

OFG BANCORP  
Form 10-Q  
August 08, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2014**

**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 001-12647**

**OFG Bancorp**

**Incorporated in the Commonwealth of Puerto Rico, IRS Employer Identification No. 66-0538893**

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer       Accelerated Filer       Non-Accelerated Filer       Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

**Number of shares outstanding of the registrant's common stock, as of the latest practicable date:**

45,060,088 common shares (\$1.00 par value per share) outstanding as of July 31, 2014

---

## TABLE OF CONTENTS

| <b>PART I – FINANCIAL INFORMATION</b> |   | <b>Page</b> |
|---------------------------------------|---|-------------|
| <b>Item 1.</b>                        | Financial Statements  |             |
|                                       | Unaudited Consolidated Statements of Financial Condition                              | 1           |
|                                       | Unaudited Consolidated Statements of Operations                                       | 2           |
|                                       | Unaudited Consolidated Statements of Comprehensive Income                             | 3           |
|                                       | Unaudited Consolidated Statements of Changes in Stockholders' Equity                  | 4           |
|                                       | Unaudited Consolidated Statements of Cash Flows                                       | 5           |
|                                       | Notes to Unaudited Consolidated Financial Statements                                  |             |
|                                       | Note 1 – Organization, Consolidation and Basis of Presentation                        | 7           |
|                                       | Note 2 – Restricted Cash  | 8           |
|                                       | Note 3 – Investment Securities  | 8           |
|                                       | Note 4 – Loans  | 15          |
|                                       | Note 5 – Allowance for Loan and Lease Losses  | 26          |
|                                       | Note 6 – FDIC Indemnification Asset and True-up Payment Obligation                    | 43          |
|                                       | Note 7 – Derivative Activities  | 44          |
|                                       | Note 8 – Accrued Interest Receivable and Other Assets                                 | 46          |
|                                       | Note 9 – Deposits and Related Interest  | 47          |
|                                       | Note 10 – Borrowings  | 49          |
|                                       | Note 11 – Offsetting Arrangements   | 52          |
|                                       | Note 12 – Related Party Transactions  | 53          |
|                                       | Note 13 – Income Taxes  | 54          |
|                                       | Note 14 – Stockholders' Equity and Earnings per Common Share                          | 54          |
|                                       | Note 15 – Guarantees  | 59          |
|                                       | Note 16 – Commitments and Contingencies   | 61          |
|                                       | Note 17 – Fair Value of Financial Instruments   | 63          |
|                                       | Note 18 – Business Segments   | 72          |
|                                       | Note 19 – Subsequent Events   | 75          |
| <b>Item 2.</b>                        | Management's Discussion and Analysis of Financial Condition and Results of Operations | 76          |
|                                       | Critical Accounting Policies and Estimates  | 77          |
|                                       | Overview of Financial Performance   | 78          |
|                                       | Selected Financial Data   | 78          |
|                                       | Analysis of Results of Operations   | 84          |
|                                       | Analysis of Financial Condition   | 95          |
| <b>Item 3.</b>                        | Quantitative and Qualitative Disclosures about Market Risk                            | 118         |

## Edgar Filing: OFG BANCORP - Form 10-Q

|                                    |   |     |
|------------------------------------|---|-----|
| <b>Item 4.</b>                     | Control and Procedures                                      | 122 |
| <b>PART II – OTHER INFORMATION</b> |   |     |
| <b>Item 1.</b>                     | Legal Proceedings   | 123 |
| <b>Item 1A.</b>                    | Risk Factors  | 123 |
| <b>Item 2.</b>                     | Unregistered Sales of Equity Securities and Use of Proceeds | 125 |
| <b>Item 3.</b>                     | Default upon Senior Securities                              | 125 |
| <b>Item 4.</b>                     | Mine Safety Disclosures                                     | 125 |
| <b>Item 5.</b>                     | Other Information   | 125 |
| <b>Item 6.</b>                     | Exhibits  | 125 |
| <b>SIGNATURES</b>                  |   | 126 |
| <b>EXHIBIT INDEX</b>               |   |     |

---



## FORWARD-LOOKING STATEMENTS

The information included in this quarterly report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to the financial condition, results of operations, plans, objectives, future performance and business of OFG Bancorp (“we,” “our,” “us” or the “Company”), including, but not limited to, statements with respect to the adequacy of the allowance for loan losses, delinquency trends, market risk and the impact of interest rate changes, capital markets conditions, capital adequacy and liquidity, and the effect of legal proceedings and new accounting standards on the Company’s financial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words “anticipate,” “believe,” “continues,” “expect,” “estimate,” “intend,” “project” and similar expressions and future or conditional verbs such as “will,” “would,” “should,” “could,” “might,” “can,” “may,” or similar expressions are generally intended to identify forward-looking statements.

These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which by their nature are beyond the Company’s control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to:

- the rate of growth in the economy and employment levels, as well as general business and economic conditions;
- changes in interest rates, as well as the magnitude of such changes;
- the fiscal and monetary policies of the federal government and its agencies;
- a credit default or potential restructuring by the Commonwealth of Puerto Rico or any of its agencies, municipalities or instrumentalities;
- changes in federal bank regulatory and supervisory policies, including required levels of capital;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) on the Company’s businesses, business practices and cost of operations;
- the relative strength or weakness of the consumer and commercial credit sectors and of the real estate market in Puerto Rico;
- the performance of the securities markets;
- competition in the financial services industry;
- additional Federal Deposit Insurance Corporation (“FDIC”) assessments; and
- possible legislative, tax or regulatory changes.

Other possible events or factors that could cause results or performance to differ materially from those expressed in these forward-looking statements include the following: negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of non-performing assets, charge-offs and provision expense; changes in interest rates and market liquidity which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets; adverse movements and volatility in debt and equity capital markets; changes in market rates and prices which may adversely impact the value of financial assets and liabilities; liabilities resulting from litigation and regulatory investigations; changes in accounting standards, rules and interpretations; increased competition; the Company's ability to grow its core businesses; decisions to downsize, sell or close units or otherwise change the Company's business mix; and management's ability to identify and manage these and other risks.

All forward-looking statements included in this quarterly report on Form 10-Q are based upon information available to the Company as of the date of this report, and other than as required by law, including the requirements of applicable securities laws, the Company assumes no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

**ITEM 1. FINANCIAL STATEMENTS**

---



## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF JUNE 30, 2014 AND DECEMBER 31, 2013

|   |    | June 30,         |    | December 31,     |
|---|----|------------------|----|------------------|
|   |    | 2014             |    | 2013             |
|   |    | (In thousands)   |    |                  |
| <b>ASSETS</b>   |    |                  |    |                  |
| <b>Cash and cash equivalents:</b>   |    |                  |    |                  |
| Cash and due from banks   | \$ | 588,257          | \$ | 614,302          |
| Money market investments  |    | 8,228            |    | 6,967            |
| <b>Total cash and cash equivalents</b>  |    | <b>596,485</b>   |    | <b>621,269</b>   |
| <b>Restricted cash</b>  |    | 15,170           |    | 82,199           |
| <b>Securities purchased under agreements to resell</b>  |    | -                |    | 60,000           |
| <b>Investments:</b>   |    |                  |    |                  |
| Trading securities, at fair value, with amortized cost of \$2,419 (December 31, 2013 - \$2,448)                               |    | 1,613            |    | 1,869            |
| Investment securities available-for-sale, at fair value, with amortized cost of \$1,385,438 (December 31, 2013 - \$1,575,043) |    | 1,418,958        |    | 1,588,425        |
| Investment securities held-to-maturity, at amortized cost, with fair value of \$26,844  |    | 26,706           |    | -                |
| Federal Home Loan Bank (FHLB) stock, at cost  |    | 24,381           |    | 24,450           |
| Other investments   |    | 65               |    | 65               |
| <b>Total investments</b>  |    | <b>1,471,723</b> |    | <b>1,614,809</b> |
| <b>Loans:</b>   |    |                  |    |                  |
| Mortgage loans held-for-sale, at lower of cost or fair value  |    | 14,792           |    | 46,529           |
| Non-covered loans, net of allowance for loan and lease losses of \$60,360 (December 31, 2013 - \$54,298)                      |    | 4,586,904        |    | 4,615,929        |
| Covered loans, net of allowance for loan and lease losses of \$59,515 (December 31, 2013 - \$52,729)                          |    | 334,344          |    | 356,961          |
| <b>Total loans, net</b>   |    | <b>4,936,040</b> |    | <b>5,019,419</b> |
| <b>Other assets:</b>  |    |                  |    |                  |
| FDIC indemnification asset  |    | 143,660          |    | 189,240          |
| Foreclosed real estate covered under shared-loss agreements with the FDIC   |    | 46,609           |    | 33,209           |
| Foreclosed real estate not covered under shared-loss agreements with the FDIC   |    | 55,626           |    | 56,815           |
| Accrued interest receivable   |    | 22,508           |    | 18,734           |

