loss exists and an allowance for credit losses is recorded through earnings, limited to the amount that the fair value of the security is less than its amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income (loss), net of taxes.

Changes in the allowance for credit losses are recorded as a provision for (or reversal of) credit loss expense. Losses are charged against the allowance when management believes the uncollectability of an available for sale debt security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Federal Home Loan Bank and Federal Reserve Bank Stock – The Company owns the stock of the Federal Home Loan Bank of Chicago (“FHLBC”) and the Federal Reserve Bank of Chicago (“FRBC”). Both of these entities require the Bank to invest in their nonmarketable stock as a condition of membership. The FHLBC is a governmental sponsored entity. The Bank continues to utilize the various products and services of the FHLBC and management considers this stock to be a long-term investment. FHLBC members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLBC stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. The Company's ability to redeem the shares owned is dependent on the redemption practices of the FHLBC. The Company records dividends in income on the ex-dividend date. FRBC stock is redeemable at par, and therefore fair value equals cost.

Loans Held-for-Sale – The Bank originates residential mortgage loans, which consist of loan products eligible for sale to the secondary market. 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 on similar loans.

Loans – Loans held-for-investment are carried at the principal amount outstanding, net of premiums and discounts associated with acquisition date fair value adjustments on acquired loans, deferred loan fees and costs, and any direct principal charge-offs. The Company has made a policy election to exclude accrued interest from the amortized cost basis of loans and report accrued interest separately from the related loan balance in other assets in the Consolidated Balance Sheets.

Interest income on loans is accrued based on principal amounts outstanding. Loan and lease origination fees, commitment fees, and certain direct loan origination costs are deferred and amortized over the life of the related loans or commitments as a yield adjustment. Fees related to standby letters of credit, whose ultimate exercise is remote, are amortized into fee income over the estimated life of the commitment. Other related fees are recognized as fee income when earned.

Past Due and Nonaccrual Loans

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement or any portion thereof remains unpaid after the due date of the scheduled payment. Generally, loans are placed on nonaccrual status (i) when either principal or interest payments become 90 days or more past due based on contractual terms unless the loan is sufficiently collateralized such that full repayment of both principal and interest is expected and is in the process of collection within a reasonable period or (ii) when an individual analysis of a borrower's creditworthiness indicates a credit should be placed on nonaccrual status whether or not the loan is 90 days or more past due. When a loan is placed on nonaccrual status, unpaid interest credited to income is reversed. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash basis method, interest income is recorded when the payment is received in cash. Nonaccrual loans are returned to accrual status when the financial position of the borrower and other relevant factors indicate there is no longer doubt that the Company will collect all principal and interest due.

Troubled Debt Restructurings (“TDRs”)

A restructuring of debt is considered a TDR when (i) the borrower is experiencing financial difficulties and (ii) the creditor grants a concession, such as forgiveness of principal, reduction of the interest rate, changes in payments, or extension of the maturity, that it would not otherwise consider. Loans are not classified as TDRs when the modification is short-term or results in only an insignificant delay or shortfall in the payments to be received. The Company's TDRs are determined on a case-by-case basis in connection with ongoing loan collection processes.

The Company does not accrue interest on any TDRs unless it believes collection of all principal and interest under the modified terms is reasonably assured. For TDRs to accrue interest, the borrower must demonstrate both some level of past performance and the capacity to perform under the modified terms. Generally, six months of consecutive payment performance by the borrower under the restructured terms is required before TDRs are returned to accrual status. However, the period could vary depending on the individual facts and circumstances of the loan. An evaluation of the borrower's current creditworthiness is used to assess whether the borrower has the capacity to repay the loan under the modified terms. This evaluation includes an estimate of expected cash flows, evidence of strong financial position, and estimates of the value of collateral, if applicable.

Purchase Credit Deteriorated (PCD) Loans

Purchased credit deteriorated loans ("PCD loans") are purchased loans, that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by the Company's assessment. An allowance for credit losses is determined using the same methodology as other loans held for investment. The initial allowance for credit losses determined on a collective basis is allocated to individual loans. The sum of the loan's purchase price and initial allowance for credit losses becomes its initial amortized cost basis. The difference between the initial amortized cost basis and the par value of the loan is a noncredit discount or premium, which is accreted or amortized into interest income over the life of the loan. Subsequent changes to the allowance for credit losses are recorded through provision for credit losses.

On January 1, 2020, the Company implemented ASU No. 2016-13, "Financial Instruments – Credit Measurement of Credit Losses on Financial Instruments (Topic 326)," also known as Current Expected Credit Losses, or CECL. As a result of CECL implementation, the Company's purchase credit impaired loans ("PCI loans") became PCD loans.

Allowance for Credit Losses ("ACL")

ACL on Loans

The ACL on loans is a valuation account that is deducted from the amortized cost basis of loans to present the net amount expected to be collected on loans. The Company's estimate of the ACL for loans reflects losses expected over the remaining contractual life of the loans. The contractual term does not consider extensions, renewals or modifications unless the Company has identified an expected troubled debt restructuring.

Determination of the ACL on loans is inherently subjective in nature since it requires significant estimates and management judgment, and includes a level of imprecision given the difficulty of identifying and assessing the factors impacting loan repayment and estimating the timing and amount of losses. While management utilizes its best judgment and information available, the ultimate adequacy of the ACL is dependent upon a variety of factors beyond the Company's direct control, including, but not limited to, the performance of the loan portfolio, consideration of current economic trends, changes in interest rates and property values, estimated losses on pools of homogeneous loans based on an analysis that uses historical loss experience for prior periods that are determined to have like characteristics with the current period such as pre-recessionary, recessionary, or recovery periods, portfolio growth and concentration risk, management and staffing changes, the interpretation of loan risk classifications by regulatory authorities and other credit market factors. While each component of the ACL on loans is determined separately, the entire balance is available for the entire loan portfolio.

The ACL methodology consists of measuring loans on a collective (pool) basis when similar risk characteristics exist. The type of credit composition and risk characteristics of each portfolio segment are as follows:

Commercial loans – Such credits typically comprise working capital loans, loans for physical asset expansion, asset acquisition loans and other commercial and industrial business loans. Loans to closely held businesses will generally be guaranteed in full or for a meaningful amount by the businesses' major owners. Commercial loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all commercial loan types. The Company classifies five different risk levels for this segment to assign a loss rate based on historical losses, and also performs an analysis using expectations for the weighted risk rating trends to run a regression analysis to a severe loss scenario to determine adjustments needed within the special mention and substandard sub-segments.

Lease financing receivables – Lease financing receivables are subject to underwriting standards and processes similar to commercial loans. These loans are often secured by equipment or transportation assets, and are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted and collateral securing loans may fluctuate in value due to economic or individual performance factors. In accordance with accounting standards, a peer group has been identified and is used to estimate losses for this portfolio, as this segment is relatively new to the Company and more than four years of the Company’s own historical loss data is not available.

Real estate - commercial loans – Real estate - commercial loans are subject to underwriting standards and processes similar to commercial and industrial loans. These are loans secured by mortgages on real estate collateral. Commercial real estate loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and/or property type. The real estate – commercial segments utilized for the ACL on loans are:

- *CRE owner occupied* – the Company classifies five different risk levels within this segment to assign a loss rate based on historical losses, as well as utilizing a forecasted average unemployment rate for the next twelve months as a loss driver.
- *CRE investor* – the Company classifies five different risk levels within this segment to assign a loss rate based on historical losses, as well as utilizing a forecasted average unemployment rate for the next twelve months as a loss driver. The primary difference between this segment and CRE owner occupied is within the slightly elevated historical loss rates and qualitative factors used, as the CRE investor properties are sponsored compared to owner occupied.

Real estate – construction loans – The Company defines real estate - construction loans as loans where the loan proceeds are controlled by the Company and used exclusively for the improvement or development of real estate in which the Company holds a mortgage. Due to the inherent risk in this type of loan, they are subject to other industry specific policy guidelines outlined in the Company’s Credit Risk Policy and are monitored closely. The Company’s historical loss rates are utilized from the prior periods which align to the current unemployment projections.

Real estate - residential loans – These are loans that are extended to purchase or refinance 1-4 family residential dwellings, or to purchase or refinance vacant lots intended for the construction of a 1-4 family home. Residential real estate loans are considered homogenous in nature. Homes may be the primary or secondary residence of the borrower or may be investment properties of the borrower. The real estate – residential segments utilized for the ACL on loans are:

- *Residential owner-occupied* – the Company applies historical loss rates from periods with like characteristics as the current period, with a longer remaining life (6.0 years) than other segments, due to the usually longer-term nature of these loans.
- *Residential investor* – the Company applies historical loss rates from periods with like characteristics as the current period, with a slightly longer remaining life (4.5 years) than other segments, but shorter duration than residential owner-occupied.
- *Multifamily* – the Company classifies five different risk levels within this segment to assign a loss rate based on historical losses, as well as utilizing a forecasted average unemployment rate for the next twelve months as a loss driver.

Home equity lines of credit (“HELOCs”) – These are lines of credit that are extended to refinance 1-4 family residential dwellings, or to finance the borrower’s needs and collateralized by the borrower’s residence. These lines may be fixed or variable in nature, and the home serving as collateral may also have a first lien outstanding. The HELOC segments utilized for the ACL on loans are:

- *HELOC legacy* - The Company’s historical loss rates are utilized from the prior periods which align to the current unemployment projections.
- *HELOC purchased* - The Company’s historical loss rates are utilized from the prior periods which align to the current unemployment projections; in addition, the peer data source used for loss rate analysis is the correspondent bank from which we purchased the HELOCs.

Consumer loans – Consumer loans include loans extended primarily for consumer and household purposes. These also include overdrafts and other items not captured by the definitions above. The primary loss factor for this segment included the unemployment rate forecast for the next twelve months.

The methodologies used for calculating the ACL on each loan segment include (i) a migration analysis for commercial, CRE owner occupied, CRE investor, and multifamily segments; (ii) a static analysis for construction, residential investor, residential owner occupied and the legacy HELOC segments; and (iii) a WARM (weighted average remaining life) methodology is used for lease financing receivables, HELOCs purchased, and consumer segments. For loan pools sub-segmented by risk level, which include commercial, real estate-commercial and multifamily segments, linear regression methods were utilized along with expected industry performance over the next twelve months to determine what level of qualitative adjustment would be necessary to account for expected risk rating migration. This methodology relied heavily on existing and anticipated weighted risk ratings by industry or property type. The forecast period used for each segment calculation was one year. In addition, the Company applies qualitative adjustments to each different loan or lease segment, as described below.

The qualitative factors applied to each loan portfolio consist of the impact of other internal and external qualitative and credit market factors as assessed by management through a detailed loan review, ACL analysis and credit discussions. These internal and external qualitative and credit market factors include:

- changes in lending policies and procedures, including changes in underwriting standards and collections, charge-offs and recovery practices;
- changes in international, national, regionally and local conditions (specific factors which impact portfolios or discrepancies with national economic factors which are utilized within the economic forecast);
- changes in the experience, depth and ability of lending management;
- changes in the volume and severity of past due loans and other similar loan conditions;
- changes in the nature and volume of the loan portfolio and terms of loans;
- the existence and effect of any concentrations of credit and changes in the levels of such concentrations (this characteristic requires any portfolio exceeding 25% of capital to have a factor considered unless the pool is otherwise well diversified or holds a relatively low inherent risk);
- effects of other external factors, such as competition, legal or regulatory factors, on the level of estimated credit losses;
- changes in the quality of our loan review functions; and
- changes in the value of underlying collateral for collateral dependent loans.

The impact of the above listed internal and external qualitative and credit market risk factors is assessed within predetermined ranges to adjust the ACL totals calculated.

Loans that do not share risk characteristics are evaluated on an individual basis. Such loans evaluated individually are not also included in the collective evaluation. The amount of expected credit loss is measured based upon the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral less applicable selling costs. When management determines that foreclosure is probable, the amount of credit loss is determined using the fair value of collateral, less costs to sell.

Loans are charged off against the ACL when management believes the uncollectibility of a loan balance is confirmed, while recoveries of amounts previously charged-off are credited to the ACL. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged off. Approved releases from previously established ACL reserves authorized under our ACL methodology also reduce the ACL. Additions to the ACL are established through the provision for credit losses on loans, which is charged to expense.

The Company's ACL methodology is intended to reflect all loan portfolio risk, but management recognizes the inability to accurately depict all future credit losses in a current ACL estimate, as the impact of various factors cannot be fully known. Accrued interest receivable on loans is excluded from the amortized cost basis of financing receivables for the purpose of determining the allowance for credit losses.

ACL on Unfunded Loan Commitments

The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk by a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The ACL related to off-balance sheet credit exposures, which is within other liabilities on the Company's Consolidated Balance Sheets, is estimated at each balance sheet date under the CECL model, and is adjusted as determined necessary through the provision for credit losses on the income statement. The estimate for ACL on unfunded loan commitments includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life.

Premises and Equipment – Premises, furniture, equipment, and leasehold improvements are stated at cost less accumulated depreciation and amortization. Depreciation expense is determined by the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on a straight-line basis over the shorter of the life of the asset or the lease term including anticipated renewals. Rates of depreciation are generally based on the following useful lives: buildings, 25 to 40 years; building improvements, 3 to 15 years or longer under limited circumstances; and furniture and equipment, 3 to 10 years. Gains and losses on dispositions are included in other noninterest income in the Consolidated Statements of Income. Maintenance and repairs are charged to operating expenses as incurred, while improvements that conform to definitions of tangible property improvements are capitalized and depreciated over the estimated remaining life.

Other Real Estate Owned ("OREO") – Real estate assets acquired in settlement of loans are recorded at the fair value of the property when acquired, less estimated costs to sell, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Any deficiency between the net book value and fair value at the foreclosure or deed in lieu date is charged to the ACL. Any reduction in OREO carrying value within 90 days of transfer to OREO would be charged to the ACL. If the fair value of the property when acquired, less estimated costs to sell, is greater than the net book value of the loan, a gain on transfer is recorded. If a determination is made more than 90 days after the transfer to OREO that the fair value for the OREO property has declined, an OREO valuation allowance is established for the

decrease between the recorded value and the updated fair value less costs to sell. Such declines are included in other noninterest expense in the Consolidated Statements of Income. A subsequent reversal of an OREO valuation adjustment can occur, but the resultant carrying value cannot exceed the cost basis established at transfer of the loan to OREO. Operating costs after acquisition are also expensed.

Mortgage Servicing Rights – The Bank is also involved in the business of servicing mortgage loans. Servicing activities include collecting principal, interest, and escrow payments from borrowers, making tax and insurance payments on behalf of the borrowers, monitoring delinquencies, executing foreclosure proceedings, and accounting for and remitting principal and interest payments to the investors. Mortgage servicing rights represent the right to a stream of cash flows and an obligation to perform specified residential mortgage servicing activities.

Mortgage loans that the Company is servicing for others aggregated to \$793.5 million and \$723.4 million at December 31, 2020, and 2019, respectively. Mortgage loans that the Company is servicing for others are not included in the consolidated balance sheets. Fees received in connection with servicing loans for others are recognized as earned. Loan servicing costs are charged to expense as incurred.

Servicing rights are recognized separately as assets when they are acquired through sales of loans and servicing rights are retained. Servicing rights are initially recorded at fair value with the effect recorded in net gains on sales of mortgage loans in the Consolidated Statements of Income. 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. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing fee income, which is included in the Consolidated Statements of Income as mortgage servicing income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned.

Under the fair value measurement method, the Company measures mortgage servicing rights at fair value at each reporting date, reports changes in fair value of servicing assets in earnings in the period in which the changes occur, and includes these changes in mortgage servicing rights mark to market in the Consolidated Statements of Income. The fair values of mortgage servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Bank-Owned Life Insurance (“BOLI”) – BOLI represents life insurance policies on the lives of certain Company employees (both current and former) for which the Company is the sole owner and beneficiary. These policies are recorded as an asset on the Consolidated Balance Sheets at their cash surrender value (“CSV”) or the amount that could be realized. The change in CSV is recorded as an increase in cash surrender value of bank-owned life insurance in the Consolidated Statements of Income in noninterest income. In addition, insurance proceeds received, net of the original premium investment, are recorded as death benefit realized on bank-owned life insurance in the Consolidated Statements of Income in noninterest income.