## Edgar Filing: OFG BANCORP - Form 10-Q

|  |  |    |                  |  |    |                  |
|--|--|----|------------------|--|----|------------------|
| Deferred tax asset, net                            |  |    | 123,298          |  |    | 137,564          |
| Premises and equipment, net                        |  |    | 82,167           |  |    | 82,903           |
| Customers' liability on acceptances                |  |    | 17,581           |  |    | 23,042           |
| Servicing assets                                   |  |    | 13,655           |  |    | 13,801           |
| Derivative assets                                  |  |    | 9,558            |  |    | 20,502           |
| Goodwill   |  |    | 86,069           |  |    | 86,069           |
| Other assets                                       |  |    | 89,996           |  |    | 98,440           |
| <b>Total assets</b>                                |  | \$ | <b>7,710,145</b> |  | \$ | <b>8,158,015</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>        |  |    |                  |  |    |                  |
| <b>Deposits:</b>                                   |  |    |                  |  |    |                  |
| Demand deposits                                    |  | \$ | 2,135,369        |  |    | 2,138,005        |
| Savings accounts                                   |  |    | 1,226,749        |  |    | 1,194,567        |
| Time deposits                                      |  |    | 1,779,115        |  |    | 2,050,693        |
| <b>Total deposits</b>                              |  |    | <b>5,141,233</b> |  |    | <b>5,383,265</b> |
| <b>Borrowings:</b>                                 |  |    |                  |  |    |                  |
| Securities sold under agreements to repurchase     |  |    | 1,012,233        |  |    | 1,267,618        |
| Advances from FHLB                                 |  |    | 360,240          |  |    | 336,143          |
| Subordinated capital notes                         |  |    | 100,797          |  |    | 100,010          |
| Other borrowings                                   |  |    | 3,837            |  |    | 3,663            |
| <b>Total borrowings</b>                            |  |    | <b>1,477,107</b> |  |    | <b>1,707,434</b> |
| <b>Other liabilities:</b>                          |  |    |                  |  |    |                  |
| Derivative liabilities                             |  |    | 13,617           |  |    | 14,937           |
| Acceptances executed and outstanding               |  |    | 17,581           |  |    | 23,042           |
| Accrued expenses and other liabilities             |  |    | 135,405          |  |    | 144,424          |
| <b>Total liabilities</b>                           |  |    | <b>6,784,943</b> |  |    | <b>7,273,102</b> |
| <b>Commitments and contingencies (See Note 16)</b> |  |    |                  |  |    |                  |
| <b>Stockholders' equity:</b>                       |  |    |                  |  |    |                  |
| Preferred stock; 10,000,000 shares authorized;     |  |    |                  |  |    |                  |
| 1,340,000 shares of Series A, 1,380,000 shares     |  |    |                  |  |    |                  |
| of Series B, and 960,000 shares of Series D        |  |    |                  |  |    |                  |
| issued and outstanding, (December 31, 2013         |  |    |                  |  |    |                  |
| - 1,340,000; 1,380,000; and 960,000) \$25          |  |    |                  |  |    |                  |
| liquidation value                                  |  |    | 92,000           |  |    | 92,000           |
| 84,000 shares of Series C issued and               |  |    |                  |  |    |                  |
| outstanding (December 31, 2013 - 84,000); \$1,000  |  |    |                  |  |    |                  |
| liquidation value                                  |  |    | 84,000           |  |    | 84,000           |
| Common stock, \$1 par value; 100,000,000 shares    |  |    |                  |  |    |                  |
| authorized; 52,729,772 shares issued:              |  |    |                  |  |    |                  |
| 45,022,823 shares outstanding (December 31,        |  |    |                  |  |    |                  |
| 2013 - 52,707,023; 45,676,922)                     |  |    | 52,730           |  |    | 52,707           |
| Additional paid-in capital                         |  |    | 538,936          |  |    | 538,071          |
| Legal surplus                                      |  |    | 66,438           |  |    | 61,957           |
| Retained earnings                                  |  |    | 160,055          |  |    | 133,629          |
| Treasury stock, at cost, 7,706,949 shares          |  |    |                  |  |    |                  |
| (December 31, 2013 - 7,030,101 shares)             |  |    | (90,712)         |  |    | (80,642)         |

Edgar Filing: OFG BANCORP - Form 10-Q

|  |  |    |                  |  |    |                  |
|--|--|----|------------------|--|----|------------------|
| Accumulated other comprehensive income, net of tax of \$1,134 (December 31, 2013 - -\$831) |  |    | 21,755           |  |    | 3,191            |
| <b>Total stockholders' equity</b>  |  |    | <b>925,202</b>   |  |    | <b>884,913</b>   |
| <b>Total liabilities and stockholders' equity</b>  |  | \$ | <b>7,710,145</b> |  | \$ | <b>8,158,015</b> |
| <b>See notes to unaudited consolidated financial statements.</b>                           |  |    |                  |  |    |                  |

1

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

## FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2013

|  | Quarter Ended June 30,                |                |      |                | Six-Month Period Ended June 30, |                |      |                |
|--|---------------------------------------|----------------|------|----------------|---------------------------------|----------------|------|----------------|
|  | 2014                                  |                | 2013 |                | 2014                            |                | 2013 |                |
|  | (In thousands, except per share data) |                |      |                |                                 |                |      |                |
| <b>Interest income:</b>  |                                       |                |      |                |                                 |                |      |                |
| Non-covered loans  | \$                                    | 88,064         | \$   | 91,105         | \$                              | 173,307        | \$   | 171,912        |
| Covered loans  |                                       | 24,879         |      | 23,999         |                                 | 48,267         |      | 44,228         |
| <b>Total interest income from loans</b>                              |                                       | <b>112,943</b> |      | <b>115,104</b> |                                 | <b>221,574</b> |      | <b>216,140</b> |
| Mortgage-backed securities   |                                       | 11,984         |      | 9,080          |                                 | 24,400         |      | 19,898         |
| Investment securities and other                                      |                                       | 973            |      | 2,118          |                                 | 3,000          |      | 4,436          |
| <b>Total interest income</b>   |                                       | <b>125,900</b> |      | <b>126,302</b> |                                 | <b>248,974</b> |      | <b>240,474</b> |
| <b>Interest expense:</b>   |                                       |                |      |                |                                 |                |      |                |
| Deposits   |                                       | 9,165          |      | 9,487          |                                 | 18,143         |      | 19,423         |
| Securities sold under agreements to repurchase                       |                                       | 7,372          |      | 7,109          |                                 | 14,784         |      | 14,357         |
| Advances from FHLB and other borrowings                              |                                       | 2,289          |      | 2,241          |                                 | 4,583          |      | 3,955          |
| Subordinated capital notes   |                                       | 996            |      | 1,170          |                                 | 1,988          |      | 2,830          |
| <b>Total interest expense</b>  |                                       | <b>19,822</b>  |      | <b>20,007</b>  |                                 | <b>39,498</b>  |      | <b>40,565</b>  |
| <b>Net interest income</b>   |                                       | <b>106,078</b> |      | <b>106,295</b> |                                 | <b>209,476</b> |      | <b>199,909</b> |
| Provision for non-covered loan and lease losses                      |                                       | 13,220         |      | 37,527         |                                 | 23,282         |      | 45,443         |
| Provision for covered loan and lease losses, net                     |                                       | 1,595          |      | 1,211          |                                 | 3,224          |      | 1,883          |
| <b>Total provision for loan and lease losses</b>                     |                                       | <b>14,815</b>  |      | <b>38,738</b>  |                                 | <b>26,506</b>  |      | <b>47,326</b>  |
| <b>Net interest income after provision for loan and lease losses</b> |                                       | <b>91,263</b>  |      | <b>67,557</b>  |                                 | <b>182,970</b> |      | <b>152,583</b> |
| <b>Non-interest income:</b>  |                                       |                |      |                |                                 |                |      |                |
| Banking service revenue  |                                       | 9,995          |      | 12,705         |                                 | 20,552         |      | 24,345         |
| Wealth management revenue  |                                       | 7,336          |      | 8,030          |                                 | 14,203         |      | 15,690         |
| Mortgage banking activities  |                                       | 1,554          |      | 3,827          |                                 | 3,249          |      | 6,963          |
| <b>Total banking and financial service revenues</b>                  |                                       | <b>18,885</b>  |      | <b>24,562</b>  |                                 | <b>38,004</b>  |      | <b>46,998</b>  |

## Edgar Filing: OFG BANCORP - Form 10-Q

|  |           |               |           |               |           |                |           |               |                |
|--|-----------|---------------|-----------|---------------|-----------|----------------|-----------|---------------|----------------|
| FDIC shared-loss expense, net:                             |           |               |           |               |           |                |           |               |                |
| FDIC indemnification asset                                 |           | (17,499)      |           | (19,225)      |           | (35,121)       |           |               | (31,425)       |
| True-up payment obligation                                 |           | (856)         |           | (740)         |           | (1,721)        |           |               | (1,411)        |
|  |           | (18,355)      |           | (19,965)      |           | (36,842)       |           |               | (32,836)       |
| Net gain (loss) on:  |           |               |           |               |           |                |           |               |                |
| Sale of securities   |           | -             |           | -             |           | 4,366          |           |               | -              |
| Derivatives  |           | (247)         |           | (164)         |           | (470)          |           |               | (934)          |
| Early extinguishment of debt                               |           | -             |           | -             |           | -              |           |               | 1,061          |
| Other non-interest income                                  |           | 224           |           | 2,302         |           | 678            |           |               | 2,349          |
| <b>Total non-interest income, net</b>                      |           | <b>507</b>    |           | <b>6,735</b>  |           | <b>5,736</b>   |           |               | <b>16,638</b>  |
| <b>Non-interest expense:</b>                               |           |               |           |               |           |                |           |               |                |
| Compensation and employee benefits                         |           | 20,707        |           | 24,089        |           | 42,494         |           |               | 47,338         |
| Professional and service fees                              |           | 3,512         |           | 5,375         |           | 7,719          |           |               | 11,853         |
| Occupancy and equipment                                    |           | 8,605         |           | 8,066         |           | 16,914         |           |               | 17,282         |
| Insurance  |           | 2,333         |           | 2,723         |           | 4,407          |           |               | 5,401          |
| Electronic banking charges                                 |           | 4,796         |           | 4,065         |           | 9,449          |           |               | 7,763          |
| Information technology expenses                            |           | 1,485         |           | 2,335         |           | 3,300          |           |               | 4,979          |
| Advertising, business promotion, and strategic initiatives |           | 1,669         |           | 1,670         |           | 3,450          |           |               | 3,079          |
| Merger and restructuring charges                           |           | -             |           | 5,273         |           | -              |           |               | 10,808         |
| Foreclosure, repossession and other real estate expenses   |           | 6,554         |           | 3,717         |           | 12,941         |           |               | 6,900          |
| Loan servicing and clearing expenses                       |           | 1,669         |           | 1,884         |           | 3,728          |           |               | 3,360          |
| Taxes, other than payroll and income taxes                 |           | 3,776         |           | 5,132         |           | 7,511          |           |               | 7,754          |
| Communication  |           | 813           |           | 835           |           | 1,770          |           |               | 1,699          |
| Printing, postage, stationary and supplies                 |           | 645           |           | 851           |           | 1,200          |           |               | 2,017          |
| Director and investor relations                            |           | 293           |           | 377           |           | 544            |           |               | 613            |
| Other  |           | 2,991         |           | 2,295         |           | 5,825          |           |               | 4,452          |
| <b>Total non-interest expense</b>                          |           | <b>59,848</b> |           | <b>68,687</b> |           | <b>121,252</b> |           |               | <b>135,298</b> |
| <b>Income before income taxes</b>                          |           | <b>31,922</b> |           | <b>5,605</b>  |           | <b>67,454</b>  |           |               | <b>33,923</b>  |
| Income tax expense (benefit)                               |           | 10,613        |           | (31,934)      |           | 22,398         |           |               | (24,808)       |
| <b>Net income</b>  |           | <b>21,309</b> |           | <b>37,539</b> |           | <b>45,056</b>  |           |               | <b>58,731</b>  |
| Less: dividends on preferred stock                         |           | (3,466)       |           | (3,466)       |           | (6,931)        |           |               | (6,931)        |
| <b>Income available to common shareholders</b>             | <b>\$</b> | <b>17,843</b> | <b>\$</b> | <b>34,073</b> | <b>\$</b> | <b>38,125</b>  | <b>\$</b> | <b>51,800</b> |                |

|  |    |               |    |               |    |               |    |               |  |
|--|----|---------------|----|---------------|----|---------------|----|---------------|--|
| <b>Earnings per common share:</b>                                |    |               |    |               |    |               |    |               |  |
| Basic  | \$ | <b>0.40</b>   | \$ | <b>0.75</b>   | \$ | <b>0.84</b>   | \$ | <b>1.14</b>   |  |
| Diluted  | \$ | <b>0.38</b>   | \$ | <b>0.68</b>   | \$ | <b>0.80</b>   | \$ | <b>1.05</b>   |  |
| <b>Average common shares outstanding and equivalents</b>         |    | <b>52,352</b> |    | <b>52,968</b> |    | <b>52,476</b> |    | <b>52,929</b> |  |
| <b>Cash dividends per share of common stock</b>                  | \$ | <b>0.08</b>   | \$ | <b>0.06</b>   | \$ | <b>0.16</b>   | \$ | <b>0.12</b>   |  |
| <b>See notes to unaudited consolidated financial statements.</b> |    |               |    |               |    |               |    |               |  |

## OFG BANCORP

**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2013**

|  | Quarter Ended June 30, |               |      |                 | Six-Month Period Ended June 30, |               |      |                 |
|--|------------------------|---------------|------|-----------------|---------------------------------|---------------|------|-----------------|
|  | 2014                   |               | 2013 |                 | 2014                            |               | 2013 |                 |
| (In thousands)   |                        |               |      |                 |                                 |               |      |                 |
| <b>Net income</b>  | \$                     | <b>21,309</b> | \$   | <b>37,539</b>   | \$                              | <b>45,056</b> | \$   | <b>58,731</b>   |
| <b>Other comprehensive income (loss) before tax:</b>             |                        |               |      |                 |                                 |               |      |                 |
| Unrealized gain (loss) on securities available-for-sale          |                        | 14,941        |      | (35,576)        |                                 | 24,504        |      | (46,568)        |
| Realized gain on investment securities included in net income    |                        | -             |      | -               |                                 | (4,366)       |      | -               |
| Unrealized gain on cash flow hedges                              |                        | 14            |      | 3,016           |                                 | 391           |      | 4,477           |
| <b>Other comprehensive income (loss) before taxes</b>            |                        | <b>14,955</b> |      | <b>(32,560)</b> |                                 | <b>20,529</b> |      | <b>(42,091)</b> |
| Income tax effect  |                        | (1,221)       |      | 1,275           |                                 | (1,965)       |      | 1,977           |
| <b>Other comprehensive income (loss) after taxes</b>             |                        | <b>13,734</b> |      | <b>(31,285)</b> |                                 | <b>18,564</b> |      | <b>(40,114)</b> |
| <b>Comprehensive income</b>                                      | \$                     | <b>35,043</b> | \$   | <b>6,254</b>    | \$                              | <b>63,620</b> | \$   | <b>18,617</b>   |
| <b>See notes to unaudited consolidated financial statements.</b> |                        |               |      |                 |                                 |               |      |                 |

## OFG BANCORP

**UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2013**

|  | Six-Month Period Ended June 30, |                 |      |                 |
|--|---------------------------------|-----------------|------|-----------------|
|  | 2014                            |                 | 2013 |                 |
|  | (In thousands)                  |                 |      |                 |
| <b>Preferred stock:</b>                        |                                 |                 |      |                 |
| Balance at beginning of period                 | \$                              | 176,000         | \$   | 176,000         |
| <b>Balance at end of period</b>                |                                 | <b>176,000</b>  |      | <b>176,000</b>  |
| <b>Common stock:</b>                           |                                 |                 |      |                 |
| Balance at beginning of period                 |                                 | 52,707          |      | 52,671          |
| Exercised stock options                        |                                 | 23              |      | 18              |
| <b>Balance at end of period</b>                |                                 | <b>52,730</b>   |      | <b>52,689</b>   |
| <b>Additional paid-in capital:</b>             |                                 |                 |      |                 |
| Balance at beginning of period                 |                                 | 538,071         |      | 537,453         |
| Stock-based compensation expense               |                                 | 946             |      | 888             |
| Exercised stock options                        |                                 | 242             |      | 167             |
| Lapsed restricted stock units                  |                                 | (323)           |      | (364)           |
| Common stock issuance costs                    |                                 | -               |      | (16)            |
| Preferred stock issuance costs                 |                                 | -               |      | (23)            |
| <b>Balance at end of period</b>                |                                 | <b>538,936</b>  |      | <b>538,105</b>  |
| <b>Legal surplus:</b>                          |                                 |                 |      |                 |
| Balance at beginning of period                 |                                 | 61,957          |      | 52,143          |
| Transfer from retained earnings                |                                 | 4,481           |      | 5,763           |
| <b>Balance at end of period</b>                |                                 | <b>66,438</b>   |      | <b>57,906</b>   |
| <b>Retained earnings:</b>                      |                                 |                 |      |                 |
| Balance at beginning of period                 |                                 | 133,629         |      | 70,734          |
| Net income                                     |                                 | 45,056          |      | 58,731          |
| Cash dividends declared on common stock        |                                 | (7,218)         |      | (5,479)         |
| Cash dividends declared on preferred stock     |                                 | (6,931)         |      | (6,931)         |
| Transfer to legal surplus                      |                                 | (4,481)         |      | (5,763)         |
| <b>Balance at end of period</b>                |                                 | <b>160,055</b>  |      | <b>111,292</b>  |
| <b>Treasury stock:</b>                         |                                 |                 |      |                 |
| Balance at beginning of period                 |                                 | (80,642)        |      | (81,275)        |
| Stock repurchased                              |                                 | (10,393)        |      | -               |
| Lapsed restricted stock units                  |                                 | 323             |      | 364             |
| Stock used to match defined contribution plan  |                                 | -               |      | 77              |
| <b>Balance at end of period</b>                |                                 | <b>(90,712)</b> |      | <b>(80,834)</b> |
| <b>Accumulated other comprehensive income,</b> |                                 |                 |      |                 |