Goodwill and Core Deposit Intangible – Goodwill is the excess of an acquisition’s purchase price over the fair value of identified net assets acquired in an acquisition and is evaluated at least annually for impairment. The Company performs its annual evaluation for goodwill impairment at November 30 each year and may elect to perform a quantitative or qualitative analysis or first conduct a qualitative analysis to determine if a quantitative analysis is necessary. In addition, the Company evaluates goodwill impairment on an interim basis if events or changes in circumstances indicate the asset might be impaired. The factors reviewed by the Company when completing a qualitative analysis include, but are not limited to, macroeconomic data, industry specific data, current market conditions, and the Company’s overall financial performance.

Due to the significant deteriorations of economic conditions stemming from the COVID-19 pandemic in the first quarter of 2020, the Company assessed impairment indicators and determined it was more likely than not the Company’s fair value exceeded its carrying value. Due to the decline in the trading price of our common stock and an elevated U.S. unemployment rate, we performed interim impairment evaluations at March 31, June 30 and September 30, 2020. At each quarter-end, we analyzed the current and expected impact of the pandemic on our business, operations, and financial condition and determined it was more likely than not the Company’s fair value exceeded its carrying value, as the negative market indicators were not observed over a sustained period of time. We performed our annual impairment test at November 30, 2020, and elected to first conduct a qualitative analysis to determine if a quantitative analysis was necessary. We analyzed the changes in the negative market indicators discussed above from September 30, 2020, the date of the most recent interim impairment test, to November 30, 2020. The result of this comparison showed an improvement in the U.S. unemployment rate from 7.9% to 6.7%, and an increase in the trading price of our common stock of 28.8%. We also analyzed the impact of the pandemic on our business, operations, and financial condition prior to November 30, 2020 as well as the expected impact in the future, in light of the improving trends discussed above. As a result of the November 30, 2020, qualitative analysis, we determined goodwill was not impaired as it was more likely than not the Company’s fair value exceeded its carrying value. Accordingly, a quantitative analysis was not performed.

The Company’s November 30, 2019, qualitative goodwill assessment resulted in the Company determining goodwill was not impaired, as it was more likely than not the Company’s fair value exceeded its carrying value.

The core deposit intangible (“CDI”) is being amortized on an accelerated method over a ten year estimated useful life. As of December 31, 2020, \$2.2 million of CDI remained, stemming from the Company’s purchase of ABC Bank in 2018 and the Talmer branch purchase in 2016. Total CDI amortization expense of \$494,000, \$539,000 and \$387,000 was recorded in 2020, 2019, and 2018, respectively. The expected future annual amortization expense for each of the next five years (2021-2025) is approximately \$459,000, \$421,000, \$379,000, \$331,000, and \$274,000.

Debt Issuance Costs – Costs associated with the issuance of debt are presented in the Consolidated Balance Sheet as a direct reduction from the carrying value of that debt liability. The deferred issuance costs are amortized over the life the related debt instrument, and included within the debt’s interest expense.

Loss Contingencies – Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

Wealth Management – Assets held in a fiduciary or agency capacity for customers are not included in the consolidated financial statements as they are not assets of the Company or its subsidiaries. Fee income is included as a component of noninterest income in the Consolidated Statements of Income.

Advertising Costs – All advertising costs incurred by the Company are expensed in the period in which they are incurred.

Equity Incentive Plan – Compensation cost is recognized for stock options and restricted stock awards issued to employees based upon the fair value of the awards at the date of grant. A binomial model is utilized to estimate the fair value of stock options, which utilizes assumptions for expected volatilities based on the previous five-year historical volatilities of the Company’s common stock. Historical data is used to estimate option exercise rates and post-vesting termination behavior, and the risk-free interest rate for the expected term of the option is based on the Treasury yield curve in effect at the time of grant. The market price of the Company’s common stock at the date of grant is used for restricted stock awards, which include restricted stock units. Compensation cost is recognized over the required service period, generally defined as the vesting period. Once the award is settled, the Company would determine whether the cumulative tax deduction exceeded the cumulative compensation cost recognized in the Consolidated Statement of Income. The cumulative tax deduction would include both the deductions from the dividends and the deduction from the exercise or vesting of the award. If the tax benefit received from the cumulative deductions exceeds the tax effect of the recognized cumulative compensation cost, the excess would be recognized as a credit to income tax expense.

Income Taxes – The Company files income tax returns in the U.S. federal jurisdiction, and in the states of Illinois, Indiana, Texas, Wisconsin and Florida. The provision for income taxes is based on income in the consolidated financial statements, rather than amounts reported on the Company’s income tax return. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Any change in tax rates will be recorded in the period in which the law is enacted.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using the enacted tax rates that are expected to apply to taxable income in years in which those temporary differences are expected to be recovered or settled.

As of December 31, 2020 and 2019, the Company evaluated tax positions taken for filings with the Internal Revenue Service and all state jurisdictions in which it operates. The Company believes that income tax filing positions will be sustained under examination and does not anticipate any adjustments that would result in a material adverse effect on the Company’s financial condition, results of operations, or cash flows. Accordingly, the Company has not recorded any reserves or related accruals for interest and penalties for uncertain tax positions at December 31, 2020 and 2019. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service from 2017 to 2019, the state of Illinois from 2017 to 2019, the states of Wisconsin and Indiana from 2010 to 2019, the state of Texas from 2016 to 2019, and Florida for 2019.

Earnings Per Common Share (“EPS”) – Basic EPS is computed by dividing net income applicable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income applicable to common stockholders by the weighted-average number of common shares outstanding plus the number of additional common shares that would have been outstanding if the dilutive potential shares had been issued. The Company’s potential common shares represent shares issuable under its long-term incentive compensation plans and, for periods prior to 2020, under the common stock warrant originally issued to preferred stockholders. Such common stock equivalents are computed based on the treasury stock method using the average market price for the period.

Treasury Stock – Treasury stock acquired is recorded at cost and is carried as a reduction of stockholders’ equity in the Consolidated Balance Sheets. Treasury stock issued is valued based on the “last in, first out” inventory method. The difference between the consideration received upon issuance and the carrying value is charged or credited to additional paid-in capital.

Mortgage Banking Derivatives – As part of the ongoing residential mortgage business, the Company enters into mortgage banking derivatives such as forward contracts and interest rate lock commitments. The derivatives and loans held-for-sale are carried at fair value with the changes in fair value recorded in current earnings. The net gain or loss on mortgage banking derivatives is included in net gains on sales of loans in the Consolidated Statements of Income.

Derivative Financial Instruments – The Company occasionally enters into derivative financial instruments as part of its interest rate risk management strategies. These derivative financial instruments consist primarily of interest rate swaps. The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and whether the Company has elected to designate a derivative as a hedging relationship and apply hedge accounting. A further consideration involves a determination on whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting is discontinued, and the adjustment to fair value of the derivative instrument is recorded in earnings. For a derivative used to hedge changes in cash flows associated with forecasted transactions, the gain or loss on the effective portion of the derivative is deferred and reported as a component of accumulated other comprehensive income, which is a component of stockholders' equity, until such time the hedged transaction affects earnings. For derivative instruments not accounted for as hedges, changes in fair value are recognized in noninterest income/expense. Counterparty risk with loan customers is managed through loan covenant agreements and, as such, does not have a significant impact on the fair value of the swaps. Counterparty risk with other banks is managed through bilateral collateralization agreements. Deferred gains and losses from derivatives not accounted for as hedges and that are terminated are amortized over the shorter of the original remaining term of the derivative or the remaining life of the underlying asset or liability.

Comprehensive Income – Comprehensive income is the total of reported earnings for all other revenues, expenses, gains, and losses that are not reported in earnings under GAAP. The Company includes the following items, net of tax, in other comprehensive income in the Consolidated Statements of Comprehensive Income: (i) changes in unrealized gains or losses on securities available-for-sale, (ii) changes in unrealized gains or losses on securities held-to-maturity established upon transfer from securities available-for-sale and (iii) the effective portion of a derivative used to hedge cash flows.

Recent Accounting Pronouncements – The following is a summary of recent accounting pronouncements that have impacted or could potentially affect the Company:

ASU 2016-13 - In June 2016, the FASB issued ASU No. 2016-13 “*Measurement of Credit Losses on Financial Instruments (Topic 326)*”, also known as Current Expected Credit Losses, or “CECL”. ASU 2016-13 was issued to provide financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date to enhance the decision making process. The new methodology reflects expected credit losses based on relevant vintage historical information, supported by reasonable forecasts of projected loss given defaults, which will affect the collectability of the reported amounts. This new methodology also requires available-for-sale debt securities to have a credit loss recorded through an allowance rather than write-downs through an other than temporary impairment analysis. In addition, an allowance is established for the credit risk related to unfunded commitments. ASU 2016-13 is effective for financial statements issued for fiscal years beginning after December 15, 2019, and was adopted by the Company as of January 1, 2020.

Based on our portfolio composition at December 31, 2019, and the economic environment at that time, we recorded an overall increase in our ACL for loans and leases of \$5.9 million and an ACL for unfunded commitments of \$1.7 million as of January 1, 2020, the date we adopted CECL. Approximately \$2.5 million of the increase to the ACL on loans resulted from the transfer of the non-accretable purchase accounting adjustments on purchased credit impaired loans. There was no impact from adoption of CECL on securities available-for sale. As a result of the adoption of this new standard on January 1, 2020, we recorded a reduction to retained earnings of approximately \$3.8 million, which was net of the \$1.4 million deferred tax asset impact stemming from adoption.

ASU 2018-16, ASU 2020-04 and ASU 2021-01 - In October 2018 the FASB issued ASU No. 2018-16 “*Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting*.” ASU 2018-16 adds the SOFR overnight index swap rate to the list of United States (U.S.) benchmark rates eligible for hedge accounting purposes, which is the fourth rate permissible to be used as a U.S. benchmark rate. This guidance is effective for annual and interim periods beginning after December 15, 2018, and we do not expect this guidance to have a material impact on the financial condition or liquidity of the Company. ASU 2020-04 and ASU 2021-01 *Reference Rate Reform* (Topic 848) were issued on March 12, 2020 and January 7, 2021, respectively, and each provide further guidance on optional expedients and exceptions for applying GAAP to contract modifications and hedging relationships due to the discontinuation of LIBOR.

The Company has formed a LIBOR transition team, and has developed a project plan to ensure all financial instruments that reference LIBOR are identified, quantified, and researched for the LIBOR fallback language available or needed. The Company has completed the International Swaps and Derivatives Association (“ISDA”) protocol adherence for LIBOR fallback language for all commercial swaps, has met with our commercial loan clients to also guide their swap fallback language adherence, and worked to revise all credit documents being issued by our Bank for new loans to ensure appropriate fallback language is included. We continue to meet regularly to address ongoing talks on the project plan, such as structuring final transition timelines to cease the issuance of any LIBOR referenced products. This project is ongoing, but the Company anticipates being ready for the proposed LIBOR cessation at the end of 2021.

Subsequent Events

On January 19, 2021, the Company’s Board of Directors declared a cash dividend of \$0.01 per share payable on February 8, 2021, to stockholders of record as of January 29, 2021.

Note 2: Cash and Due from Banks

At December 31, 2019, the Bank was required to maintain average balances on hand or with the FRBC of \$12.4 million. As of March 26, 2020, the FRBC eliminated reserve requirements for certain depository institutions, including the Bank. As such, there was no reserve requirement at December 31, 2020. The nature of the Company’s business requires that it maintain amounts with other banks and federal funds which, at times, may exceed federally insured limits. Management monitors these correspondent relationships, and the Company has not experienced any losses in such accounts.

Note 3: Securities

The following table summarizes the amortized cost and fair value of the securities portfolio at December 31, and the corresponding amounts of gross unrealized gains and losses were as follows:

	Amortized Cost ¹	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2020				
Securities available-for-sale				
U.S. Treasury	\$ 4,014	\$ 103	\$ -	\$ 4,117
U.S. government agencies	6,811	-	(154)	6,657
U.S. government agencies mortgage-backed	16,098	1,112	(1)	17,209
States and political subdivisions	229,352	21,269	(1,362)	249,259
Collateralized mortgage obligations	53,999	2,866	(280)	56,585
Asset-backed securities	130,959	1,370	(511)	131,818
Collateralized loan obligations	30,728	15	(210)	30,533
Total securities available-for-sale	\$ 471,961	\$ 26,735	\$ (2,518)	\$ 496,178
December 31, 2019				
Securities available-for-sale				
U.S. Treasury	\$ 4,010	\$ 26	\$ -	\$ 4,036
U.S. government agencies	8,502	-	(165)	8,337
U.S. government agencies mortgage-backed	16,164	443	(19)	16,588
States and political subdivisions	240,399	11,207	(2,431)	249,175
Collateralized mortgage obligations	57,059	963	(38)	57,984
Asset-backed securities	82,114	617	(887)	81,844
Collateralized loan obligations	66,898	29	(243)	66,684
Total securities available-for-sale	\$ 475,146	\$ 13,285	\$ (3,783)	\$ 484,648

¹ Excludes interest receivable of \$2.7 million and \$3.2 million at December 31, 2020 and December 31, 2019, respectively, that is recorded in other assets on the consolidated balance sheet.

FHLBC stock was \$3.7 million at December 31, 2020 and December 31, 2019. FRBC stock was \$6.2 million at December 31, 2020 and December 31, 2019. Our FHLBC stock is necessary to maintain access to FHLBC advances.

Securities valued at \$335.8 million as of December 31, 2020, were pledged to secure deposits and borrowings, and for other purposes, an increase from \$320.8 million at year-end 2019.

The fair value, amortized cost and weighted average yield of debt securities at December 31, 2020, by contractual maturity, were as follows in the table below. Securities not due at a single maturity date are shown separately.

	Amortized Cost	Weighted Average Yield	Fair Value
Securities available-for-sale			
Due in one year or less	\$ 423	2.09 %	\$ 427
Due after one year through five years	5,833	2.11	6,062
Due after five years through ten years	27,802	2.33	29,027
Due after ten years	206,119	3.02	224,517
	<u>240,177</u>	2.92	<u>260,033</u>
Mortgage-backed and collateralized mortgage obligations	70,097	2.95	73,794
Asset-backed securities	130,959	1.37	131,818
Collateralized loan obligations	30,728	2.04	30,533
Total securities available-for-sale	<u>\$ 471,961</u>	2.44 %	<u>\$ 496,178</u>

At December 31, 2020, the Company's investments include asset-backed securities totaling \$105.0 million that are backed by student loans originated under the Federal Family Education Loan program ("FFEL"). Under the FFEL, private lenders made federally guaranteed student loans to parents and students. While the program was modified several times before elimination in 2010, FFEL securities are generally guaranteed by the U.S. Department of Education ("DOE") at not less than 97% of the principal amount of the loans. The guarantee will reduce to 85% if the DOE receives reimbursement requests in excess of 5% of insured loans; reimbursement will drop to 75% if reimbursement requests exceed 9% of insured loans. As of December 31, 2020, the likelihood of the decrease in the government guarantee was minimal as the average rate of reimbursement for 2020 was less than 1.0%.

The Company has accumulated the securities issued from one originator that individually amounted to over 10% of the Company's stockholders equity. The amortized cost and fair value of securities related to this issuer are as follows:

Issuer	December 31, 2020	
	Amortized Cost	Fair Value
Towd Point Mortgage Trust	33,198	35,479

Securities with unrealized losses with no corresponding allowance for credit losses at December 31, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (in thousands except for number of securities):

December 31, 2020	Less than 12 months in an unrealized loss position			12 months or more in an unrealized loss position			Total		
	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value
Securities available-for-sale									
U.S. government agencies	-	\$ -	\$ -	4	\$ 154	\$ 6,657	4	\$ 154	\$ 6,657
U.S. government agencies mortgage-backed	1	1	141	-	-	-	1	1	141
States and political subdivisions	-	-	-	1	1,362	3,433	1	1,362	3,433
Collateralized mortgage obligations	4	279	8,142	1	1	146	5	280	8,288
Asset-backed securities	1	2	251	3	509	49,572	4	511	49,823
Collateralized loan obligations	1	31	7,468	4	179	21,477	5	210	28,945
Total securities available-for-sale	<u>7</u>	<u>\$ 313</u>	<u>\$ 16,002</u>	<u>13</u>	<u>\$ 2,205</u>	<u>\$ 81,285</u>	<u>20</u>	<u>\$ 2,518</u>	<u>\$ 97,287</u>

December 31, 2019	Less than 12 months in an unrealized loss position			12 months or more in an unrealized loss position			Total		
	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value
Securities available-for-sale									
U.S. government agencies	-	\$ -	\$ -	4	\$ 165	\$ 8,337	4	\$ 165	\$ 8,337
U.S. government agencies mortgage-backed	3	10	3,018	2	9	843	5	19	3,861
States and political subdivisions	6	1,665	41,043	2	766	6,593	8	2,431	47,636
Collateralized mortgage obligations	2	26	9,054	2	12	1,209	4	38	10,263
Asset-backed securities	4	839	54,540	1	48	3,238	5	887	57,778
Collateralized loan obligations	4	62	21,927	4	181	25,020	8	243	46,947
Total securities available-for-sale	<u>19</u>	<u>\$ 2,602</u>	<u>\$ 129,582</u>	<u>15</u>	<u>\$ 1,181</u>	<u>\$ 45,240</u>	<u>34</u>	<u>\$ 3,783</u>	<u>\$ 174,822</u>

The unrealized loss attributable to our collateral loan obligations are the result of spread widening in that sector due to the current economic environment. The unrealized loss attributable to our U.S. government agencies is associated with our SBA positions. Shortly after purchase a structural change in the SBA program occurred that led to higher prepayments which negatively affected these positions. The unrealized loss attributable to states and political subdivisions, collateralized mortgage obligations, and asset-backed securities are

due to limited illiquidity as a result of a few securities with uncommon structures and lesser known issuers. The asset-backed securities are primarily backed by student loans under the FFEL program, these securities are 97% guaranteed by U.S. DOE and have a long history of no credit losses. At December 31, 2020, we have no intent to sell any securities that were in an unrealized loss position nor is it expected that we would be required to sell the securities prior to their anticipated recovery.

The following table presents net realized gains (losses) on securities available-for-sale for the years ended:

	Year Ended December 31,		
	2020	2019	2018
Securities available-for-sale			
Proceeds from sales of securities	\$ 18,006	\$ 191,298	\$ 94,663
Gross realized gains on securities	17	5,521	369
Gross realized losses on securities	(42)	(1,010)	(9)
Net realized (losses) gains	\$ (25)	\$ 4,511	\$ 360
Income tax (expense) benefit on net realized gains (losses)	\$ 7	\$ (1,267)	\$ (100)
Effective tax rate applied	28.0 %	28.1 %	27.8 %

Note 4: Loans and Allowance for Credit Losses on Loans

The composition of loans by portfolio segment as of December 31, were as follows:

	2020	2019
Commercial ¹	\$ 407,159	\$ 332,842
Leases	141,601	119,751
Commercial real estate - Investor	582,042	520,095
Commercial real estate - Owner occupied	333,070	345,504
Construction	98,486	69,617
Residential real estate - Investor	56,137	71,105
Residential real estate - Owner occupied	116,388	136,023
Multifamily	189,040	189,773
HELOC	80,908	91,605
HELOC - Purchased	19,487	31,852
Other ²	10,533	12,258
Total loans, excluding deferred loan costs and PCI loans ³	2,034,851	1,920,425
Net deferred loan costs	-	1,786
Total loans, excluding PCI loans ³	2,034,851	1,922,211
PCI loans	-	8,601
Total loans, including deferred loan costs and PCI loans ³	\$ 2,034,851	\$ 1,930,812
Allowance for credit losses on loans	(33,855)	(19,789)
Net loans ⁴	\$ 2,000,996	\$ 1,911,023

¹ Includes \$74.1 million of PPP loans at December 31, 2020

² Unless otherwise noted, the "Other" segment includes consumer loans and overdrafts in this table and in subsequent tables within Note 4 - Loans and Allowance for Credit Losses on Loans.

³ After the Company's adoption of CECL, all PCD loans are included within each relevant portfolio segment and are not separately reported as PCI loans.

⁴ Excludes accrued interest receivable of \$7.0 million and \$6.5 million at December 31, 2020 and December 31, 2019, respectively, that is recorded in other assets on the consolidated balance sheet.

It is the policy of the Company to review each prospective credit prior to making a loan in order to determine if an adequate level of security or collateral has been obtained. The type of collateral, when required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to lending laws, the Company's lending standards and credit monitoring procedures. Although the Bank makes loans primarily 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. The real estate related categories above represent 72.5% and 75.4% of the portfolio at December 31, 2020 and December 31, 2019, respectively, and include a mix of owner and non-owner occupied, residential, construction and multifamily loans.

The following table represent the activity in the ACL for loans for the year ended December 31, 2020:

	<u>Beginning Balance</u>	<u>Impact of Adopting ASC 326</u>	<u>Provision for Credit Losses</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Ending Balance</u>
Commercial	\$ 3,015	\$ (292)	\$ 72	\$ 39	\$ 56	\$ 2,812
Leases	1,262	501	2,233	206	98	3,888
Commercial real estate - Investor	6,218	(741)	4,075	512	165	9,205
Commercial real estate - Owner occupied	3,678	(848)	487	1,763	697	2,251
Construction	513	1,334	2,095	60	172	4,054
Residential real estate - Investor	601	740	350	8	57	1,740
Residential real estate - Owner occupied	1,257	1,320	(107)	43	287	2,714
Multifamily	1,444	1,732	449	-	-	3,625
HELOC	1,161	1,526	(1,198)	127	387	1,749
HELOC - Purchased	-	-	265	66	-	199
Other	640	607	445	244	170	1,618
Ending Balance, December 31, 2020	\$ 19,789	\$ 5,879	\$ 9,166	\$ 3,068	\$ 2,089	\$ 33,855

The following table presents activity in the allowance for loan and lease losses for the years ended December 31, 2019 and December 31, 2018, as determined in accordance with ASC 310 prior to the adoption of ASU 2016-13:

Allowance for loan and lease losses:	<u>Beginning Balance</u>	<u>Provision for Loan Losses</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Ending Balance</u>
Commercial	\$ 2,832	\$ 218	\$ 109	\$ 74	\$ 3,015
Leases	734	577	49	-	1,262
Commercial real estate - Investor	6,339	(497)	303	679	6,218
Commercial real estate - Owner occupied	3,515	874	716	5	3,678
Construction	969	(448)	9	1	513
Residential real estate - Investor	554	43	7	11	601
Residential real estate - Owner occupied	1,377	(86)	111	77	1,257
Multifamily	616	813	-	15	1,444
HELOC	1,449	(351)	109	172	1,161
HELOC - Purchased	-	229	229	-	-
Other	621	228	409	200	640
Ending Balance, December 31, 2019	\$ 19,006	\$ 1,600	\$ 2,051	\$ 1,234	\$ 19,789

Allowance for loan and lease losses:	<u>Beginning Balance</u>	<u>Provision for Loan Losses</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Ending Balance</u>
Commercial	\$ 2,453	\$ 263	\$ 41	\$ 157	\$ 2,832
Leases	692	55	13	-	734
Commercial real estate - Investor	5,020	2,255	1,376	440	6,339
Commercial real estate - Owner occupied	3,157	523	172	7	3,515
Construction	923	(5)	(16)	35	969
Residential real estate - Investor	542	(110)	(13)	109	554
Residential real estate - Owner occupied	1,304	(784)	(10)	847	1,377
Multifamily	1,345	(941)	(22)	190	616
HELOC	1,446	(214)	147	364	1,449
HELOC - Purchased	-	-	-	-	-
Other	579	186	409	265	621
Ending Balance, December 31, 2018	\$ 17,461	\$ 1,228	\$ 2,097	\$ 2,414	\$ 19,006

The following table presents the collateral dependent loans and the related ACL allocated by segment of loans as of December 31, 2020:

December 31, 2020	Accounts				Total	ACL Allocation
	Real Estate	Receivable	Equipment	Other		
Commercial	\$ -	\$ 1,070	\$ -	\$ 55	\$ 1,125	\$ 56
Leases	-	-	2,377	597	2,974	880
Commercial real estate - Investor	4,179	-	-	-	4,179	84
Commercial real estate - Owner occupied	9,726	-	-	-	9,726	195
Construction	1,891	-	-	-	1,891	952
Residential real estate - Investor	928	-	-	-	928	-
Residential real estate - Owner occupied	3,535	-	-	-	3,535	10
Multifamily	3,838	-	-	-	3,838	378
HELOC	1,053	-	-	-	1,053	78
HELOC - Purchased	-	-	-	-	-	-
Other	-	-	-	4	4	4
Total	\$ 25,150	\$ 1,070	\$ 2,377	\$ 656	\$ 29,253	\$ 2,637

Aged analysis of past due loans by class of loans as of December 31, were as follows:

December 31, 2020 ¹	30-59 Days	60-89 Days	90 Days or	Total Past	Current	Total Loans	90 days or
	Past Due	Past Due	Greater Past	Due			Greater Past
Commercial	\$ -	\$ -	\$ 52	\$ 52	\$ 407,107	\$ 407,159	\$ -
Leases	613	59	316	988	140,613	141,601	163
Commercial real estate - Investor	1,439	-	1,108	2,547	579,495	582,042	-
Commercial real estate - Owner occupied	1,848	958	7,309	10,115	322,955	333,070	-
Construction	1,237	-	-	1,237	97,249	98,486	-
Residential real estate - Investor	1,022	20	484	1,526	54,611	56,137	157
Residential real estate - Owner occupied	859	286	717	1,862	114,526	116,388	114
Multifamily	3,282	467	-	3,749	185,291	189,040	-
HELOC	549	50	206	805	80,103	80,908	-
HELOC - Purchased	47	-	-	47	19,440	19,487	-
Other	20	-	-	20	10,513	10,533	-
Total	\$ 10,916	\$ 1,840	\$ 10,192	\$ 22,948	\$ 2,011,903	\$ 2,034,851	\$ 434

¹ Loans modified under the CARES Act are considered current if they are in compliance with the modified terms.

There were 499 loans which totaled \$231.3 million modified under the CARES Act. As of December 31, 2020, 51 loans of the original 499 loans deferred, or \$32.7 million, had an active deferral request and were in compliance with modified terms; 448 loans which totaled \$198.6 million had resumed payments or paid off. Details of loans in active deferral is below:

December 31, 2020	1st Deferral	2nd Deferral	3rd Deferral	Total
Loans modified under CARES Act, in deferral	\$ 9,431	\$ 19,906	\$ 3,408	\$ 32,745
Loans modified under CARES Act, in nonaccrual, within deferral above	999	1,230	2,121	4,350

The following table presents the age analysis of past due loans as of December 31, 2019, as determined in accordance with ASC 310 prior to the adoption of ASU 2016-13:

December 31, 2019	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded
								Investment 90 days or Greater Past Due and Accruing
Commercial	\$ 1,271	\$ 925	\$ 2,103	\$ 4,299	\$ 328,399	\$ 144	\$ 332,842	\$ 2,132
Leases	362	-	81	443	118,979	329	119,751	128
Commercial real estate - Investor	626	95	343	1,064	517,336	1,695	520,095	348
Commercial real estate - Owner occupied	2,469	1,026	-	3,495	336,829	5,180	345,504	-
Construction	26	-	-	26	69,498	93	69,617	-
Residential real estate - Investor	141	125	-	266	70,051	788	71,105	-
Residential real estate - Owner occupied	3,450	1,351	-	4,801	128,650	2,572	136,023	-
Multifamily	10	1,700	-	1,710	187,995	68	189,773	-
HELOC	735	50	18	803	89,438	1,364	91,605	20
HELOC - Purchased	-	-	-	-	31,672	180	31,852	-
Other ¹	28	-	-	28	13,997	19	14,044	-
Total, excluding PCI	<u>9,118</u>	<u>5,272</u>	<u>2,545</u>	<u>16,935</u>	<u>1,892,844</u>	<u>12,432</u>	<u>1,922,211</u>	<u>2,628</u>
PCI loans, net of purchase accounting adjustments	261	-	-	261	5,377	2,963	8,601	-
Total	<u>\$ 9,379</u>	<u>\$ 5,272</u>	<u>\$ 2,545</u>	<u>\$ 17,196</u>	<u>\$ 1,898,221</u>	<u>\$ 15,395</u>	<u>\$ 1,930,812</u>	<u>\$ 2,628</u>

¹ The "Other" class includes consumer loans, overdrafts and net deferred costs.

The following table presents all nonaccrual loans and loans on nonaccrual for which there was no related allowance for credit losses as of:

	December 31, 2020		December 31, 2019	
	Nonaccrual	Nonaccrual With no ACL	Nonaccrual	Nonaccrual With no ACL
Commercial	\$ 1,125	\$ 1,070	\$ 144	\$ -
Leases	2,638	309	329	70
Commercial real estate - Investor	1,632	1,632	1,695	1,590
Commercial real estate - Owner occupied	9,262	6,780	5,180	2,366
Construction	-	-	93	93
Residential real estate - Investor	928	928	788	788
Residential real estate - Owner occupied	3,206	3,206	2,572	2,475
Multifamily	2,437	2,437	68	68
HELOC	1,052	845	1,364	1,154
HELOC - Purchased	-	-	180	180
Other ¹	-	-	19	2
Total, excluding PCI loans	<u>22,280</u>	<u>17,207</u>	<u>12,432</u>	<u>8,786</u>
PCI loans, net of purchase accounting adjustments	-	-	2,963	2,963
Total	<u>\$ 22,280</u>	<u>\$ 17,207</u>	<u>\$ 15,395</u>	<u>\$ 11,749</u>

The Company recognized \$70,000 of interest on nonaccrual loans during the year ended December 31, 2020. The amount of accrued interest reversed against interest income totaled \$377,000 for the year ended December 31, 2020.

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. This analysis includes loans with outstanding balances or commitments greater than \$50,000 and excludes homogeneous loans such as home equity lines 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.

Credit Quality Indicators by class of loans as of December 31, were as follows:

	2020	2019	2018	2017	2016	Prior	Revolving Loans	Revolving Loans Converted To Term Loans	Total
Commercial									
Pass	\$ 101,796	\$ 42,294	\$ 14,519	\$ 6,265	\$ 1,825	\$ 1,691	\$ 230,388	\$ -	\$ 398,778
Special Mention	5,130	425	68	-	3	-	76	-	5,702
Substandard	273	52	1,524	-	-	-	830	-	2,679
Total commercial	107,199	42,771	16,111	6,265	1,828	1,691	231,294	-	407,159
Leases									
Pass	56,605	52,168	16,830	6,545	5,242	651	-	-	138,041
Special Mention	175	163	-	-	-	-	-	-	338
Substandard	-	1,434	798	59	450	481	-	-	3,222
Total leases	56,780	53,765	17,628	6,604	5,692	1,132	-	-	141,601
Commercial real estate - Investor									
Pass	173,781	158,677	92,156	66,762	55,963	15,966	1,319	-	564,624
Special Mention	2,394	9,592	220	-	95	-	-	-	12,301
Substandard	2,709	1,126	71	-	340	871	-	-	5,117
Total commercial real estate - investor	178,884	169,395	92,447	66,762	56,398	16,837	1,319	-	582,042
Commercial real estate - Owner occupied									
Pass	72,605	52,809	73,719	45,315	50,000	25,507	1,324	-	321,279
Special Mention	604	-	-	-	-	-	-	-	604
Substandard	1,564	2,154	1,780	1,664	501	3,524	-	-	11,187
Total commercial real estate - owner occupied	74,773	54,963	75,499	46,979	50,501	29,031	1,324	-	333,070
Construction									
Pass	50,170	24,163	7,203	539	218	1,261	9,702	-	93,256
Special Mention	38	-	-	-	-	-	-	-	38
Substandard	-	3,135	2,057	-	-	-	-	-	5,192
Total construction	50,208	27,298	9,260	539	218	1,261	9,702	-	98,486
Residential real estate - Investor									
Pass	9,371	14,194	8,522	7,775	2,431	11,184	1,144	-	54,621
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	349	-	610	-	91	466	-	-	1,516
Total residential real estate - investor	9,720	14,194	9,132	7,775	2,522	11,650	1,144	-	56,137
Residential real estate - Owner occupied									
Pass	18,308	23,450	10,808	15,409	10,394	31,325	2,654	-	112,348
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	47	-	412	219	526	2,836	-	-	4,040
Total residential real estate - owner occupied	18,355	23,450	11,220	15,628	10,920	34,161	2,654	-	116,388
Multifamily									
Pass	40,671	30,849	44,301	38,133	12,147	7,735	197	-	174,033
Special Mention	-	6,901	-	548	-	-	-	-	7,449
Substandard	69	-	4,254	927	118	2,190	-	-	7,558
Total multifamily	40,740	37,750	48,555	39,608	12,265	9,925	197	-	189,040
HELOC									
Pass	2,511	2,174	1,679	2,120	504	803	69,483	-	79,274
Special Mention	-	-	-	-	-	-	94	-	94
Substandard	-	-	86	37	271	91	1,055	-	1,540