Edgar Filing: OFG BANCORP - Form 10-Q

|  |           |                |  |           |                |
|--|-----------|----------------|--|-----------|----------------|
| <b>net of tax:</b>   |           |                |  |           |                |
| Balance at beginning of period                                   |           | 3,191          |  |           | 55,880         |
| Other comprehensive income (loss), net of tax                    |           | 18,564         |  |           | (40,114)       |
| <b>Balance at end of period</b>                                  |           | <b>21,755</b>  |  |           | <b>15,766</b>  |
| <b>Total stockholders' equity</b>                                | <b>\$</b> | <b>925,202</b> |  | <b>\$</b> | <b>870,924</b> |
| <b>See notes to unaudited consolidated financial statements.</b> |           |                |  |           |                |

## OFG BANCORP

**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2013**

|   | Six-Month Period Ended June 30, |          |      |           |
|---|---------------------------------|----------|------|-----------|
|   | 2014                            |          | 2013 |           |
|   | (In thousands)                  |          |      |           |
| <b>Cash flows from operating activities:</b>                                      |                                 |          |      |           |
| Net income  | \$                              | 45,056   | \$   | 58,731    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |          |      |           |
| Amortization of deferred loan origination fees, net of costs                      |                                 | 1,330    |      | 486       |
| Amortization of fair value discounts on acquired loans                            |                                 | 6,884    |      | 3,504     |
| Amortization of investment securities premiums, net of accretion of discounts     |                                 | 203      |      | 12,624    |
| Amortization of core deposit and customer relationship intangibles                |                                 | 1,085    |      | 1,288     |
| Amortization of fair value premiums on acquired deposits                          |                                 | 2,908    |      | 9,649     |
| FDIC shared-loss expense, net   |                                 | 36,842   |      | 32,836    |
| Depreciation and amortization of premises and equipment                           |                                 | 4,826    |      | 5,265     |
| Deferred income tax expense (benefit), net  |                                 | 13,211   |      | (30,776)  |
| Provision for covered and non-covered loan and lease losses, net                  |                                 | 26,506   |      | 47,326    |
| Stock-based compensation  |                                 | 946      |      | 888       |
| (Gain) loss on:   |                                 |          |      |           |
| Sale of securities  |                                 | (4,366)  |      | -         |
| Sale of mortgage loans held-for-sale  |                                 | (2,447)  |      | (1,771)   |
| Derivatives   |                                 | 646      |      | 934       |
| Early extinguishment of debt  |                                 | -        |      | (1,061)   |
| Foreclosed real estate  |                                 | 5,052    |      | 3,109     |
| Sale of other repossessed assets  |                                 | 3,305    |      | 465       |
| Sale of premises and equipment  |                                 | (10)     |      | -         |
| Originations of loans held-for-sale   |                                 | (86,058) |      | (179,127) |
| Proceeds from sale of loans held-for-sale   |                                 | 47,834   |      | 68,809    |
| Net (increase) decrease in:   |                                 |          |      |           |
| Trading securities  |                                 | 256      |      | (1,714)   |
| Accrued interest receivable   |                                 | (3,774)  |      | 46        |
| Servicing assets  |                                 | 146      |      | (2,199)   |

## Edgar Filing: OFG BANCORP - Form 10-Q

|  |  |                |  |  |                |
|--|--|----------------|--|--|----------------|
| Other assets   |  | 11,651         |  |  | 20,737         |
| Net increase (decrease) in:                                      |  |                |  |  |                |
| Accrued interest on deposits and borrowings                      |  | (932)          |  |  | (995)          |
| Accrued expenses and other liabilities                           |  | (16,247)       |  |  | 12,093         |
| <b>Net cash provided by operating activities</b>                 |  | <b>94,853</b>  |  |  | <b>61,147</b>  |
| <b>Cash flows from investing activities:</b>                     |  |                |  |  |                |
| Purchases of:  |  |                |  |  |                |
| Investment securities available-for-sale                         |  | (217,974)      |  |  | (17,802)       |
| Investment securities held-to-maturity                           |  | (26,707)       |  |  | -              |
| FHLB stock   |  | (76,725)       |  |  | (12,465)       |
| Maturities and redemptions of:                                   |  |                |  |  |                |
| Investment securities available-for-sale                         |  | 295,013        |  |  | 313,866        |
| FHLB stock   |  | 76,794         |  |  | 28,720         |
| Proceeds from sales of:  |  |                |  |  |                |
| Investment securities available-for-sale                         |  | 163,235        |  |  | 75,660         |
| Foreclosed real estate and other repossessed assets              |  | 22,991         |  |  | 31,131         |
| Premises and equipment   |  | 20             |  |  | 1,667          |
| Origination and purchase of loans, excluding loans held-for-sale |  | (347,691)      |  |  | (422,590)      |
| Principal repayment of loans, including covered loans            |  | 339,102        |  |  | 528,274        |
| Reimbursements from the FDIC on shared-loss agreements           |  | 18,700         |  |  | 18,696         |
| Additions to premises and equipment                              |  | (4,100)        |  |  | (6,237)        |
| Net change in securities purchased under agreements to resell    |  | 60,000         |  |  | 80,000         |
| Net change in restricted cash                                    |  | 67,029         |  |  | 8,990          |
| <b>Net cash provided by investing activities</b>                 |  | <b>369,687</b> |  |  | <b>627,910</b> |

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2013 – (Continued)

|  | Six-Month Period Ended June 30, |                  |           |                  |
|--|---------------------------------|------------------|-----------|------------------|
|  | 2014                            |                  | 2013      |                  |
|  | (In thousands)                  |                  |           |                  |
| <b>Cash flows from financing activities:</b>                                       |                                 |                  |           |                  |
| Net increase (decrease) in:  |                                 |                  |           |                  |
| Deposits   |                                 | (235,062)        |           | (36,125)         |
| Short term borrowings  |                                 | -                |           | (92,210)         |
| Securities sold under agreements to repurchase                                     |                                 | (255,000)        |           | (381,358)        |
| FHLB advances, federal funds purchased, and other borrowings                       |                                 | 24,279           |           | (231,617)        |
| Subordinated capital notes   |                                 | 787              |           | (46,017)         |
| Exercise of stock options and restricted units lapsed, net                         |                                 | 265              |           | 185              |
| Purchase of treasury stock   |                                 | (10,393)         |           | -                |
| Termination of derivative instruments  |                                 | -                |           | (858)            |
| Dividends paid on preferred stock  |                                 | (6,931)          |           | (6,931)          |
| Dividends paid on common stock   |                                 | (7,269)          |           | (5,479)          |
| Other financing activities   |                                 | -                |           | (39)             |
| <b>Net cash used in financing activities</b>                                       |                                 | <b>(489,324)</b> |           | <b>(800,449)</b> |
| <b>Net change in cash and cash equivalents</b>                                     |                                 | <b>(24,784)</b>  |           | <b>(111,392)</b> |
| Cash and cash equivalents at beginning of period                                   |                                 | 621,269          |           | 855,235          |
| <b>Cash and cash equivalents at end of period</b>                                  | <b>\$</b>                       | <b>596,485</b>   | <b>\$</b> | <b>743,843</b>   |
| <b>Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:</b>      |                                 |                  |           |                  |
| Interest paid  | \$                              | 42,667           | \$        | 40,491           |
| Income taxes paid  | \$                              | 319              | \$        | 378              |
| Mortgage loans securitized into mortgage-backed securities                         | \$                              | 46,505           | \$        | 89,590           |
| Transfer from loans to foreclosed real estate and other repossessed assets         | \$                              | 47,852           | \$        | 45,714           |
| Reclassification of loans held-for-investment portfolio to held-for-sale portfolio | \$                              | 473              | \$        | 40,328           |
| Reclassification of loans held-for-sale portfolio to held-for-investment portfolio | \$                              | 26,376           | \$        | -                |
| Securities sold but not yet delivered  | \$                              | -                | \$        | 16,732           |
|  |                                 |                  |           |                  |

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

6

---

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION**

*Nature of Operations*

OFG Bancorp (the “Company”) is a publicly-owned financial holding company incorporated under the laws of the Commonwealth of Puerto Rico. The Company operates through various subsidiaries including, a commercial bank, Oriental Bank (or the “Bank”), a securities broker-dealer, Oriental Financial Services Corp. (“Oriental Financial Services”), an insurance agency, Oriental Insurance, Inc. (“Oriental Insurance”) and a retirement plan administrator, Caribbean Pension Consultants, Inc. (“CPC”). Through these subsidiaries and their respective divisions, the Company provides a wide range of banking and financial services such as commercial, consumer and mortgage lending, auto loans, financial planning, insurance sales, money management and investment banking and brokerage services, as well as corporate and individual trust services. On April 25, 2013, the Company changed its corporate name from Oriental Financial Group Inc. to OFG Bancorp.