Total HELOC	<u>2,511</u>	<u>2,174</u>	<u>1,765</u>	<u>2,157</u>	<u>775</u>	<u>894</u>	<u>70,632</u>	<u>-</u>	<u>80,908</u>
HELOC - Purchased									
Pass	-	-	-	-	-	19,487	-	-	19,487
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Total HELOC - purchased	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,487</u>	<u>-</u>	<u>-</u>	<u>19,487</u>
Other									
Pass	1,555	574	569	229	559	341	6,702	-	10,529
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	4	-	-	-	-	-	4
Total other	<u>1,555</u>	<u>574</u>	<u>573</u>	<u>229</u>	<u>559</u>	<u>341</u>	<u>6,702</u>	<u>-</u>	<u>10,533</u>
Total loans									
Pass	527,373	401,352	270,306	189,092	139,283	115,951	322,913	-	1,966,270
Special Mention	8,341	17,081	288	548	98	-	170	-	26,526
Substandard	5,011	7,901	11,596	2,906	2,297	10,459	1,885	-	42,055
Total loans	<u>\$ 540,725</u>	<u>\$ 426,334</u>	<u>\$ 282,190</u>	<u>\$ 192,546</u>	<u>\$ 141,678</u>	<u>\$ 126,410</u>	<u>\$ 324,968</u>	<u>\$ -</u>	<u>\$ 2,034,851</u>

Credit quality indicators by loan segment at December 31, 2019 were as follows:

December 31, 2019

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Commercial	\$ 307,948	\$ 13,206	\$ 11,688	\$ -	\$ 332,842
Leases	119,045	377	329	-	119,751
Commercial real estate - Investor	510,640	4,529	4,926	-	520,095
Commercial real estate - Owner occupied	330,891	6,657	7,956	-	345,504
Construction	69,355	-	262	-	69,617
Residential real estate - Investor	69,715	-	1,390	-	71,105
Residential real estate - Owner occupied	132,258	134	3,631	-	136,023
Multifamily	187,560	1,710	503	-	189,773
HELOC	89,804	12	1,789	-	91,605
HELOC - Purchased	31,672	-	180	-	31,852
Other ¹	13,685	-	359	-	14,044
Total, excluding PCI loans	\$ 1,862,573	\$ 26,625	\$ 33,013	\$ -	\$ 1,922,211
PCI loans, net of purchase accounting adjustments	573	261	7,767	-	8,601
Total	<u>\$ 1,863,146</u>	<u>\$ 26,886</u>	<u>\$ 40,780</u>	<u>\$ -</u>	<u>\$ 1,930,812</u>

¹ The "Other" class includes consumer, overdrafts and net deferred costs.

The Company had \$546,000 and \$831,000 in consumer mortgage loans in the process of foreclosure as of December 31, 2020 and December 31, 2019, respectively.

Troubled debt restructurings ("TDRs") 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 participates 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 amount of expected loan losses for TDRs is measured based upon the present value of expected future cash flows discounted at the loan's effective interest rate, the fair value of the underlying collateral less applicable selling costs, or the observable market price of the loan.

The CARES Act, as extended by certain provisions of the Consolidated Appropriations Act, 2021, permits banks to suspend requirements under GAAP for loan modifications to borrowers affected by COVID-19 that may otherwise be characterized as troubled debt restructurings and suspend any determination related thereto if (i) the borrower was not more than 30 days past due as of December 31,

2019, (ii) the modifications are related to COVID-19, and (iii) the modification occurs between March 1, 2020 and the earlier of 60 days after the date of termination of the national emergency or January 1, 2022.

The number of loans that were modified during the period, including the amortized cost basis pre- and post-modification are summarized as follows:

	TDR Modifications		
	Year Ended December 31, 2020		
	# of contracts	Pre-modification balance	Post-modification balance
Troubled debt restructurings			
Residential real estate - Owner occupied			
HAMP ¹	3	\$ 410	\$ 395
Total	3	\$ 410	\$ 395

	TDR Modifications		
	Year Ended December 31, 2019		
	# of contracts	Pre-modification balance	Post-modification balance
Troubled debt restructurings			
Commercial real estate - Investor			
Other ²	2	\$ 1,217	\$ 1,200
Commercial real estate - Owner Occupied			
Deferral ³	1	421	418
Residential real estate - Owner occupied			
HAMP ¹	3	399	293
HELOC			
Other ²	1	39	38
Total	7	\$ 2,076	\$ 1,949

¹ HAMP: Home Affordable Modification Program

² Other: Change of terms from bankruptcy court

³ Deferral: Refers to the deferral of principal

TDRs are classified as being in default on a case-by-case basis when they fail to be in compliance with the modified terms. There were no TDRs that defaulted during year 2020 and \$39,000 of HELOC TDRs that defaulted during year 2019.

As of December 31, 2020 and 2019, there were no commitments to lend additional funds to debtors whose terms have been modified in a TDR.

There were no loans purchased and/or sold during year 2020.

Loans to principal officers, directors, and their affiliates, which are made in the ordinary course of business, as of December 31, were as follows:

	2020	2019
Beginning balance	\$ 961	\$ 1,417
New loans	644	634
Repayments and other reductions	(822)	(1,025)
Change in related party status	-	(65)
Ending balance	<u>\$ 783</u>	<u>\$ 961</u>

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.

	Twelve Months Ended December 31,		
	2020	2019	2018
Other real estate owned			
Balance at beginning of period	\$ 5,004	\$ 7,175	\$ 8,371
Property additions, net of acquisition adjustments	898	872	3,316
Property improvements	-	-	59
Less:			
Proceeds from property disposals, net of participation purchase and of gains/losses	3,071	2,515	3,990
Period valuation adjustments	357	519	581
Other adjustments	-	9	-
Balance at end of period	<u>\$ 2,474</u>	<u>\$ 5,004</u>	<u>\$ 7,175</u>

Activity in the valuation allowance was as follows:

	Twelve Months Ended December 31,		
	2020	2019	2018
Balance at beginning of period	\$ 6,712	\$ 8,027	\$ 8,208
Provision for unrealized losses	357	519	581
Reductions taken on sales	(5,426)	(1,834)	(762)
Balance at end of period	<u>\$ 1,643</u>	<u>\$ 6,712</u>	<u>\$ 8,027</u>

Expenses related to OREO, net of lease revenue includes:

	Twelve Months Ended December 31,		
	2020	2019	2018
Gain on sales, net	\$ (204)	\$ (264)	\$ (792)
Provision for unrealized losses	357	519	581
Operating expenses	535	173	649
Less:			
Lease revenue	37	5	42
Net OREO expense	<u>\$ 651</u>	<u>\$ 423</u>	<u>\$ 396</u>

Note 6: Premises and Equipment

Premises and equipment at December 31, were as follows:

	2020			2019		
	Cost	Accumulated Depreciation/ Amortization	Net Book Value	Cost	Accumulated Depreciation/ Amortization	Net Book Value
Land	\$ 18,501	\$ -	\$ 18,501	\$ 18,501	\$ -	\$ 18,501
Buildings	43,579	25,909	17,670	43,457	24,912	18,545
Leasehold improvements	2,324	699	1,625	2,314	399	1,915
Furniture and equipment	51,461	43,780	7,681	47,696	42,303	5,393
Total Premises and Equipment	<u>\$ 115,865</u>	<u>\$ 70,388</u>	<u>\$ 45,477</u>	<u>\$ 111,968</u>	<u>\$ 67,614</u>	<u>\$ 44,354</u>

Note 7: Deposits

Major classifications of deposits at December 31, were as follows:

	<u>2020</u>	<u>2019</u>
Noninterest bearing demand	\$ 909,505	\$ 669,795
Savings	399,057	307,015
NOW accounts	486,612	425,792
Money market accounts	316,465	282,478
Certificates of deposit of less than \$100,000	200,107	227,578
Certificates of deposit of \$100,000 through \$250,000	164,982	151,279
Certificates of deposit of more than \$250,000	60,345	62,812
Total deposits	<u>\$ 2,537,073</u>	<u>\$ 2,126,749</u>

The Company had \$59.1 million and \$31.4 million in listing service deposits as of December 31, 2020 and 2019. Deposits held by senior officers and directors, including their related interests, totaled \$2.3 million and \$2.9 million as of December 31, 2020 and 2019.

At December 31, 2020, scheduled maturities of time deposits were as follows:

2021	\$ 349,003
2022	30,295
2023	18,308
2024	7,774
2025	20,054
Total time deposits	<u>\$ 425,434</u>

Note 8: Borrowings

The following table is a summary of borrowings as of December 31, 2020:

	<u>2020</u>	<u>2019</u>
Securities sold under repurchase agreements	\$ 66,980	\$ 48,693
Other short-term borrowings ¹	-	48,500
Junior subordinated debentures ²	25,773	57,734
Senior notes	44,375	44,270
Notes payable and other borrowings	23,393	6,673
Total borrowings	<u>\$ 160,521</u>	<u>\$ 205,870</u>

¹ Includes short-term FHLBC advances and the outstanding portion of an operating line of credit.

² See Note 9: Junior Subordinated Debentures, below.

The Company enters into deposit sweep transactions where the transaction amounts are secured by pledged securities. These transactions consistently mature within 1 to 90 days from the transaction date and are governed by sweep repurchase agreements. All sweep repurchase agreements are treated as financings secured by U.S. government agencies, collateralized mortgage obligations, mortgage-backed securities and/or highly-rated issues of State and political subdivisions, and had a carrying amount of \$67.0 million and \$48.7 million at December 31, 2020 and 2019, respectively. The fair value of the pledged collateral was \$94.4 million and \$70.7 million at December 31, 2020 and December 31, 2019, respectively. At December 31, 2020, there were no customers with secured balances exceeding 10% of stockholders' equity.

Total FHLBC advances are generally limited to the lower of 35% of total assets and the amount of acceptable collateral adjusted for applicable funding percentages as determined by the FHLBC. As of December 31, 2020, the Bank had no outstanding short-term FHLBC advances. As of December 31, 2019, the Bank had outstanding short-term FHLBC advances in the amount of \$48.5 million with a weighted average interest rate of 1.78%. As of December 31, 2020, FHLBC stock owned by the Bank was valued at \$3.7 million, the fair value of securities pledged to the FHLBC was \$54.7 million, and the principal balance of loans pledged was \$625.8 million. In 2018, the Bank assumed \$23.4 million of long-term FHLBC advances with the ABC acquisition. At December 31, 2020, one remaining long-term FHLBC advance, which is included in notes payable and other borrowings, has a total outstanding balance of \$6.4 million and is scheduled to mature over the next 5.25 years with an interest rate of 2.83%. At December 31, 2019, these long-term FHLBC advances had a total outstanding balance of \$6.7 million and were scheduled to mature over the next 6.25 years with interest rate of 2.83%. Based

on the total amount of securities and loans pledged, the Bank had total borrowing capacity of \$459.5 million. Adjusting for the outstanding advances and letters of credit, the Bank had a remaining funding availability of \$336.9 million on December 31, 2020.

The Company also has \$44.4 million of senior notes outstanding, net of deferred issuance costs, as of December 31, 2020 and \$44.3 million as of December 31, 2019. The senior notes were issued in 2016, had an original maturity of ten years, and terms include interest payable semiannually at 5.75% for five years. Beginning December 31, 2021, the senior debt will pay interest at a floating rate, with interest payable quarterly at three month LIBOR plus 385 basis points. The notes are redeemable, in whole or in part, at the option of the Company, beginning with the interest payment date on December 31, 2021, and on any floating rate interest payment date thereafter, at a redemption price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. As of December 31, 2020 and 2019, unamortized debt issuance costs related to the senior notes were \$625,000 and \$730,000, respectively, and are included as a reduction of the balance of the senior notes on the Consolidated Balance Sheets. These deferred issuance costs will be amortized to interest expense over the ten year term of the notes and included in the Consolidated Statements of Income.

On February 24, 2020, the Company originated a \$20.0 million term note, of which \$17.0 million is outstanding as of December 31, 2020, with a correspondent bank, the proceeds of which were used in the redemption of the Company's 7.80% cumulative trust preferred securities issued by Old Second Capital Trust I and related junior subordinated debentures. See the discussion in Note 9 – *Junior Subordinated Debentures*. The term note was issued for a three year term at one-month LIBOR plus 175 basis points, requires principal and interest payments quarterly, with no prepayment penalties; any remaining balances are due on February 24, 2023. The balance of this note is included within Notes payable and other borrowings on the Consolidated Balance Sheet. The Company also has an undrawn line of credit of \$20.0 million with a correspondent bank to be used for short-term funding needs; advances under this line can be outstanding up to 360 days from the date of issuance. This line of credit has not been utilized since early 2019.

Scheduled maturities and weighted average rates of borrowings for the years ended December 31, were as follows:

	2020		2019	
	Balance	Weighted Average Rate	Balance	Weighted Average Rate
2020	\$ -	-	\$ 97,193	1.85 %
2021	70,980	0.46 %	-	-
2022	4,000	1.91	-	-
2023	9,000	1.91	-	-
2024	-	-	-	-
2025	-	-	-	-
Thereafter	76,541	5.24	108,677	6.11
Total borrowings	\$ 160,521	2.86 %	\$ 205,870	4.10 %

Note 9: Junior Subordinated Debentures

On March 2, 2020, the Company redeemed 7.80% cumulative trust preferred securities issued by Old Second Capital Trust I (“OSBCP”) and related debentures, which totaled \$32.6 million. These debentures were originally issued in 2003 for a term of 30 years at 7.80%, and subject to regulatory approval, were able to be called in whole or in part by the Company after June 30, 2008. The Company received regulatory approval to redeem the debentures in early 2020, and notified OSBCP stockholders of the redemption in late January 2020. Cash disbursed for the redemption, including accrued interest on the debentures, totaled \$33.0 million, or \$10.13 per OSBCP share. The OSBCP redemption was funded by cash on hand and the \$20 million term note discussed in Note 8 – *Borrowings*. Upon redemption of the junior subordinated debentures related to OSBCP in March 2020, the Company recognized the remaining unamortized debt issuance costs of \$635,000.

The Company sold \$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. These trust preferred securities also mature in 30 years, but subject to 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 were fixed at 6.77% through June 15, 2017, and float at 150 basis points over three-month LIBOR thereafter. Upon conversion to a floating rate on June 16, 2017, a cash flow hedge was initiated, whereby the Company swapped the three-month LIBOR for a fixed rate of 2.8%. Accordingly, the effective rate of the instrument was 4.4% as of December 31, 2020 and 2019. The Company issued a new \$25.8 million subordinated debenture to the Old Second Capital Trust II in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

The Trust I and Trust II the debentures issued by the Company are disclosed on the Consolidated Balance Sheets as junior subordinated debentures and the related interest expense for each issuance is included in the Consolidated Statements of Income. As of December 31, 2020 and 2019, unamortized debt issuance costs related to the junior subordinated debentures were \$1,000 and \$644,000 respectively, and are included as a reduction to the balance of the junior subordinated debentures on the Consolidated Balance Sheets.

Under the terms of the subordinated debenture issued to Old Second Capital Trust II, the Company is allowed to defer payments of interest for 20 quarterly periods without default or penalty, but such amounts continue to accrue. Also during a deferral period, the Company generally may not pay cash dividends on or repurchase its common stock or preferred stock. As of December 31, 2020, the Company is current on the payments due on these securities.

Note 10: Income Taxes

Income tax expense (benefit) for the years ending December 31, were as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Current federal	\$ 6,269	\$ 4,815	\$ -
Current state	3,960	1,151	84
Deferred federal	(135)	3,177	6,226
Deferred state	(511)	3,259	3,614
Total income tax expenses	<u>\$ 9,583</u>	<u>\$ 12,402</u>	<u>\$ 9,924</u>

The following were the components of the deferred tax assets and liabilities as of December 31:

	<u>2020</u>	<u>2019</u>
Allowance for credit losses	\$ 11,058	\$ 6,082
Deferred compensation	1,093	907
Goodwill amortization/impairment	2,212	3,456
Stock based compensation	1,356	1,622
Business combination adjustments	255	1,547
OREO write-downs	614	1,931
Federal recognized built-in loss ("RBIL") carryforward	142	340
State net operating loss and RBIL carryforward	60	326
Other assets	2,182	2,270
Total deferred tax assets	<u>18,972</u>	<u>18,481</u>
Accumulated depreciation on premises and equipment	(1,237)	(746)
Mortgage servicing rights	(1,261)	(1,779)
Amortization of core deposit intangible	(171)	(144)
State tax benefits	(930)	(927)
Other liabilities	(1,481)	(1,637)
Total deferred tax liabilities	<u>(5,080)</u>	<u>(5,233)</u>
Net deferred tax asset before adjustments related to other comprehensive income	<u>13,892</u>	<u>13,248</u>
Tax effect of adjustments related to other comprehensive income	(5,771)	(1,789)
Net deferred tax asset	<u>\$ 8,121</u>	<u>\$ 11,459</u>

At December 31, 2020, the Company no longer has federal nor state net operating loss carryforward. The Company had \$674,000 of recognized built-in loss carryforward, which is below the \$945,300 limitation per year under IRC Section 382.

The components of the provision for deferred income tax expense (benefit) for the years ending December 31, were as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Provision for credit losses	\$ (4,976)	\$ (279)	\$ (426)
Deferred compensation	(186)	(242)	(15)
Amortization of core deposit intangible	27	14	957
Stock based compensation	266	(245)	(511)
Business combination adjustments	1,292	985	927
OREO write-downs	1,317	406	48
Federal net operating loss and RBIL carryforward	198	1,859	5,041
State net operating loss and RBIL carryforward	266	3,708	2,986
Depreciation	491	303	59
Mortgage servicing rights	(518)	(431)	124
Goodwill amortization/impairment	1,244	1,242	1,389
State tax benefits	3	(912)	(550)
Other, net	(70)	28	(189)
Total deferred tax (benefit) expense	<u>\$ (646)</u>	<u>\$ 6,436</u>	<u>\$ 9,840</u>

Effective tax rates differ from federal statutory rates applied to financial statement income for the years ended December 31, due to the following:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Tax at statutory federal income tax rate	\$ 7,856	\$ 10,890	\$ 9,227
Nontaxable interest income, net of disallowed interest deduction	(1,067)	(1,409)	(1,600)
BOLI income	(271)	(480)	(422)
State income taxes, net of federal benefit	2,570	3,496	2,927
Stock based compensation	297	(207)	(305)
Other, net	198	112	97
Total tax at effective tax rate	<u>\$ 9,583</u>	<u>\$ 12,402</u>	<u>\$ 9,924</u>

The Company evaluated positive and negative evidence in order to determine if it was more likely than not that the deferred tax asset would be recovered through future income. Significant positive evidence evaluated included recent and projected earnings, significantly improved asset quality and an improved capital position. No significant negative evidence was noted.

Note 11: Equity Compensation Plans

Stock-based awards are outstanding under the Company's 2014 Equity Incentive Plan, as amended (the "2014 Plan"), and the Company's 2019 Equity Incentive Plan (the "2019 Plan", together with the 2014 Plan, the "Plans"). The 2019 Plan was approved at the May 2019 annual stockholders' meeting and the number of authorized shares under the 2019 Plan is fixed at 600,000. Following the approval of the 2019 Plan, no further awards will be granted under the 2014 Plan or any other prior plan. The 2019 Plan authorizes the granting of qualified stock options, non-qualified stock options, restricted stock, restricted stock units, and stock appreciation rights ("SARs"). Awards may be granted to selected directors, officers, employees or eligible service providers under the 2019 Plan at the discretion of the Compensation Committee of the Company's Board of Directors. As of December 31, 2020, 354,268 shares remained available for issuance under the 2019 Plan.

The Company granted 16,500 stock options in 2009 under the 2008 Equity Incentive Plan, and there are no remaining outstanding stock options as of December 31, 2020. No stock options were granted in 2009 through 2020. There were 4,500 stock options exercised during each of 2019 and 2018, and no stock options exercised during 2020. At December 31, 2020, the Company had no unrecognized compensation cost related to unvested stock options as all stock options have fully vested.

A summary of stock option activity as of each year is as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Intrinsic value of options exercised	\$ -	\$ 27	\$ 27
Cash received from option exercises	-	32	33
Tax benefit realized from option exercises	-	5	5
Weighted average fair value of options granted	-	-	-

Generally, restricted stock and restricted stock units granted under the Plans vest three years from the grant date, but the Compensation Committee of the Company's Board of Directors has discretionary authority to change the terms of particular awards including the vesting schedule.

Under the 2019 Plan, unless otherwise provided in an award agreement, upon the occurrence of a change in control, all stock options and SARs then held by the participant will become fully exercisable immediately if, and all stock awards and cash incentive awards will become fully earned and vested immediately if, (i) the 2019 Plan is not an obligation of the successor entity following a change in control or (ii) the 2019 Plan is an obligation of the successor entity following a change in control and the participant incurs a termination of service without cause or for good reason following the change in control. Notwithstanding the immediately preceding sentence, if the vesting of an award is conditioned upon the achievement of performance measures, then such vesting will generally be subject to the following: if, at the time of the change in control, the performance measures are less than 50% attained (pro rata based upon the time of the period through the change in control), the award will become vested and exercisable on a fractional basis with the numerator being equal to the percentage of attainment and the denominator being 50%; and if, at the time of the change in control, the performance measures are at least 50% attained (pro rata based upon the time of the period through the change in control), the award will become fully earned and vested immediately upon the change in control.

Awards of restricted stock units under the Plans generally entitled holders to voting and dividend rights upon grant and are subject to forfeiture until certain restrictions have lapsed including employment for a specific period. Awards of restricted stock units under the Plans are also subject to forfeiture until certain restrictions have lapsed including employment for a specific period, but do not entitle holders to voting rights until the restricted period ends and shares are transferred in connection with the units.

Total compensation cost that has been charged for the Plans was \$2.1 million, \$2.5 million and \$2.3 million the years ending December 31, 2020, 2019 and 2018 respectively.

There were 140,944 and 171,356 restricted stock units granted during the years ending December 31, 2020 and 2019, respectively. Compensation expense is recognized over the vesting period of the restricted stock unit based on the market value of the award on the grant date.

A summary of changes in the Company's unvested restricted awards for the years ending December 31, 2020, is as follows:

	December 31, 2020	
	Restricted Stock Shares and Units	Weighted Average Grant Date Fair Value
Unvested at January 1	555,283	\$ 12.85
Granted	140,944	12.18
Vested	(149,952)	11.16
Forfeited	(13,666)	12.97
Unvested at December 31	<u>532,609</u>	<u>\$ 13.15</u>

Total unrecognized compensation cost of restricted stock unit awards was \$2.1 million as of December 31, 2020, which is expected to be recognized over a weighted-average period of 1.75 years.

Note 12: Earnings Per Share

The earnings per share, both basic and diluted, are included below as of December 31, (in thousands except for per share data):

	2020	2019	2018
Basic earnings per share:			
Weighted-average common shares outstanding	29,623,333	29,891,046	29,728,308
Net income	\$ 27,825	\$ 39,455	\$ 34,012
Basic earnings per share	\$ 0.94	\$ 1.32	\$ 1.14
Diluted earnings per share:			
Weighted-average common shares outstanding	29,623,333	29,891,046	29,728,308
Dilutive effect of unvested restricted awards ¹	550,739	525,302	532,692
Dilutive effect of stock options and warrants	-	-	47,935
Diluted average common shares outstanding	<u>30,174,072</u>	<u>30,416,348</u>	<u>30,308,935</u>
Net Income	\$ 27,825	\$ 39,455	\$ 34,012
Diluted earnings per share	\$ 0.92	\$ 1.30	\$ 1.12

¹ Includes the common stock equivalents for restricted share rights that are dilutive.

The above earnings per share calculation did not include a warrant for 815,339 shares of common stock that was outstanding as of December 31, 2018, because the warrant was anti-dilutive at an exercise price of \$13.43. Of note, the warrant was sold at auction by the Treasury in June 2013 to a third party investor. This warrant was issued in January 2009 at an exercise price of \$13.43 per share, and expired on January 16, 2019. On January 16, 2019, the warrant for 815,339 shares of the Company's common stock was exercised in a cashless transaction. As of the date of exercise, the Company's closing market price was \$14.23 per share, resulting in 45,836 shares being issued. These shares were issued from treasury stock held by the Company, and resulted in a \$313,000 reduction of treasury stock in January 2019.

Note 13: Commitments

In the normal course of business, there are outstanding commitments that are not reflected in the Consolidated Financial Statements. Commitments include financial instruments that involve, to varying degrees, elements of credit, interest rate, and liquidity risk. In management's opinion, these do not represent unusual risks and management does not anticipate significant losses as a result of these transactions. The Company uses the same credit policies in making commitments and conditional obligations for borrowers as it does for on-balance sheet instruments.

The following table is a summary of financial instrument commitments as of December 31, were as follows:

	December 31, 2020			December 31, 2019		
	Fixed	Variable	Total	Fixed	Variable	Total
Letters of credit:						
Borrower:						
Financial standby	\$ 329	\$ 9,051	\$ 9,380	\$ 339	\$ 9,612	\$ 9,951
Commercial standby	-	-	-	-	-	-
Performance standby	356	4,517	4,873	571	6,212	6,783
	<u>685</u>	<u>13,568</u>	<u>14,253</u>	<u>910</u>	<u>15,824</u>	<u>16,734</u>
Non-borrower:						
Performance standby	-	67	67	-	67	67
Total letters of credit	<u>\$ 685</u>	<u>\$ 13,635</u>	<u>\$ 14,320</u>	<u>\$ 910</u>	<u>\$ 15,891</u>	<u>\$ 16,801</u>
Unused loan commitments:	<u>\$ 88,883</u>	<u>\$ 316,298</u>	<u>\$ 405,181</u>	<u>\$ 111,348</u>	<u>\$ 320,120</u>	<u>\$ 431,468</u>

The Bank occupies facilities under long-term operating leases, some of which include provisions for future rent increases. In addition, the Company leases space at sites that house automatic teller machines (ATMs). The Company also receives rental income on certain leased properties. As of December 31, 2020, aggregate future minimum rental income to be received under noncancelable leases totaled \$48,000. Total facility net operating lease expense or revenue recorded under all operating leases was a net expense of \$223,000, \$248,000 and \$180,000 in 2020, 2019 and 2018, respectively. Total ATM lease expense, including the costs related to servicing those ATM's, was \$1.0 million, \$916,000 and \$979,000 in 2020, 2019 and 2018, respectively, with growth in expense in 2018 due to the ATMs obtained with the acquisition of ABC Bank, and growth in expense in 2020 due to repairs stemming from civil unrest and resultant maintenance costs required.

The following table below is the estimated aggregate minimum annual rental commitments at December 31, 2020:

	2021	2022	2023	2024	2025	2026 and there after
Rental commitment	\$ 762	\$ 625	\$ 612	\$ 628	\$ 643	\$ 3,297

Legal proceedings

The Company and its subsidiaries, from time to time, pursue collection suits and other actions that arise in the ordinary course of business against their borrowers and are defendants in legal actions arising from normal business activities. Management, after consultation with legal counsel, believes that the ultimate liabilities, if any, resulting from these actions will not have a material adverse effect on the financial position of the Bank or on the consolidated financial position of the Company based on all known information at this time.

Note 14: Regulatory & Capital Matters

The Bank is subject to the risk-based capital regulatory guidelines, which include the methodology for calculating the risk-weighted Bank assets, developed by the Office of the Comptroller of the Currency (the “OCC”) and the other bank regulatory agencies. In connection with the current economic environment, the Bank’s current level of nonperforming assets and the risk-based capital guidelines, the Bank’s board of directors’ guidelines are for the Bank to maintain a Tier 1 leverage capital ratio at or above eight percent (8%) and a total risk-based capital ratio at or above twelve percent (12%). The Bank currently exceeds those thresholds.

Bank holding companies are required to maintain minimum levels of capital in accordance with capital guidelines implemented by the Board of Governors of the Federal Reserve System. The general bank and holding company capital adequacy guidelines in force as of the periods reported are shown in the accompanying table, as are the capital ratios of the Company and the Bank, as of December 31, 2020, and December 31, 2019.

In July 2013, the U.S. federal banking authorities issued final rules (the “Basel III Rules”) establishing more stringent regulatory capital requirements for U.S. banking institutions, which went into effect on January 1, 2015. A detailed discussion of the Basel III Rules is included in Part I, Item 1 of the under the heading “Supervision and Regulation.”

The Company and the Bank are subject to regulatory capital requirements administered by federal banking agencies. The capital ratios below are calculated pursuant to the capital requirements in effect for the periods reported below.

Capital levels and industry defined regulatory minimum required levels at December 31, were as follows:

	Actual		Minimum Capital Adequacy with Capital Conservation Buffer, if applicable ¹		Well Capitalized Under Prompt Corrective Action Provisions ²	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2020						
Common equity tier 1 capital to risk weighted assets						
Consolidated	\$ 277,199	11.94	\$ 162,512	7.000 %	N/A	N/A
Old Second Bank	318,466	13.75	162,128	7.000	\$ 150,548	6.50 %
Total capital to risk weighted assets						
Consolidated	331,178	14.26	243,855	10.500	N/A	N/A
Old Second Bank	347,408	15.00	243,186	10.500	231,605	10.00
Tier 1 capital to risk weighted assets						
Consolidated	302,199	13.01	197,440	8.500	N/A	N/A
Old Second Bank	318,466	13.75	196,870	8.500	185,289	8.00
Tier 1 capital to average assets						
Consolidated	302,199	10.21	118,393	4.00	N/A	N/A
Old Second Bank	318,466	10.74	118,609	4.00	148,262	5.00
2019						
Common equity tier 1 capital to risk weighted assets						
Consolidated	\$ 251,477	11.14 %	\$ 158,020	7.000 %	N/A	N/A
Old Second Bank	322,496	14.35	157,315	7.000	\$ 146,078	6.50 %
Total capital to risk weighted assets						
Consolidated	327,886	14.53	236,944	10.500	N/A	N/A
Old Second Bank	342,280	15.23	235,978	10.500	224,741	10.00
Tier 1 capital to risk weighted assets						
Consolidated	308,102	13.65	191,858	8.500	N/A	N/A
Old Second Bank	322,496	14.35	191,026	8.500	179,789	8.00
Tier 1 capital to average assets						
Consolidated	308,102	11.93	103,303	4.00	N/A	N/A
Old Second Bank	322,496	12.50	103,199	4.00	128,998	5.00

¹ Amounts are shown inclusive of a capital conservation buffer of 2.50%. Under the Federal Reserve’s Small Bank Holding Company Policy Statement, the Company is not subject to the minimum capital adequacy and capital conservation buffer capital requirements at the holding company level, unless otherwise advised by the Federal Reserve (such capital requirements are applicable only at the Bank level). Although the minimum regulatory capital requirements are not applicable to the Company, we calculate these ratios for our own planning and monitoring purposes.

² *The prompt corrective action provisions are only applicable at the Bank level. The Bank exceeded the general minimum regulatory requirements to be considered “well capitalized.”*

As part of its response to the impact of the COVID-19 pandemic, in the first quarter of 2020, U.S. federal regulatory authorities issued an interim final rule that provided banking organizations that adopted CECL during the 2020 calendar year with the option to delay for two years the estimated impact of CECL on regulatory capital relative to regulatory capital determined under the prior incurred loss methodology, followed by a three-year transition period to phase out the aggregate amount of the capital benefit provided during the initial two-year delay (i.e., a five-year transition in total). In connection with our adoption of CECL on January 1, 2020, we have elected to utilize the five-year CECL transition. The cumulative amount that is not recognized in regulatory capital, in addition to the \$3.8 million Day 1 impact of CECL adoption, will be phased in at 25% per year beginning January 1, 2022. As of December 31, 2020, the capital measures of the Company exclude \$5.7 million, which is the Day 1 impact to retained earnings and 25% of the \$10.4 million increase in the allowance for credit losses during 2020, excluding PCD loans.