On April 30, 2010, the Bank acquired certain assets and assumed certain deposits and other liabilities of Eurobank, a Puerto Rico commercial bank, in an FDIC-assisted acquisition. On December 18, 2012, the Company acquired a group of Puerto Rico based entities that included Banco Bilbao Vizcaya Argentaria Puerto Rico (“BBVAPR”), a Puerto Rico commercial bank, as well as a securities broker-dealer and an insurance agency, which is referred to herein as the “BBVAPR Acquisition.” The businesses acquired in the BBVAPR Acquisition were integrated with the Company’s existing business.

*Recent Accounting Developments*

On March 14, 2014, the FASB issued guidance that amended the Master Glossary of the Accounting Standards Codification (“ASC”), including technical corrections related to glossary links, glossary term deletions, and glossary term name changes. In addition, this guidance included more substantive, limited-scope improvements to reduce instances of the same term appearing multiple times in the Master Glossary with similar, but not entirely identical, definitions. These are items that represent narrow and incremental improvements to U.S. GAAP and are not purely technical corrections and affect a wide variety of Topics in the ASC. The amendments in this guidance apply to all reporting entities within the scope of the affected accounting guidance and are effective upon issuance for both public entities and non-public entities. The Company adopted this guidance upon issuance with no impact on our financial position and results of operations.

On June 19, 2014, the FASB issued updated guidance on the accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. This guidance seeks to resolve the diversity in practice that exists when accounting for share-based payments. In particular, this guidance requires a performance target that affects vesting and that could be achieved after the requisite service period to be treated as a performance conditions. For all entities, this guidance is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, with earlier adoption permitted. We are currently evaluating the impact, if any, that the adoption of this guidance will have on our financial position or results of operations.

Other than the accounting pronouncement disclosed above, there were no other new accounting pronouncements issued during the three months and six months ended June 30, 2014 that could have a material impact on the Company's financial position, operating results or financials statement disclosures.

**OFG BANCORP****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****NOTE 2 – RESTRICTED CASH**

The following table includes the composition of the Company's restricted cash:

|   | <b>June 30,</b>  |  | <b>December 31,</b> |
|---|------------------|--|---------------------|
|   | <b>2014</b>      |  | <b>2013</b>         |
| <b>(In thousands)</b>   |                  |  |                     |
| Cash pledged as collateral to other financial institutions to secure: |                  |  |                     |
| Securities sold under agreements to repurchase                        | \$ -             |  | \$ 67,029           |
| Derivatives   | 2,980            |  | 2,980               |
| Obligations under agreement of loans sold with recourse               | 12,190           |  | 12,190              |
|   | <b>\$ 15,170</b> |  | <b>\$ 82,199</b>    |

The Company delivers cash as collateral to meet margin calls for some long term securities sold under agreements to repurchase. At December 31, 2013, the Company had \$67.0 million in cash pledged as collateral for securities sold under agreements to repurchase. At June 30, 2014, the Company did not have cash pledged as collateral for securities sold under agreements to repurchase.

As part of its derivative activities, the Company has entered into collateral agreements with certain financial counterparties. At both June 30, 2014 and December 31, 2013, the Company had delivered \$3.0 million of cash as collateral for such derivatives activities.

As part of the BBVAPR Acquisition, the Company assumed various contracts with the Federal National Mortgage Association ("FNMA") which required collateral to guarantee the repurchase, if necessary, of certain mortgage loans sold with recourse. At June 30, 2014 and December 31, 2013, the Company had \$12.2 million of cash pledged as collateral for such recourse obligations.

**NOTE 3 – INVESTMENT SECURITIES***Money Market Investments*



The Company considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At June 30, 2014 and December 31, 2013, money market instruments included as part of cash and cash equivalents amounted to \$8.2 million and \$7.0 million, respectively.

***Securities Purchased Under Agreements to Resell***

Securities purchased under agreements to resell consist of short-term investments and are carried at the amounts at which the assets will be subsequently resold as specified in the respective agreements. At December 31, 2013, securities purchased under agreements to resell amounted to \$60.0 million. At June 30, 2014, there were no securities purchased under agreements to resell.

The amounts advanced under those agreements are reflected as assets in the consolidated statements of financial condition. It is the Company's policy to take possession of securities purchased under agreements to resell. Agreements with third parties specify the Company's right to request additional collateral based on its monitoring of the fair value of the underlying securities on a daily basis. The fair value of the collateral securities held by the Company on these transactions as of December 31, 2013 was approximately \$64.6 million.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Investment Securities*

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Company at June 30, 2014 and December 31, 2013 were as follows:

|  | June 30, 2014       |                  |                  |                     |              |  |  |
|--|---------------------|------------------|------------------|---------------------|--------------|--|--|
|  | Amortized           | Gross            | Gross            | Fair                | Weighted     |  |  |
|  | Cost                | Unrealized       | Unrealized       | Value               | Average      |  |  |
|  |                     | Gains            | Losses           |                     | Yield        |  |  |
|  | (In thousands)      |                  |                  |                     |              |  |  |
| <b>Available-for-sale</b>  |                     |                  |                  |                     |              |  |  |
| <b>Mortgage-backed securities</b>                                |                     |                  |                  |                     |              |  |  |
| FNMA and FHLMC certificates                                      | \$ 1,070,034        | \$ 44,076        | \$ 1,992         | \$ 1,112,118        | 3.10%        |  |  |
| GNMA certificates  | 5,560               | 389              | 21               | 5,928               | 4.92%        |  |  |
| CMOs issued by US government-sponsored agencies                  | 200,111             | 306              | 3,786            | 196,631             | 1.79%        |  |  |
| <b>Total mortgage-backed securities</b>                          | <b>1,275,705</b>    | <b>44,771</b>    | <b>5,799</b>     | <b>1,314,677</b>    | <b>2.90%</b> |  |  |
| <b>Investment securities</b>                                     |                     |                  |                  |                     |              |  |  |
| US Treasury securities   | 9,000               | -                | -                | 9,000               | 0.01%        |  |  |
| Obligations of US government-sponsored agencies                  | 74,613              | -                | 38               | 74,575              | 0.17%        |  |  |
| Obligations of Puerto Rico government and political subdivisions | 22,391              | -                | 5,591            | 16,800              | 5.32%        |  |  |
| Other debt securities  | 3,729               | 177              | -                | 3,906               | 2.95%        |  |  |
| <b>Total investment securities</b>                               | <b>109,733</b>      | <b>177</b>       | <b>5,629</b>     | <b>104,281</b>      | <b>1.30%</b> |  |  |
| <b>Total securities available for sale</b>                       | <b>\$ 1,385,438</b> | <b>\$ 44,948</b> | <b>\$ 11,428</b> | <b>\$ 1,418,958</b> | <b>2.77%</b> |  |  |
| <b>Held-to-maturity</b>  |                     |                  |                  |                     |              |  |  |
| <b>Mortgage-backed securities</b>                                |                     |                  |                  |                     |              |  |  |
| FNMA and FHLMC certificates                                      | 26,706              | 138              | -                | 26,844              | 2.52%        |  |  |
| <b>Total</b>   | <b>\$ 1,412,144</b> | <b>\$ 45,086</b> | <b>\$ 11,428</b> | <b>\$ 1,445,802</b> | <b>2.77%</b> |  |  |

| December 31, 2013  |                |                  |                  |               |                  |               |       |                  |              |
|--|----------------|------------------|------------------|---------------|------------------|---------------|-------|------------------|--------------|
|  | Amortized      |                  | Gross Unrealized |               | Gross Unrealized |               | Fair  |                  | Weighted     |
|  | Cost           |                  | Gains            |               | Losses           |               | Value |                  | Average      |
|  | (In thousands) |                  |                  |               |                  |               |       |                  |              |
| <b>Available-for-sale</b>  |                |                  |                  |               |                  |               |       |                  |              |
| <b>Mortgage-backed securities</b>                                |                |                  |                  |               |                  |               |       |                  |              |
| FNMA and FHLMC certificates                                      | \$             | 1,190,910        | \$               | 33,089        | \$               | 6,669         | \$    | 1,217,330        | 2.93%        |
| GNMA certificates  |                | 7,406            |                  | 433           |                  | 24            |       | 7,815            | 4.92%        |
| CMOs issued by US government-sponsored agencies                  |                | 220,801          |                  | 407           |                  | 6,814         |       | 214,394          | 1.78%        |
| <b>Total mortgage-backed securities</b>                          |                | <b>1,419,117</b> |                  | <b>33,929</b> |                  | <b>13,507</b> |       | <b>1,439,539</b> | <b>2.76%</b> |
| <b>Investment securities</b>                                     |                |                  |                  |               |                  |               |       |                  |              |
| Obligations of US government-sponsored agencies                  |                | 10,691           |                  | -             |                  | 42            |       | 10,649           | 1.21%        |
| Obligations of Puerto Rico government and political subdivisions |                | 121,035          |                  | -             |                  | 6,845         |       | 114,190          | 4.38%        |
| Other debt securities  |                | 24,200           |                  | 167           |                  | 320           |       | 24,047           | 3.46%        |
| <b>Total investment securities</b>                               |                | <b>155,926</b>   |                  | <b>167</b>    |                  | <b>7,207</b>  |       | <b>148,886</b>   | <b>2.99%</b> |
| <b>Total securities available-for-sale</b>                       | \$             | <b>1,575,043</b> | \$               | <b>34,096</b> | \$               | <b>20,714</b> | \$    | <b>1,588,425</b> | <b>2.89%</b> |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The amortized cost and fair value of the Company's investment securities at June 30, 2014, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

|  | June 30, 2014      |                  |            |                  |                  |               |            |               |
|--|--------------------|------------------|------------|------------------|------------------|---------------|------------|---------------|
|  | Available-for-sale |                  |            |                  | Held-to-maturity |               |            |               |
|  | Amortized Cost     |                  | Fair Value |                  | Amortized Cost   |               | Fair Value |               |
|  | (In thousands)     |                  |            |                  | (In thousands)   |               |            |               |
| <b>Mortgage-backed securities</b>                                |                    |                  |            |                  |                  |               |            |               |
| Due after 5 to 10 years  |                    |                  |            |                  |                  |               |            |               |
| FNMA and FHLMC certificates                                      | \$                 | 24,631           | \$         | 25,109           | \$               | -             | \$         | -             |
| <b>Total due after 5 to 10 years</b>                             |                    | <b>24,631</b>    |            | <b>25,109</b>    |                  | <b>-</b>      |            | <b>-</b>      |
| Due after 10 years   |                    |                  |            |                  |                  |               |            |               |
| FNMA and FHLMC certificates                                      |                    | 1,045,403        |            | 1,087,009        |                  | 26,706        |            | 26,844        |
| GNMA certificates  |                    | 5,560            |            | 5,928            |                  | -             |            | -             |
| CMOs issued by US government-sponsored agencies                  |                    | 200,111          |            | 196,631          |                  | -             |            | -             |
| <b>Total due after 10 years</b>                                  |                    | <b>1,251,074</b> |            | <b>1,289,568</b> |                  | <b>26,706</b> |            | <b>26,844</b> |
| <b>Total mortgage-backed securities</b>                          |                    | <b>1,275,705</b> |            | <b>1,314,677</b> |                  | <b>26,706</b> |            | <b>26,844</b> |
| <b>Investment securities</b>                                     |                    |                  |            |                  |                  |               |            |               |
| Due in less than one year  |                    |                  |            |                  |                  |               |            |               |
| US Treasury securities   |                    | 9,000            |            | 9,000            |                  | -             |            | -             |
| Obligations of US government and sponsored agencies              |                    | 66,000           |            | 66,000           |                  | -             |            | -             |
| <b>Total due in less than one year</b>                           |                    | <b>75,000</b>    |            | <b>75,000</b>    |                  | <b>-</b>      |            | <b>-</b>      |
| Due from 1 to 5 years  |                    |                  |            |                  |                  |               |            |               |
| Obligations of Puerto Rico government and political subdivisions |                    | 11,927           |            | 9,543            |                  | -             |            | -             |
| <b>Total due from 1 to 5 years</b>                               |                    | <b>11,927</b>    |            | <b>9,543</b>     |                  | <b>-</b>      |            | <b>-</b>      |
| Due after 5 to 10 years  |                    |                  |            |                  |                  |               |            |               |
| Obligations of US government and sponsored agencies              |                    | 8,613            |            | 8,575            |                  | -             |            | -             |
| <b>Total due after 5 to 10 years</b>                             |                    | <b>8,613</b>     |            | <b>8,575</b>     |                  | <b>-</b>      |            | <b>-</b>      |
| Due after 10 years   |                    |                  |            |                  |                  |               |            |               |
|  |                    | 10,464           |            | 7,257            |                  | -             |            | -             |

Edgar Filing: OFG BANCORP - Form 10-Q

|  |           |                  |           |                  |           |               |           |  |               |
|--|-----------|------------------|-----------|------------------|-----------|---------------|-----------|--|---------------|
| Obligations of Puerto Rico<br>government and political<br>subdivisions |           |                  |           |                  |           |               |           |  |               |
| Other debt securities  |           | 3,729            |           | 3,906            |           | -             |           |  | -             |
| <b>Total due after 10 years</b>  |           | <b>14,193</b>    |           | <b>11,163</b>    |           | -             |           |  | -             |
| <b>Total investment<br/>securities</b>                                 |           | <b>109,733</b>   |           | <b>104,281</b>   |           | -             |           |  | -             |
| <b>Total securities available-for-sale</b>                             | <b>\$</b> | <b>1,385,438</b> | <b>\$</b> | <b>1,418,958</b> | <b>\$</b> | <b>26,706</b> | <b>\$</b> |  | <b>26,844</b> |

10

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At December 31, 2013, obligations of the Puerto Rico government and its political subdivisions included a \$98.7 million principal amount, LIBOR floating rate bond with a maturity date of July 1, 2024, that was subject to mandatory tender for purchase by the end of the third year anniversary of the closing date, which was June 1, 2014. The bond was also subject to optional demand tender for purchase upon the occurrence and continuance of certain events, including (among others) the withdrawal, suspension or reduction below investment grade of the credit rating on any general obligation of the Commonwealth by any of the three major rating agencies. This bond was repaid by the issuer on March 17, 2014.

The Company, as part of its asset/liability management, may purchase U.S. Treasury securities and U.S. government-sponsored agency discount notes close to their maturities as alternatives to cash deposits at correspondent banks or as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased. During the six-month period ended June 30, 2014, the Company sold \$48.1 million of available-for-sale Government National Mortgage Association (“GNMA”) certificates that were sold as part of its recurring mortgage loan origination and securitization activities. These sales did not realize any gains or losses during such period. In addition, during the six-month period ended June 30, 2014, certain available-for-sale securities were sold to realize gains and to invest the proceeds in other investment securities with attractive yields and terms that protect the Company’s net interest margin.

For the six-month period ended June 30, 2014 the Company recorded a net gain on sale of securities of \$4.4 million. The tables below present the gross realized gains by category for such period. There was no realized gain or loss for the six-month period ended June 30, 2013.

| Description                                  | Six-Month Period Ended June 30, 2014 |                |            |                |           |              |           |          |
|--|--------------------------------------|----------------|------------|----------------|-----------|--------------|-----------|----------|
|  | Sale Price                           |                | Book Value |                | Gross     |              | Gross     |          |
|  | at Sale                              |                | at Sale    |                | Gains     |              | Losses    |          |
|  | (In thousands)                       |                |            |                |           |              |           |          |
| <b>Sale of securities available-for-sale</b> |                                      |                |            |                |           |              |           |          |
| <b>Mortgage-backed securities</b>            |                                      |                |            |                |           |              |           |          |
| FNMA and FHLMC certificates                  | \$                                   | 115,158        | \$         | 110,792        | \$        | 4,366        | \$        | -        |
| GNMA certificates                            |                                      | 48,077         |            | 48,077         |           | -            |           | -        |
| <b>Total</b>                                 | <b>\$</b>                            | <b>163,235</b> | <b>\$</b>  | <b>158,869</b> | <b>\$</b> | <b>4,366</b> | <b>\$</b> | <b>-</b> |

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Edgar Filing: OFG BANCORP - Form 10-Q