Dividend Restrictions

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. Pursuant to the Basel III rules that were fully phased-in at January 1, 2019, the Bank must keep a capital conservation buffer of 2.5% on all risk-based capital requirements in order to avoid additional limitations on capital distributions.

Note 15: Mortgage Banking Derivatives

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. It is the Company’s practice to sell mortgage-backed securities (“MBS”) contracts for the future delivery to economically hedge the effect of changes in interest rates resulting from its commitments to fund the loans. These contracts are also derivatives and collectively with the forward commitments for the future delivery of mortgage loans are considered forward contracts. These mortgage banking derivatives, which are not designated in hedge relationships using the accepted accounting for derivative instruments and hedging activities at December 31, were as follows:

	<u>2020</u>	<u>2019</u>
Forward contracts:		
Notional amount	\$ 46,500	\$ 13,500
Fair value	(228)	(15)
Rate lock commitments:		
Notional amount	\$ 37,972	\$ 10,167
Fair value	1,068	265

Fair values were estimated based on changes in mortgage interest rates from the date of the commitments. The Company sold \$384.4 million in loans to investors receiving proceeds of \$388.5 million and resulting in a gain on sale of \$15.5 million for the year ended December 31, 2020. Sales to investors included \$312.0 million, or 83.2% to FNMA and \$44.2 million, or 11.8%, to FHLMC for the year ended December 31, 2020. No other individual investor was sold more than 10% of the total loans sold.

Note 16: Fair Value Measurements

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

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 view about the assumptions that market participants would use in pricing an asset or liability.

Transfers between levels are deemed to have occurred at the end of the reporting period. At December 31, 2020 and 2019, there were no transfers between levels.

The majority of securities are valued by external pricing services or dealer market participants and are classified in Level 2 of the fair value hierarchy. Both market and income valuation approaches are utilized. Quarterly, the Company evaluates the methodologies used by the external pricing services or dealer market participants to develop the fair values to determine whether the results of the valuations are representative of an exit price in the Company's principal markets and an appropriate representation of fair value. The Company uses the following methods and significant assumptions to estimate fair value:

- Government-sponsored agency debt securities are primarily priced using available market information through processes such as benchmark spreads, market valuations of like securities, like securities groupings and matrix pricing.
- Other government-sponsored agency securities, MBS and some of the actively traded real estate mortgage investment conduits and collateralized mortgage obligations are priced using available market information including benchmark yields, prepayment speeds, spreads, volatility of similar securities and trade date.
- State and political subdivisions are largely grouped by characteristics (e.g., 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.
- Beginning March 31, 2015, auction rate asset backed securities are priced using market spreads, cash flows, prepayment speeds, and loss analytics. This process supports the transfer to Level 2 valuations.
- Annually every security holding is priced by a pricing service independent of the regular and recurring pricing services used. The independent service provides a measurement to indicate if the price assigned by the regular service is within or outside of a reasonable range. Management reviews this report and applies judgment in adjusting calculations at year end related to securities pricing.
- Residential mortgage loans available 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, e.g. residential mortgage loans with locked interest rates 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 MBS are considered derivatives. Fair values are estimated based on observable changes in mortgage interest rates including prices for MBS 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 valuation pricing models using an income approach reflecting readily observable market parameters such as interest rate yield curves.
- The fair value of impaired loans with specific allocations of the ACL is essentially based on recent real estate appraisals or the fair value of the collateralized asset. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are made in the appraisal process by the appraisers to reflect differences between the available comparable sales and income data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.
- Nonrecurring adjustments to certain commercial and residential real estate properties classified as OREO are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are 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, a valuation loss is recognized.

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

The tables below present the balance of assets and liabilities at December 31, measured by the Company at fair value on a recurring basis are as follows:

	December 31, 2020			
	Level 1	Level 2	Level 3	Total
Assets:				
Securities available-for-sale				
U.S. Treasury	\$ 4,117	\$ -	\$ -	\$ 4,117
U.S. government agencies	-	6,657	-	6,657
U.S. government agencies mortgage-backed	-	17,209	-	17,209
States and political subdivisions	-	244,940	4,319	249,259
Collateralized mortgage obligations	-	56,585	-	56,585
Asset-backed securities	-	131,818	-	131,818
Collateralized loan obligations	-	30,533	-	30,533
Loans held-for-sale	-	12,611	-	12,611
Mortgage servicing rights	-	-	4,224	4,224
Interest rate swap agreements	-	9,388	-	9,388
Mortgage banking derivatives	-	840	-	840
Total	\$ 4,117	\$ 510,581	\$ 8,543	\$ 523,241
Liabilities:				
Interest rate swap agreements, including risk participation agreements	\$ -	\$ 13,159	\$ -	\$ 13,159
Total	\$ -	\$ 13,159	\$ -	\$ 13,159

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Assets:				
Securities available-for-sale				
U.S. Treasury	\$ 4,036	\$ -	\$ -	\$ 4,036
U.S. government agencies	-	8,337	-	8,337
U.S. government agencies mortgage-backed	-	16,588	-	16,588
States and political subdivisions	-	243,756	5,419	249,175
Collateralized mortgage obligations	-	57,984	-	57,984
Asset-backed securities	-	81,844	-	81,844
Collateralized loan obligations	-	66,684	-	66,684
Loans held-for-sale	-	3,061	-	3,061
Mortgage servicing rights	-	-	5,935	5,935
Interest rate swap agreements	-	2,771	-	2,771
Mortgage banking derivatives	-	250	-	250
Total	\$ 4,036	\$ 481,275	\$ 11,354	\$ 496,665
Liabilities:				
Interest rate swap agreements, including risk participation agreements	\$ -	\$ 5,974	\$ -	\$ 5,974
Total	\$ -	\$ 5,974	\$ -	\$ 5,974

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

	Year Ended December 31, 2020	
	Securities available- for-sale	
	States and Political Subdivisions	Mortgage Servicing Rights
Beginning balance January 1, 2020	\$ 5,419	\$ 5,935
Total gains or losses		
Included in earnings	(20)	(2,483)
Included in other comprehensive income	(628)	-
Purchases, issuances, sales, and settlements		
Purchases	13,086	-
Issuances	-	2,288
Settlements	(13,538)	(1,516)
Ending balance December 31, 2020	<u>\$ 4,319</u>	<u>\$ 4,224</u>

	Year Ended December 31, 2019	
	Securities available- for-sale	
	States and Political Subdivisions	Mortgage Servicing Rights
Beginning balance January 1, 2019	\$ 8,165	\$ 7,357
Total gains or losses		
Included in earnings	(32)	(1,953)
Included in other comprehensive income	726	-
Purchases, issuances, sales, and settlements		
Purchases	17,938	-
Issuances	-	1,240
Settlements	(21,378)	(709)
Ending balance December 31, 2019	<u>\$ 5,419</u>	<u>\$ 5,935</u>

The following table and commentary presents quantitative and qualitative information about Level 3 fair value measurements as of December 31, 2020:

<u>Measured at fair value on a recurring basis:</u>	<u>Fair Value</u>	<u>Valuation Methodology</u>	<u>Unobservable Inputs</u>	<u>Range of Input</u>	<u>Weighted Average of Inputs</u>
Mortgage servicing rights	\$ 4,224	Discounted Cash Flow	Discount Rate Prepayment Speed	11.0 - 15.0% 5.5 - 59.1%	11.0 % 19.5 %

The following table and commentary presents quantitative and qualitative information about Level 3 fair value measurements as of December 31, 2019:

<u>Measured at fair value on a recurring basis:</u>	<u>Fair Value</u>	<u>Valuation Methodology</u>	<u>Unobservable Inputs</u>	<u>Range of Input</u>	<u>Weighted Average of Inputs</u>
Mortgage servicing rights	\$ 5,935	Discounted Cash Flow	Discount Rate Prepayment Speed	10.0 - 58.8% 0.0 - 69.0%	10.1 % 14.1 %

In addition to the above, Level 3 fair value measurement included \$4.3 million for state and political subdivisions representing various local municipality securities at December 31, 2020. Level 3 fair value measurement included \$5.4 million on the state and political subdivisions line at December 31, 2019. Given the small dollar amount and size of the municipality issuances involved, this is categorized as Level 3 based on the payment stream received by the Company from the municipalities. That payment stream is otherwise an unobservable input.

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 OREO. For assets measured at fair value on a nonrecurring basis at December 31, 2020 the following tables provide the level of valuation assumptions used to determine each valuation and the carrying value of the related assets:

	December 31, 2020			
	Level 1	Level 2	Level 3	Total
Individually evaluated loans ¹	\$ -	\$ -	\$ 9,675	\$ 9,675
Other real estate owned, net ²	-	-	2,474	2,474
Total	\$ -	\$ -	\$ 12,149	\$ 12,149

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 \$12.3 million and a valuation allowance of \$2.6 million, resulting in an increase of specific allocations within the provision for credit losses of \$1.4 million for the year ending December 31, 2020.

² OREO is measured at the lower of carrying or fair value less costs to sell, and had a net carrying amount of \$2.5 million, which is made up of the outstanding balance of \$4.1 million, net of a valuation allowance of \$1.6 million at December 31, 2020.

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Impaired loans ¹	\$ -	\$ -	\$ 7,435	\$ 7,435
Other real estate owned, net ²	-	-	5,004	5,004
Total	\$ -	\$ -	\$ 12,439	\$ 12,439

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 \$8.6 million and a valuation allowance of \$1.2 million, resulting in an increase of specific allocations within the provision for loan and lease losses of \$783,000 for the year ending December 31, 2019.

² OREO is measured at the lower of carrying or fair value less costs to sell, and had a net carrying amount of \$5.0 million, which is made up of the outstanding balance of \$12.6 million, net of a valuation allowance of \$6.7 million and participations of \$937,000, at December 31, 2019.

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

Note 17: Fair Value of Financial Instruments

The estimated fair values approximate carrying amount for all items except those described in the following table. Securities available-for-sale 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 carrying value of FHLBC stock approximates fair value as the stock is nonmarketable and can only be sold to the FHLBC or another member institution at par. FHLBC stock is carried at cost and considered a Level 2 fair value. For December 31, 2020 and 2019, the fair values of loans and leases are estimated on an exit price basis incorporating discounts for credit, liquidity and marketability factors. 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 volume is not considered material. The fair value of mortgage banking derivatives is discussed in Note 15: Mortgage Banking Derivatives, above.

The carrying amount and estimated fair values of financial instruments at December 31, were as follows:

	December 31, 2020				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	\$ 24,306	\$ 24,306	\$ 24,306	\$ -	\$ -
Interest earning deposits with financial institutions	305,597	305,597	305,597	-	-
Securities available-for-sale	496,178	496,178	4,117	487,742	4,319
FHLBC and FRBC stock	9,917	9,917	-	9,917	-
Loans held-for-sale	12,611	12,611	-	12,611	-
Net loans	2,000,996	2,009,773	-	-	2,009,773
Interest rate swap agreements	9,388	9,388	-	9,388	-
Interest rate lock commitments and forward contracts	840	840	-	840	-
Interest receivable on securities and loans	9,698	9,698	-	9,698	-
Financial liabilities:					
Noninterest bearing deposits	\$ 909,505	\$ 909,505	\$ 909,505	\$ -	\$ -
Interest bearing deposits	1,627,568	1,630,109	-	1,630,109	-
Securities sold under repurchase agreements	66,980	66,980	-	66,980	-
Other short-term borrowings	-	-	-	-	-
Junior subordinated debentures	25,773	14,658	-	14,658	-
Senior notes	44,375	44,600	44,600	-	-
Note payable and other borrowings	23,393	24,043	-	24,043	-
Interest rate swap agreements	13,071	13,071	-	13,071	-
Interest payable on deposits and borrowings	418	418	-	418	-

	December 31, 2019				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	\$ 34,096	\$ 34,096	\$ 34,096	\$ -	\$ -
Interest earning deposits with financial institutions	16,536	16,536	16,536	-	-
Securities available-for-sale	484,648	484,648	4,036	475,193	5,419
FHLBC and FRBC stock	9,917	9,917	-	9,917	-
Loans held-for-sale	3,061	3,061	-	3,061	-
Net loans	1,911,023	1,915,531	-	-	1,915,531
Interest rate swap agreements	2,771	2,771	-	2,771	-
Interest rate lock commitments and forward contracts	250	250	-	250	-
Interest receivable on securities and loans	9,697	9,697	-	9,697	-
Financial liabilities:					
Noninterest bearing deposits	\$ 669,795	\$ 669,795	\$ 669,795	\$ -	\$ -
Interest bearing deposits	1,456,954	1,457,832	-	1,457,832	-
Securities sold under repurchase agreements	48,693	48,693	-	48,693	-
Other short-term borrowings	48,500	48,500	-	48,500	-
Junior subordinated debentures	57,734	51,188	33,614	17,574	-
Senior notes	44,270	46,269	46,269	-	-
Note payable and other borrowings	6,673	7,003	-	7,003	-
Interest rate swap agreements	5,921	5,921	-	5,921	-
Interest payable on deposits and borrowings	1,079	1,079	-	1,079	-

Note 18: Financial Instruments with Off-Balance Sheet Risk and Derivative Transactions

Risk Management Objective of Using Derivatives

The Company is exposed to certain risk arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The

Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its assets and liabilities and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's loan portfolio.

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. Prior to 2019, such derivatives were used to hedge the variable cash flows associated with existing variable-rate borrowings. In December of 2019, the Company also executed a loan pool hedge of \$50 million to convert variable rate loans to a fixed rate index for a five year term.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in Accumulated Other Comprehensive Income and subsequently reclassified into interest income or interest expense in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest income or expense as interest payments are received on the variable rate loan pool or the Company's variable-rate borrowings. During the next twelve months, the Company estimates that an additional \$182,000 will be reclassified as an increase to interest income and an additional \$167,000 will be reclassified as an increase to interest expense.

Non-designated Hedges

Derivatives not designated as hedges are not speculative and result from a service the Company provides to certain customers. The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting derivatives that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate derivatives associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer derivatives and the offsetting derivatives are recognized directly in earnings.

The Company also grants mortgage loan interest rate lock commitments to borrowers, subject to normal loan underwriting standards. The interest rate risk associated with these loan interest rate lock commitments is managed with 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 revenue. Fair values are estimated based on observable changes in mortgage interest rates including mortgage-backed securities prices from the date of the commitment.

Disclosure of Fair Values of Derivative Instruments on the Balance Sheet

The Company entered into a forward starting interest rate swap on August 18, 2015, with an effective date of June 15, 2017. This transaction had a notional amount totaling \$25.8 million as of December 31, 2020 and 2019, was designated as a cash flow hedge of certain junior subordinated debentures and was determined to be fully effective during the period presented. As such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swap is recorded in other liabilities with changes in fair value recorded in other comprehensive income, net of tax. The amount included in other comprehensive income would be reclassified to current earnings should all or a portion of the hedge no longer be considered effective. We expect the hedge to remain fully effective during the remaining term of the swap. The Bank will pay the counterparty a fixed rate and receive a floating rate based on three month LIBOR. The trust preferred securities changed from fixed rate to floating rate in June 15, 2017. The cash flow hedge has a maturity date of June 15, 2037.

In December of 2019, the Company also executed a loan pool hedge of \$50.0 million to convert variable rate loans to a fixed rate index for a five year term. This transaction falls under hedge accounting standards and is paired against a pool the Bank's Libor-based loans. Overall, the new swap only bolsters income in down rate scenarios by a modest degree. We consider the current level of interest rate risk to be moderate but intend to continue looking for market opportunities for further hedging opportunities.

The Bank also has interest rate derivative positions to assist with risk management that are not designated as hedging instruments. These derivative positions relate to transactions in which the Bank enters an interest rate swap with a client while at the same time entering into an offsetting interest rate swap with another financial institution. The Bank had \$17.2 million of cash collateral pledged with one correspondent financial institution and held \$1.4 million of cash pledged from another correspondent bank to support interest rate swap

activity at December 31, 2020, and no investment securities were required to be pledged to any correspondent financial institutions. The Bank had \$114,000 of cash collateral pledged with one correspondent financial institution to support interest rate swap activity at December 31, 2019 and \$11.0 million of investment securities were required to be pledged to two correspondent financial institutions. At December 31, 2020, the notional amount of non-hedging interest rate swaps was \$189.1 million with a weighted average maturity of 4.7 years. At December 31, 2019, the notional amount of non-hedging interest rate swaps was \$177.9 million with a weighted average maturity of 5.9 years. The Bank offsets derivative assets and liabilities that are subject to a master netting arrangement.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Balance Sheets as of December 31, were as follows:

Fair Value of Derivative Instruments

	No. of Trans.	Notional Amount \$	December 31, 2020			
			Balance Sheet Location	Fair Value \$	Balance Sheet Location	Fair Value \$
Derivatives designated as hedging instruments						
Interest rate swap agreements	2	75,774	Other Assets	2,697	Other Liabilities	6,380
Total derivatives designated as hedging instruments				<u>2,697</u>		<u>6,380</u>
Derivatives not designated as hedging instruments						
Interest rate swaps with commercial loan customers	28	189,126	Other Assets	6,691	Other Liabilities	6,691
Interest rate lock commitments and forward contracts	205	84,472	Other Assets	840	Other Liabilities	-
Other contracts	4	26,523	Other Assets	-	Other Liabilities	88
Total derivatives not designated as hedging instruments				<u>7,531</u>		<u>6,779</u>

	No. of Trans.	Notional Amount \$	December 31, 2019			
			Balance Sheet Location	Fair Value \$	Balance Sheet Location	Fair Value \$
Derivatives designated as hedging instruments						
Interest rate swap agreements	2	75,774	Other Assets	-	Other Liabilities	3,150
Total derivatives designated as hedging instruments				<u>-</u>		<u>3,150</u>
Derivatives not designated as hedging instruments						
Interest rate swaps with commercial loan customers	25	177,872	Other Assets	2,920	Other Liabilities	2,920
Interest rate lock commitments and forward contracts	87	23,667	Other Assets	250	Other Liabilities	-
Other contracts	4	28,176	Other Assets	-	Other Liabilities	53
Total derivatives not designated as hedging instruments				<u>3,170</u>		<u>2,973</u>

Disclosure of the Effect of Fair Value and Cash Flow Hedge Accounting

The fair value and cash flow hedge accounting related to derivatives covered under ASC Subtopic 815-20 impacted Accumulated Other Comprehensive Income ("AOCI") and the Income Statement. The loss recognized in AOCI on derivatives totaled \$2.7 million as of December 31, 2020, and \$2.3 million as of December 31, 2019. The amount of the loss reclassified from AOCI to interest income or interest expense on the income statement totaled \$57,000 and \$50,000 for the years ended December 31, 2020, and December 31, 2019, respectively.

Credit-risk-related Contingent Features

For derivative transactions involving counterparties who are lending customers of the Company, the derivative credit exposure is managed through the normal credit review and monitoring process, which may include collateralization, financial covenants and/or financial guarantees of affiliated parties. Agreements with such customers require that losses associated with derivative transactions receive payment priority from any funds recovered should a customer default and ultimate disposition of collateral or guarantees occur.

Credit exposure to broker/dealer counterparties is managed through agreements with each derivative counterparty that require collateralization of fair value gains owed by such counterparties. Some small degree of credit exposure exists due to timing differences between when a gain may occur and the subsequent point in time that collateral is delivered to secure that gain. This is monitored by the Company and procedures are in place to minimize this exposure. Such agreements also require the Company to collateralize counterparties in circumstances wherein the fair value of the derivatives result in loss to the Company.

Other provisions of such agreements define certain events that may lead to the declaration of default and/or the early termination of the derivative transaction(s), including the following:

- if the Company either defaults or is capable of being declared in default on any of its indebtedness (exclusive of deposit obligations);
- if a merger occurs that materially changes the Company's creditworthiness in an adverse manner; or
- if certain specified adverse regulatory actions occur, such as the issuance of a Cease and Desist Order, or citations for actions considered Unsafe and Unsound or that may lead to the termination of deposit insurance coverage by the Federal Deposit Insurance Corporation.

Note 19: Preferred Stock

The Series B preferred stock was issued as part of the Treasury's Troubled Asset Relief Program and Capital Purchase Program in 2009. Concurrent with issuing the Series B preferred stock in 2009, 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 Company recorded the warrant as equity, and the allocation was based on their relative fair values in accordance with accounting guidance. The fair value was determined for both the Series B preferred stock and the warrant as part of the allocation process in the amounts of \$68.2 million and \$4.8 million, respectively. In 2014 and 2015, the Company completed redemption of all 73,000 shares of Series B preferred stock issued in 2009. On January 16, 2019, the warrant was exercised; see further disclosures in Note 12: Earnings Per Share, above.

Preferred stock of 300,000 shares is authorized but unissued as of December 31, 2020 and 2019.

Note 20: Parent Company Condensed Financial Information

Condensed Balance Sheets for the years ended December 31, were as follows:

	<u>2020</u>	<u>2019</u>
Assets		
Noninterest bearing deposit with bank subsidiary	\$ 47,601	\$ 26,562
Investment in subsidiaries	353,722	352,703
Other assets	3,270	3,981
Total assets	<u>\$ 404,593</u>	<u>\$ 383,246</u>
Liabilities and Stockholders' Equity		
Junior subordinated debentures	\$ 25,773	\$ 57,734
Senior notes	44,375	44,270
Notes Payable	17,000	-
Other liabilities	10,358	3,378
Stockholders' equity	307,087	277,864
Total liabilities and stockholders' equity	<u>\$ 404,593</u>	<u>\$ 383,246</u>

Condensed Statements of Income for the years ended December 31 were as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Operating Income			
Cash dividends received from subsidiaries	\$ 41,300	\$ 20,000	\$ 30,000
Other income	32	109	106
Total operating income	<u>41,332</u>	<u>20,109</u>	<u>30,106</u>
Operating Expenses			
Junior subordinated debentures	2,216	3,724	3,716
Senior notes	2,693	2,700	2,688
Notes payable	362	-	-
Other interest expense	-	13	98
Other expenses	3,669	4,025	4,208
Total operating expense	<u>8,940</u>	<u>10,462</u>	<u>10,710</u>
Income before income taxes and equity in undistributed net income of subsidiaries	32,392	9,647	19,396
Income tax benefit	<u>(2,215)</u>	<u>(3,187)</u>	<u>(3,355)</u>
Income before equity in undistributed net income of subsidiaries	34,607	12,834	22,751
Equity in undistributed net income of subsidiaries	<u>(6,782)</u>	<u>26,621</u>	<u>11,261</u>
Net income available to common stockholders	<u>\$ 27,825</u>	<u>\$ 39,455</u>	<u>\$ 34,012</u>

Condensed Statements of Cash Flows for the years ended December 31, were as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Cash Flows from Operating Activities			
Net Income	\$ 27,825	\$ 39,455	\$ 34,012
Adjustments to reconcile net income to net cash from operating activities:			
Equity in undistributed net income of subsidiaries	6,782	(26,621)	(11,261)
Provision for deferred tax expense (benefit)	(514)	4,186	6,697
Change in taxes payable	5,933	3,896	(1,211)
Change in other assets	954	-	97
Stock-based compensation	2,089	2,516	2,257
Other, net	682	(80)	172
Net cash provided by (used in) operating activities	<u>43,751</u>	<u>23,352</u>	<u>30,763</u>
Cash Flows from Investing Activities			
Cash paid for acquisition, net of cash and cash equivalents retained	-	-	(47,074)
Net cash used in investing activities	<u>-</u>	<u>-</u>	<u>(47,074)</u>
Cash Flows from Financing Activities			
Net change in other short-term borrowings	-	(4,000)	4,000
Dividend paid on common stock	(1,186)	(1,195)	(1,189)
Purchases of treasury stock	(5,922)	(666)	(505)
Redemption of junior subordinated debentures	(32,604)	-	-
Issuance of term note	20,000	-	-
Repayment of term note	(3,000)	-	-
Proceeds from exercise of stock option	-	32	33
Net cash (used in) provided by financing activities	<u>(22,712)</u>	<u>(5,829)</u>	<u>2,339</u>
Net change in cash and cash equivalents	21,039	17,523	(13,972)
Cash and cash equivalents at beginning of year	26,562	9,039	23,011
Cash and cash equivalents at end of year	<u>\$ 47,601</u>	<u>\$ 26,562</u>	<u>\$ 9,039</u>

Note 21: Employee Benefit Plans

Old Second Bancorp, Inc. Employees 401(k) Savings Plan and Trust

The Company sponsors a qualified, tax-exempt defined contribution plan (the "401(k) Plan") qualifying under section 401(k) of the Internal Revenue Code. Virtually all employees are eligible to participate after meeting certain age and service requirements; these service requirements were shortened in 2020 from eligibility the first day of a quarter after 90 days of service to the first day of a month after 30 days of service. Eligible employees are permitted to contribute up to a dollar limit set by law of their compensation to the 401(k) Plan. For the years ended December 31, 2020, 2019 and 2018, a discretionary match equal to 100% of the first 3% and 50% of the next 2% was made to participants of the 401(k) Plan. Participants are 100% vested in the discretionary matching contributions. Participants can choose between several different investment options under the 401(k) Plan, including shares of the Company's common stock. An additional component of the 401(k) Plan arrangement allows the Company to make annual discretionary profit sharing contributions based on the Company's profitability in a given year, and on each participant's annual compensation. The Company elected not to make a discretionary profit sharing contribution for the years end December 31, 2020, 2019 and 2018.

The total expense relating to the 401(k) Plan was approximately \$1.2 million in 2020 and \$1.1 million in both 2019 and 2018.

Old Second Bancorp, Inc. Voluntary Deferred Compensation Plan for Executives and Directors

The Company sponsors a deferred compensation plan, which is a means by which certain executives and directors may voluntarily defer a portion of their salary, bonus and directors fees, as applicable. This plan is an unfunded, nonqualified deferred compensation arrangement. Company obligations under this arrangement as of December 31, 2020, 2019 and 2018 and are included in other liabilities.

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
Old Second Bancorp, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Old Second Bancorp, Inc. and subsidiaries (the “Company”) as of December 31, 2020 and 2019; the related consolidated statements of income; comprehensive income; stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020; and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

We also have audited the Company’s internal control over financial reporting as of December 31, 2020, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), based on criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our report dated March 8, 2021 expressed an unqualified opinion.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company has changed its method of accounting for credit losses effective January 1, 2020 due to the adoption of Accounting Standards Codification Topic 326: *Financial Instruments – Credit Losses* (“ASC 326”). The Company adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles. The adoption of Topic 326 and its subsequent application is also communicated as a critical audit matter below.

Basis for Opinion

The Company’s management is responsible for these financial statements. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Credit Losses – Loans Collectively Evaluated on Collectively Evaluated Loans – Refer to Notes 1 and 4 to the financial statements

Critical Audit Matter Description

As a result of the Company’s adoption of Topic 326 effective January 1, 2020, the determination of the allowance for credit losses (ACL) is estimated utilizing the current expected credit loss (CECL) methodology.

Estimates of expected credit losses under the CECL methodology determined in accordance with ASC 326 are based on past events, current conditions and reasonable and supportable forecasts, and the expected life of the loans and leases. In order to estimate expected credit losses, the Company implemented a new loss estimation model primarily utilizing a cohort methodology to calculate historical loss rates by loan portfolio class, then considered whether qualitative adjustments to historical loss rates were warranted. Significant

management judgment is required when determining whether, and the magnitude thereof, qualitative adjustments for each loan portfolio are required. Prior to the determination of these adjustments, management considers whether the historical loss rates need to be adjusted to reflect the extent to which management expects current conditions at the reporting date related to the loan and lease portfolio, such as its volume and nature, the credit culture, or other management factors, and reasonable and supportable forecasts, which are highly judgmental, to differ from the conditions that existed for the period over which historical information was evaluated.

Given the accounting for credit losses significantly changed under ASC 326, significant judgment was required by management in the application of new accounting policies, establishment of a new methodology, and development of new subjective judgments. Accordingly, performing audit procedures to evaluate the Company's implementation and subsequent application of Topic 326 for loans involved a high degree of auditor judgment and required significant effort, including the need to involve more experienced audit personnel.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to the Company's initial adoption of ASC 326 and its subsequent application included, but were not limited to, the following:

- We tested the design and operating effectiveness of management's controls over key assumptions and judgments, the CECL estimation model for loan portfolios, management's determination of qualitative adjustments, and the selection and application of new accounting policies.
- We evaluated the appropriateness of the Company's accounting policies, methodologies, and elections involved in the adoption of the CECL methodology.
- We evaluated the reasonableness and conceptual soundness of the methodology as applied in the CECL model, including the key assumptions and judgments in estimating the ACL.
- Specifically related to the qualitative adjustments made to historical loss rates, we:
 - Assessed the appropriateness of the framework developed by management to determine the qualitative adjustments applied.
 - Evaluated management's reasonable and supportable forecasts of unemployment rates and real GDP by comparing forecasts to relevant external data.
 - We assessed the reasonableness of management's determination whether, and the magnitude thereof, qualitative adjustments were warranted based on the current conditions at the report date compared to the period from which the historical loss rates were evaluated.

/s/ Plante & Moran PLLC

We have served as the Company's auditor since 2010.

Chicago, Illinois
March 8, 2021

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), as of December 31, 2020. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2020, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and such information is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers as appropriate to allow timely decisions regarding required disclosure.

There were no changes in the Company's internal control over financial reporting during the quarter ended December 31, 2020, that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

As of December 31, 2020, management assessed the effectiveness of the Company's internal control over financial reporting based on the framework established in the "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management has determined that the Company's internal control over financial reporting was effective as of December 31, 2020, based on the criteria specified.

Plante & Moran PLLC, the independent registered public accounting firm that audited the consolidated financial statements of the Company incorporated by reference into this Annual Report on Form 10-K, has issued an attestation report, included herein, on the Company's internal control over financial reporting as of December 31, 2020.

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
Old Second Bancorp, Inc.

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting as of December 31, 2020, of Old Second Bancorp, Inc. and subsidiaries (the “Company”), based on criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the “COSO framework”). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in the COSO framework.

We also have audited the accompanying consolidated balance sheets of the Company as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively referred to as the “financial statements”), in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”). Our report dated March 8, 2021, expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying “Management’s Report on Internal Control Over Financial Reporting.” Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Plante & Moran PLLC

We have served as the Company’s auditor since 2010.

Chicago, Illinois
March 8, 2021

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The Company incorporates by reference the information required by Item 10 that is contained in the Proxy Statement for the 2021 Annual Meeting of Stockholders to be filed with the SEC within 120 days after December 31, 2020, on form DEF 14A (the “Proxy Statement”), under the following captions:

- “Proposal 1—Election of Directors,” including “—Director Experience” and “—Biographical Information for Executive Officers;”
- “Corporate Governance and the Board of Directors—Code of Business Conduct and Ethics;” and
- “Corporate Governance and the Board of Directors—Committees of the Board of Directors—Audit Committee.”

There have been no material changes to the procedures by which security holders may recommend nominees to our Board of Directors.

Item 11. Executive Compensation

The Company incorporates by reference the information required by Item 11 that is contained in our Proxy Statement under the following captions:

- “Compensation Discussion and Analysis;”
- “Compensation Committee Report;”
- “Executive Compensation;”
- “Director Compensation;” and
- “Corporate Governance and the Board of Directors—Compensation Committee Interlocks and Insider Participation.”

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth information for (i) all equity compensation plans previously approved by the Company’s stockholders and (ii) all equity compensation plans not previously approved by the Company’s stockholders. Equity compensation includes options, warrants, rights and restricted stock units which may be granted from time to time. As of December 31, 2020, the below equity awards were outstanding:

Equity Compensation Plan Information

<u>Plan category</u>	<u>Number of securities to be issued upon the exercise of outstanding options and restricted stock units</u>	<u>Weighted-average exercise price of outstanding options and restricted stock units</u>	<u>Number of securities remaining available for future issuance</u>
Equity compensation plans approved by security holders ¹	532,609	\$ 13.15	354,268
Equity compensation plans not approved by security holders	-	-	-
Total	532,609	\$ 13.15	354,268

¹ Reflects the outstanding awards under our 2019 Equity Incentive Plan and our 2014 Equity Incentive Plan, as well as the total remaining share reserve under our 2019 Equity Incentive Plan.

The Company incorporates by reference the other information that is required by this Item 12 that is contained in our Proxy Statement under the caption “Security Ownership of Certain Beneficial Owners and Management.”