The following tables show the Company's gross unrealized losses and fair value of investment securities available-for-sale and held-to-maturity, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013:

|  | June 30, 2014       |                |            |               |       |                |
|--|---------------------|----------------|------------|---------------|-------|----------------|
|  | 12 months or more   |                |            |               |       |                |
|  | Amortized           |                | Unrealized |               | Fair  |                |
|  | Cost                |                | Loss       |               | Value |                |
|  | (In thousands)      |                |            |               |       |                |
| <b>Securities available-for-sale</b>                             |                     |                |            |               |       |                |
| CMOs issued by US government-sponsored agencies                  | \$                  | 156,542        | \$         | 3,734         | \$    | 152,808        |
| FNMA and FHLMC certificates                                      |                     | 190,630        |            | 1,992         |       | 188,638        |
| Obligations of Puerto Rico government and political subdivisions |                     | 22,391         |            | 5,591         |       | 16,800         |
| GNMA certificates  |                     | 199            |            | 21            |       | 178            |
|  | \$                  | <b>369,762</b> | \$         | <b>11,338</b> | \$    | <b>358,424</b> |
|  |                     |                |            |               |       |                |
|  | Less than 12 months |                |            |               |       |                |
|  | Amortized           |                | Unrealized |               | Fair  |                |
|  | Cost                |                | Loss       |               | Value |                |
|  | (In thousands)      |                |            |               |       |                |
| <b>Securities available-for-sale</b>                             |                     |                |            |               |       |                |
| CMOs issued by US government-sponsored agencies                  | \$                  | 16,365         | \$         | 52            | \$    | 16,313         |
| Obligations of US government and sponsored agencies              |                     | 8,613          |            | 38            |       | 8,575          |
|  | \$                  | <b>24,978</b>  | \$         | <b>90</b>     | \$    | <b>24,888</b>  |
|  |                     |                |            |               |       |                |
|  | Total               |                |            |               |       |                |
|  | Amortized           |                | Unrealized |               | Fair  |                |
|  | Cost                |                | Loss       |               | Value |                |
|  | (In thousands)      |                |            |               |       |                |
| <b>Securities available-for-sale</b>                             |                     |                |            |               |       |                |
| CMOs issued by US government-sponsored agencies                  | \$                  | 172,907        | \$         | 3,786         | \$    | 169,121        |
| FNMA and FHLMC certificates                                      |                     | 190,630        |            | 1,992         |       | 188,638        |
| Obligations of Puerto Rico government and political subdivisions |                     | 22,391         |            | 5,591         |       | 16,800         |
| Obligations of US government and sponsored agencies              |                     | 8,613          |            | 38            |       | 8,575          |
| GNMA certificates  |                     | 199            |            | 21            |       | 178            |
|  | \$                  | <b>394,740</b> | \$         | <b>11,428</b> | \$    | <b>383,312</b> |





## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | December 31, 2013   |                |            |               |  |    |                |
|--|---------------------|----------------|------------|---------------|--|----|----------------|
|  | 12 months or more   |                |            |               |  |    |                |
|  | Amortized           |                | Unrealized |               |  |    | Fair           |
|  | Cost                |                | Loss       |               |  |    | Value          |
|  | (In thousands)      |                |            |               |  |    |                |
| <b>Securities available-for-sale</b>                             |                     |                |            |               |  |    |                |
| Obligations of Puerto Rico government and political subdivisions | \$                  | 20,845         | \$         | 5,470         |  | \$ | 15,375         |
| CMOs issued by US government-sponsored agencies                  |                     | 2,559          |            | 237           |  |    | 2,322          |
| GNMA certificates  |                     | 81             |            | 11            |  |    | 70             |
|  | \$                  | <b>23,485</b>  | \$         | <b>5,718</b>  |  | \$ | <b>17,767</b>  |
|  |                     |                |            |               |  |    |                |
|  |                     |                |            |               |  |    |                |
|  | Less than 12 months |                |            |               |  |    |                |
|  | Amortized           |                | Unrealized |               |  |    | Fair           |
|  | Cost                |                | Loss       |               |  |    | Value          |
|  | (In thousands)      |                |            |               |  |    |                |
| <b>Securities available-for-sale</b>                             |                     |                |            |               |  |    |                |
| Obligations of Puerto Rico government and political subdivisions | \$                  | 100,190        | \$         | 1,375         |  | \$ | 98,815         |
| CMOs issued by US government-sponsored agencies                  |                     | 182,661        |            | 6,577         |  |    | 176,084        |
| GNMA certificates  |                     | 122            |            | 13            |  |    | 109            |
| FNMA and FHLMC certificates                                      |                     | 220,913        |            | 6,669         |  |    | 214,244        |
| Obligations of US government and sponsored agencies              |                     | 10,691         |            | 42            |  |    | 10,649         |
| Other debt securities  |                     | 20,000         |            | 320           |  |    | 19,680         |
|  | \$                  | <b>534,577</b> | \$         | <b>14,996</b> |  | \$ | <b>519,581</b> |
|  |                     |                |            |               |  |    |                |
|  |                     |                |            |               |  |    |                |
|  | Total               |                |            |               |  |    |                |
|  | Amortized           |                | Unrealized |               |  |    | Fair           |
|  | Cost                |                | Loss       |               |  |    | Value          |
|  | (In thousands)      |                |            |               |  |    |                |
| <b>Securities available-for-sale</b>                             |                     |                |            |               |  |    |                |
| Obligations of Puerto Rico government and political subdivisions | \$                  | 121,035        | \$         | 6,845         |  | \$ | 114,190        |
| CMOs issued by US government-sponsored agencies                  |                     | 185,220        |            | 6,814         |  |    | 178,406        |

Edgar Filing: OFG BANCORP - Form 10-Q

|   |    |                |  |    |               |  |    |                |
|---|----|----------------|--|----|---------------|--|----|----------------|
| GNMA certificates                                   |    | 203            |  |    | 24            |  |    | 179            |
| FNMA and FHLMC certificates                         |    | 220,913        |  |    | 6,669         |  |    | 214,244        |
| Obligations of US government and sponsored agencies |    | 10,691         |  |    | 42            |  |    | 10,649         |
| Other debt securities                               |    | 20,000         |  |    | 320           |  |    | 19,680         |
|   | \$ | <b>558,062</b> |  | \$ | <b>20,714</b> |  | \$ | <b>537,348</b> |

13

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The Company performs valuations of the investment securities on a monthly basis. Moreover, the Company conducts quarterly reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered by comparing the present value of cash flows expected to be collected from the security, discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the “credit loss.” Other-than-temporary impairment analysis is based on estimates that depend on market conditions and are subject to further change over time. In addition, while the Company believes that the methodology used to value these exposures is reasonable, the methodology is subject to continuing refinement, including those made as a result of market developments. Consequently, it is reasonably possible that changes in estimates or conditions could result in the need to recognize additional other-than-temporary impairment charges in the future.

Most of the investments in an unrealized loss position at June 30, 2014 (\$372.3 million or 94%) consist of securities issued or guaranteed by the U.S. Treasury or U.S. government-sponsored agencies, all of which are highly liquid securities that have a large and efficient secondary market. Their aggregate losses and their variability from period to period are the result of changes in market conditions, and not due to the repayment capacity or creditworthiness of the issuers or guarantors of such securities.

The remaining investments in an unrealized loss position at June 30, 2014 (\$22.4 million or 6%) consist of obligations issued or guaranteed by the government of Puerto Rico and its political subdivisions or instrumentalities. The recent decline in the market value of these securities is mainly attributed to an increase in volatility as a result of changes in market conditions that reflect the significant economic and fiscal challenges that Puerto Rico is facing, including a protracted economic recession, sizable government debt-service obligations and structural budget deficits, high unemployment and a shrinking population. Moreover, uncertainty in regards to the impact of the recently enacted Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”) and the related subsequent negative rating decisions taken by the credit rating agencies has affected the market value of these securities. As of June 30, 2014, the Company analyzed these investments and considered several factors that, in the Company’s view, support the ability of the Commonwealth and the particular political subdivisions or instrumentalities to continue servicing their debt obligations. Such factors include (i) the collateralization and sources of repayment for such debt obligations; (ii) the government’s efforts to increase revenues and reduce expenses to tackle its recurrent budget deficits; (iii) the Commonwealth’s constitutional framework that provides that “public debt” constitutes a first claim on available Commonwealth resources; and (iv) the Commonwealth’s compliance and commitment to its contractual debt obligations. In addition, the Company believes it is probable that it will collect all amounts due according to the contractual terms of its Puerto Rico government bonds. Based on these factors, the Company expects that such bonds will be repaid in full when due, and given that the Company does not have the intent to sell any such bonds in an unrealized loss position, the Company does not consider them to be other-than-temporarily impaired as of June 30, 2014.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 4 - LOANS

The Company's loan portfolio is composed of covered loans and non-covered loans. Covered loans are subject to loss sharing agreements with the FDIC and non-covered loans are not subject to FDIC loss sharing agreements. The risks of covered loans are different from the risks of non-covered loans because of the loss protection provided by the FDIC to covered loans. Loans acquired in the BBVAPR Acquisition are included as non-covered loans in the unaudited consolidated statements of financial condition. Non-covered loans are further subdivided between originated and other loans, acquired loans accounted for under ASC 310-20 (loans with revolving feature and/or acquired at a premium), and acquired loans accounted for under ASC 310-30 (loans acquired with deteriorated credit quality, including those by analogy).