Item 13. Certain Relationships and Related Transactions, and Director Independence

The Company incorporates by reference the information that is required by this Item 13 that is contained in our Proxy Statement under the captions “Corporate Governance and the Board of Directors - Director Independence” and “ - Certain Relationships and Related Party Transactions.”

Item 14. Principal Accountant Fees and Services

The Company incorporates by reference the information required by this Item 14 that is contained in our Proxy Statement under the caption "Ratification of our Independent Public Accountants."

PART IV

Item 15. Exhibits and Financial Statement Schedules

(1) **Index to Financial Statements:** See Part II--Item 8. Financial Statements and Supplementary Data.

(2) **Financial Statement Schedules**

All financial statement schedules as required by Item 8 of Form 10-K have been omitted because the information requested is either not applicable or has been included in the consolidated financial statements or notes thereto.

(3) **Exhibits:** See Exhibit Index.

Item 16. Form 10-K Summary

Not Applicable.

Exhibits:

EXHIBIT INDEX	
EXHIBIT NO.	Description of Exhibits
3.1	<u>Restated Certificate of Incorporation of Old Second Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Annual Report on Form 10-K filed on March 11, 2016).</u>
3.2	<u>Amendment to Old Second Bancorp, Inc.'s Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on May 22, 2019).</u>
3.3	<u>Certificate of Elimination Eliminating References to Series A Junior Participating Preferred Stock From the Restated Certificate of Incorporation, as Amended, of Old Second Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on June 5, 2019).</u>
3.4	<u>Bylaws of Old Second Bancorp, Inc., as amended and restated through November 4, 2020 (incorporated by reference to Exhibit 3.1 of the Company's Form 10-Q filed on November 6, 2020).</u>
4.1	<u>Specimen Common Stock Certificate of Old Second Bancorp, Inc. (incorporated by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1 filed on January 17, 2014).</u>
4.2	<u>Indenture, dated as of December 15, 2016, between the Company and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed on December 15, 2016).</u>
4.3	<u>First Supplemental Indenture, dated as of December 15, 2016, between the Company and Wells Fargo Bank National Association (incorporated by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed on December 15, 2016).</u>
4.4	<u>Form of 5.750% Fixed-to-Floating Rate Senior Notes Due 2026 (incorporated by reference to Exhibit 5.1 of the Company's Current Report on Form 8-K filed on December 15, 2016).</u>
4.5#	<u>Description of Capital Stock.</u>
10.1	<u>Form of Indenture relating to trust preferred securities (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-3 filed on May 20, 2003).</u>

10.2	<u>Indenture between Old Second Bancorp, Inc. as issuer, and Wells Fargo Bank, National Association, as Trustee, dated as of April 30, 2007 (incorporated by reference to Exhibit 99(b)(2) of the Company's Amendment No. 1 to Schedule TO filed on May 2, 2007).</u>
10.3*	<u>Old Second Bancorp, Inc. 2008 Equity Incentive Plan (incorporated by reference to Appendix A to the Company's Proxy Statement on Form DEF 14A filed on March 17, 2008).</u>
10.4*	<u>Employment Agreement, dated September 16, 2014, by and among Old Second Bancorp, Inc. and James L. Eccher (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on September 18, 2014).</u>
10.5*	<u>Old Second Bancorp, Inc. Amended and Restated Voluntary Deferred Compensation Plan for Executives dated September 1, 2008 (incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-K filed on March 6, 2020).</u>
10.6*	<u>Old Second Bancorp, Inc. Amended and Restated Voluntary Deferred Compensation Plan for Directors dated September 1, 2008 (incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-K filed on March 6, 2020).</u>
10.7*	<u>2008 Equity Incentive Plan Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on February 23, 2009).</u>
10.8*	<u>2008 Equity Incentive Plan Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on February 23, 2009).</u>
10.9*	<u>2008 Equity Incentive Plan Incentive Stock Option (incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed on February 23, 2009).</u>
10.10*	<u>2008 Equity Incentive Plan Non-Qualified Stock Option (incorporated by reference to Exhibit 10.4 of the Company's Current Report on Form 8-K filed on February 23, 2009).</u>
10.11*	<u>Restated Old Second Bancorp, Inc. 2014 Equity Incentive Plan (restated to combine the 2014 Equity Incentive Plan included as Appendix A to the Company's Proxy Statement filed on Form DEFA filed on April 21, 2014, and the First Amendment thereto and to correct a scrivener's error in such First Amendment included as Appendix A to the Company's Proxy Statement filed on Form DEF14A filed on April 12, 2016) (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q filed on November 7, 2018).</u>
10.12*	<u>Offer Letter, dated August 1, 2016, between Old Second National Bank and Gary Collins (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q filed on November 8, 2016).</u>
10.13*	<u>2014 Equity Incentive Plan Restricted Stock Award Agreement (incorporated by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed on June 24, 2014).</u>
10.14*	<u>2014 Equity Incentive Plan Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.4 of the Company's Registration Statement on Form S-8 filed on June 24, 2014).</u>
10.15*	<u>Old Second Bancorp, Inc. 2002 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 of the Company's Registration Statement on Form S-8 filed on September 12, 2006).</u>
10.16*	<u>Offer letter, dated April 3, 2017, between the Company and Bradley Adams (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q filed on August 7, 2017).</u>
10.17*	<u>Revised Compensation and Benefits Assurance Agreement, dated as of April 25, 2017, between the Company and Gary Collins (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on April 28, 2017).</u>
10.18*	<u>Compensation and Benefits Assurance Agreement, dated May 2, 2017, between the Company and Bradley Adams (incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q filed on August 7, 2017).</u>

10.19*	<u>First Amendment of Old Second Bancorp, Inc. Employment Agreement with James Echer dated as of September 1, 2017 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on September 1, 2017).</u>
10.20*	<u>Form of Compensation and Benefits Assurance Agreement (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on September 1, 2017). Pursuant to Instruction 2 of Item 601, one form of Compensation and Benefits Assurance Agreement has been filed which has been executed by each of the following executive officers: Keith Gottschalk and Donald Pilmer.</u>
10.21*	<u>Executive Annual Incentive Plan dated February 19, 2018 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on February 23, 2018).</u>
10.22*	<u>Form of Performance-Based Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on April 18, 2018).</u>
10.23*	<u>Form of Director Performance-Based Restricted Stock Agreement (incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q filed on August 7, 2018).</u>
10.24*	<u>Old Second Bancorp, Inc. 2019 Equity Incentive Plan (incorporated by reference to Appendix A to the Company's definitive proxy statement for the Annual Meeting filed with the SEC on April 19, 2019).</u>
10.25*	<u>Form of Time Vesting Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.8 to the Company's Registration Statement on Form S-8 filed on May 29, 2019).</u>
10.26*	<u>Form of Director Time Vesting Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.9 to the Company's Registration Statement on Form S-8 filed on May 29, 2019).</u>
10.27*	<u>Old Second Bancorp, Inc. Voluntary Deferred Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 29, 2020).</u>
10.28*#	<u>Compensation and Benefits Assurance Agreement, effective June 17, 2014, between the Company and Richard A. Gartelmann.</u>
21.1#	<u>A list of all subsidiaries of the Company.</u>
23.1#	<u>Consent of Plante & Moran, PLLC.</u>
24.1#	Power of Attorney (contained herein as part of the signature pages).
31.1#	<u>Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a).</u>
31.2#	<u>Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a).</u>
32.1#	<u>Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2#	<u>Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101#	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets December 31, 2020, and December 31, 2019; (ii) Consolidated Statements of Income Years Ended December 31, 2020, 2019 and 2018; (iii) Consolidated Statements of Comprehensive Income Years Ended December 31, 2020, 2019 and 2018; (iv) Consolidated Statements of Cash Flows Years Ended December 31, 2020, 2019 and 2018; (v) Changes in Stockholders' Equity Years Ended December 31, 2020, 2019 and 2018; and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text and in detail.
104#	The cover page from the Company's Annual Report on Form 10-K Report for the year ended December 31, 2020, formatted in inline XBRL and contained in Exhibit 101.

*Management contract or compensatory plan or arrangement.

Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OLD SECOND BANCORP, INC.

BY: /s/ James L. Eccher

James L. Eccher

President and Chief Executive Officer

DATE: March 08, 2021

SIGNATURES (Continued)

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints James L. Eccher, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that attorney-in-fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ William B. Skoglund</u> William B. Skoglund	Chairman of the Board, Director	March 08, 2021
<u>/s/ James L. Eccher</u> James L. Eccher	President and Chief Executive Officer, Director Old Second Bancorp and Old Second National Bank (principal executive officer)	March 08, 2021
<u>/s/ Bradley S. Adams</u> Bradley S. Adams	Executive Vice President and Chief Financial Officer (principal financial and accounting officer)	March 08, 2021
<u>/s/ Gary Collins</u> Gary Collins	Vice Chairman of the Board, Director	March 08, 2021
<u>/s/ Edward Bonifas</u> Edward Bonifas	Director	March 08, 2021
<u>/s/ Barry Finn</u> Barry Finn	Director	March 08, 2021
<u>/s/ William Kane</u> William Kane	Director	March 08, 2021
<u>/s/ John Ladowicz</u> John Ladowicz	Director	March 08, 2021
<u>/s/ Billy J. Lyons</u> Billy J. Lyons	Director	March 08, 2021
<u>/s/ Hugh McLean</u> Hugh McLean	Director	March 08, 2021
<u>/s/ Duane Suits</u> Duane Suits	Director	March 08, 2021
<u>/s/ James F. Tapscott</u> James F. Tapscott	Director	March 08, 2021
<u>/s/ Patti Temple Rocks</u> Patti Temple Rocks	Director	March 08, 2021
<u>/s/ Jill E. York</u> Jill E. York	Director	March 08, 2021

Old Second Bancorp, Inc. and Old Second National Bank Directors

William Skoglund

Chairman
Old Second Bancorp, Inc. &
Old Second National Bank

James Eccher

President & CEO
Old Second Bancorp, Inc. &
Old Second National Bank

Gary Collins

Vice Chairman
Old Second Bancorp, Inc. &
Old Second National Bank

Edward Bonifas

Executive Vice President
Alarm Detection Systems, Inc.

Barry Finn

Retired, President & CEO
Rush-Copley Medical Center

William Kane

General Partner
The Label Printers, Inc.

John Ladowicz

Former Chairman & CEO
HeritageBanc Inc. & Heritage Bank

Billy J. Lyons

Retired National Bank Examiner at OCC
(Office of the Comptroller of Currency)

Hugh McLean

Partner, Rock Island Capital, LLC
Former Regional President of Talmer Bancorp, Inc.

Duane Suits

Retired Partner, Sikich LLP

James Tapscott

Retired Partner, McGladrey LLP

Patti Temple Rocks

Senior Partner, Head of Client Impact
ICF Next

Jill E. York

Retired Executive and CFO of Fifth Third
Bank and MB Financial; Former Partner with
McGladrey & Pullen, LLP

Old Second Bancorp, Inc. and Old Second National Bank Executive Officers

James Eccher

President & CEO
Old Second Bancorp, Inc. &
Old Second National Bank

Gary Collins

Vice Chairman
Old Second Bancorp, Inc. &
Old Second National Bank

Bradley Adams

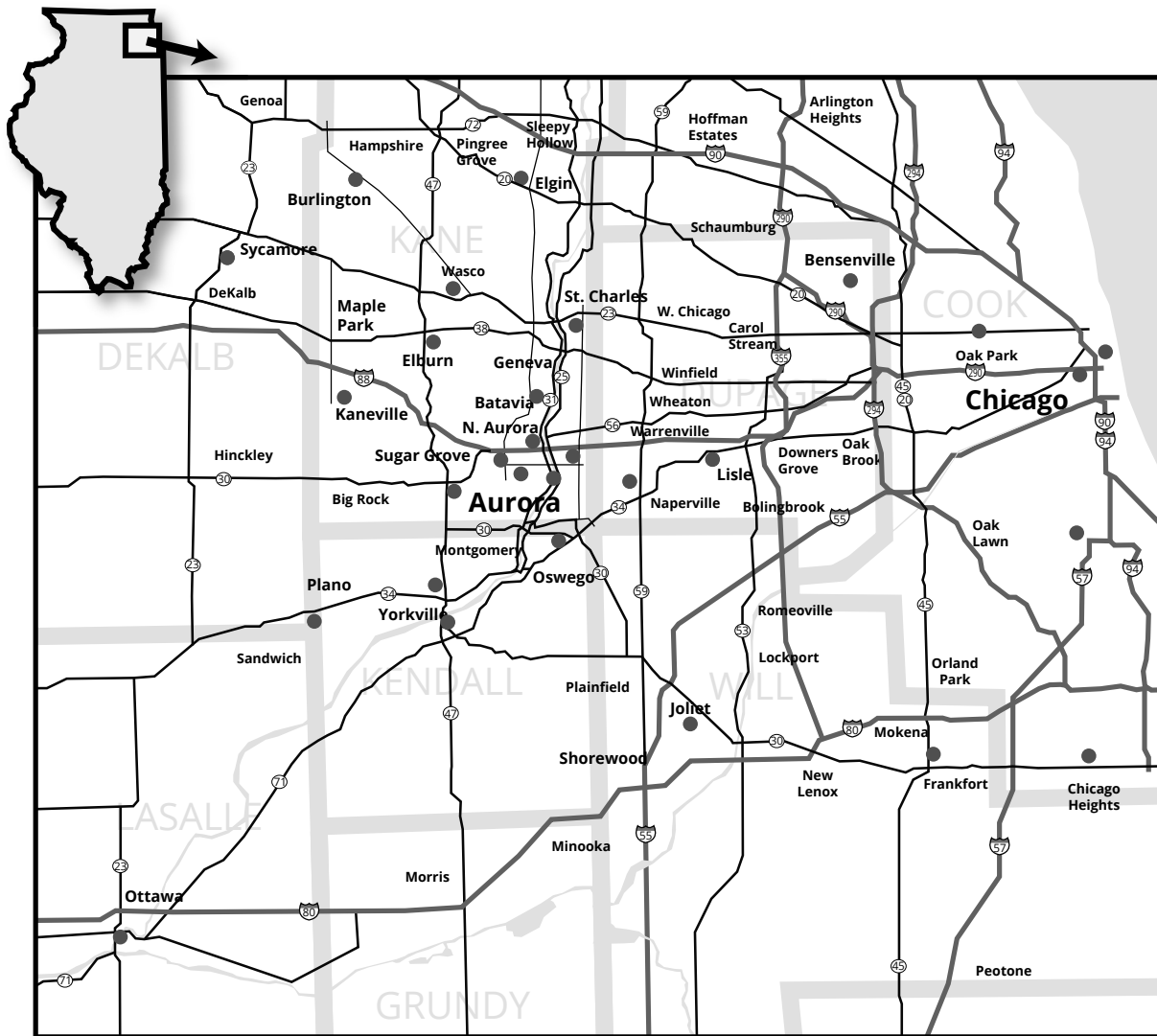
Executive Vice President & CFO
Old Second Bancorp, Inc. &
Old Second National Bank

Donald Pilmer

Executive Vice President,
Chief Lending Officer
Old Second Bancorp, Inc. &
Old Second National Bank

Richard A. Gartelmann, Jr. CFP®

Executive Vice President,
O2 Wealth Management
Old Second Bancorp, Inc. &
Old Second National Bank



Old Second National Bank

37 S. River St., Aurora
 555 Redwood Dr., Aurora
 1350 N. Farnsworth Ave., Aurora
 1230 N. Orchard Road, Aurora
 4080 Fox Valley Ctr. Dr., Aurora
 1991 W. Wilson St., Batavia
 2 S. York Road, Bensenville
 194 S. Main St., Burlington
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 6400 W. North Avenue, Chicago
 1301 W. Taylor Street, Chicago
 333 W. Wacker Dr., Ste. 1010, Chicago
 195 W. Joe Orr Rd., Chicago Heights
 749 N. Main St., Elburn
 3290 Rt. 20, Elgin

20201 S. LaGrange Rd., Frankfort
 850 Essington Rd., Joliet
 2S101 Harter Rd., Kaneville
 3101 Ogden Ave., Lisle
 200 W. John St., North Aurora
 1200 Douglas Rd., Oswego
 323 E. Norris Dr., Ottawa
 7050 Burroughs Ave., Plano
 801 S. Kirk Road, St. Charles
 Route 47 @ Cross St., Sugar Grove
 1810 DeKalb Ave., Sycamore
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