The composition of the Company's loan portfolio at June 30, 2014 and December 31, 2013 was as follows:

|   | June 30,       |                  | December 31, |                  |
|---|----------------|------------------|--------------|------------------|
|   | 2014           |                  | 2013         |                  |
|   | (In thousands) |                  |              |                  |
| <b>Non-covered loans:</b>   |                |                  |              |                  |
| <b>Originated and other loans and leases held for investment:</b>   |                |                  |              |                  |
| Mortgage  | \$             | 788,001          | \$           | 766,265          |
| Commercial  |                | 1,183,172        |              | 1,127,657        |
| Consumer  |                | 161,538          |              | 127,744          |
| Auto and leasing  |                | 508,034          |              | 379,874          |
|   |                | <b>2,640,745</b> |              | <b>2,401,540</b> |
| <b>Acquired loans:</b>  |                |                  |              |                  |
| <b>Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b>                   |                |                  |              |                  |
| Commercial  |                | 38,602           |              | 77,681           |
| Consumer  |                | 49,604           |              | 56,174           |
| Auto  |                | 238,399          |              | 301,584          |
|   |                | <b>326,605</b>   |              | <b>435,439</b>   |
| <b>Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)</b> |                |                  |              |                  |
| Mortgage  |                | 692,069          |              | 717,904          |
| Commercial  |                | 508,530          |              | 545,117          |
| Construction  |                | 123,743          |              | 126,427          |

## Edgar Filing: OFG BANCORP - Form 10-Q

|   |           |                  |           |                  |
|---|-----------|------------------|-----------|------------------|
| Consumer  |           | 43,824           |           | 63,620           |
| Auto  |           | 308,512          |           | 379,145          |
|   |           | <b>1,676,678</b> |           | <b>1,832,213</b> |
|   |           | <b>4,644,028</b> |           | <b>4,669,192</b> |
| Deferred loan cost , net  |           | 3,236            |           | 1,035            |
| <b>Loans receivable</b>   |           | <b>4,647,264</b> |           | <b>4,670,227</b> |
| Allowance for loan and lease losses on non-covered loans                  |           | (60,360)         |           | (54,298)         |
| <b>Loans receivable, net</b>  |           | <b>4,586,904</b> |           | <b>4,615,929</b> |
| Mortgage loans held-for-sale  |           | 14,792           |           | 46,529           |
| <b>Total non-covered loans, net</b>                                       |           | <b>4,601,696</b> |           | <b>4,662,458</b> |
| <b>Covered loans:</b>   |           |                  |           |                  |
| Loans secured by 1-4 family residential properties                        |           | 121,416          |           | 121,748          |
| Construction and development secured by 1-4 family residential properties |           | 18,566           |           | 17,304           |
| Commercial and other construction   |           | 248,700          |           | 264,249          |
| Consumer  |           | 5,177            |           | 6,119            |
| Leasing   |           | -                |           | 270              |
| <b>Total covered loans</b>  |           | <b>393,859</b>   |           | <b>409,690</b>   |
| Allowance for loan and lease losses on covered loans                      |           | (59,515)         |           | (52,729)         |
| <b>Total covered loans, net</b>   |           | <b>334,344</b>   |           | <b>356,961</b>   |
| <b>Total loans, net</b>   | <b>\$</b> | <b>4,936,040</b> | <b>\$</b> | <b>5,019,419</b> |

During the six-month period ended June 30, 2014, the Company reclassified \$26.4 million in mortgage loans held-for-sale to held-for-investment.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Non-covered Loans*Originated and Other Loans and Leases Held for Investment

The Company's originated and other loans held for investment are encompassed within four portfolio segments: mortgage, commercial, consumer, and auto and leasing.

The following tables present the aging of the recorded investment in gross originated and other loans held for investment as of June 30, 2014 and December 31, 2013 by class of loans. Mortgage loans past due included delinquent loans in the GNMA buy-back option program. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.

|                                       | June 30, 2014  |               |          |            |           |             |    |              |
|---------------------------------------|----------------|---------------|----------|------------|-----------|-------------|----|--------------|
|                                       |                |               |          |            |           |             |    | Loans<br>90+ |
|                                       |                |               |          |            |           |             |    | Days<br>Past |
|                                       |                |               |          |            |           |             |    | Due and      |
|                                       | 30-59<br>Days  | 60-89<br>Days | 90+ Days | Total Past |           |             |    | Still        |
|                                       | Past Due       | Past Due      | Past Due | Due        | Current   | Total Loans |    | Accruing     |
|                                       | (In thousands) |               |          |            |           |             |    |              |
| <b>Mortgage</b>                       |                |               |          |            |           |             |    |              |
| Traditional (by<br>origination year): |                |               |          |            |           |             |    |              |
| Up to the<br>year 2002                | \$ 5,182       | \$ 2,540      | \$ 3,225 | \$ 10,947  | \$ 59,426 | \$ 70,373   | \$ | 70           |
| Years 2003<br>and 2004                | 5,503          | 1,905         | 2,929    | 10,337     | 51,945    | 62,282      |    | -            |
| Year 2005                             | 6,775          | 2,959         | 6,783    | 16,517     | 69,352    | 85,869      |    | 89           |
| Year 2006                             | 10,562         | 3,781         | 5,278    | 19,621     | 94,765    | 114,386     |    | -            |
| Years 2007,<br>2008                   |                |               |          |            |           |             |    |              |
| and 2009                              | 3,962          | 2,051         | 5,859    | 11,872     | 82,471    | 94,343      |    | -            |



## Edgar Filing: OFG BANCORP - Form 10-Q

|   |               |               |               |                |                  |                  |              |
|---|---------------|---------------|---------------|----------------|------------------|------------------|--------------|
| Years 2010,<br>2011, 2012, 2013<br>and 2014 | 3,345         | 2,745         | 5,432         | 11,522         | 184,150          | 195,672          | 339          |
|   | 35,329        | 15,981        | 29,506        | 80,816         | 542,109          | 622,925          | 498          |
| Non-traditional                             | 1,997         | 1,128         | 2,655         | 5,780          | 32,254           | 38,034           | -            |
| Loss<br>mitigation<br>program               | 8,239         | 7,779         | 12,427        | 28,445         | 59,519           | 87,964           | 4,378        |
|   | 45,565        | 24,888        | 44,588        | 115,041        | 633,882          | 748,923          | 4,876        |
| Home equity<br>secured personal<br>loans    | -             | -             | 138           | 138            | 611              | 749              | -            |
| GNMA's<br>buy-back option<br>program        | -             | -             | 38,329        | 38,329         | -                | 38,329           | -            |
|   | <b>45,565</b> | <b>24,888</b> | <b>83,055</b> | <b>153,508</b> | <b>634,493</b>   | <b>788,001</b>   | <b>4,876</b> |
| <b>Commercial</b>                           |               |               |               |                |                  |                  |              |
| Commercial<br>secured by real<br>estate:    |               |               |               |                |                  |                  |              |
| Corporate                                   | -             | -             | -             | -              | 90,886           | 90,886           | -            |
| Institutional                               | -             | -             | -             | -              | 30,701           | 30,701           | -            |
| Middle<br>market                            | 685           | -             | 638           | 1,323          | 139,902          | 141,225          | -            |
| Retail                                      | 1,634         | 494           | 6,198         | 8,326          | 148,862          | 157,188          | -            |
| Floor plan                                  | -             | -             | -             | -              | 1,680            | 1,680            | -            |
| Real estate                                 | -             | -             | -             | -              | 11,878           | 11,878           | -            |
|   | 2,319         | 494           | 6,836         | 9,649          | 423,909          | 433,558          | -            |
| Other<br>commercial and<br>industrial:      |               |               |               |                |                  |                  |              |
| Corporate                                   | -             | -             | -             | -              | 61,329           | 61,329           | -            |
| Institutional                               | -             | -             | -             | -              | 487,725          | 487,725          | -            |
| Middle<br>market                            | -             | 760           | -             | 760            | 80,034           | 80,794           | -            |
| Retail                                      | 536           | 149           | 1,343         | 2,028          | 75,728           | 77,756           | -            |
| Floor plan                                  | -             | -             | -             | -              | 42,010           | 42,010           | -            |
|   | 536           | 909           | 1,343         | 2,788          | 746,826          | 749,614          | -            |
|   | <b>2,855</b>  | <b>1,403</b>  | <b>8,179</b>  | <b>12,437</b>  | <b>1,170,735</b> | <b>1,183,172</b> | <b>-</b>     |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| June 30, 2014                  |                  |                  |                  |                   |                     |                     |                 |  |  |  |              |
|--------------------------------|------------------|------------------|------------------|-------------------|---------------------|---------------------|-----------------|--|--|--|--------------|
|                                |                  |                  |                  |                   |                     |                     |                 |  |  |  | Loans<br>90+ |
|                                |                  |                  |                  |                   |                     |                     |                 |  |  |  | Days<br>Past |
|                                |                  |                  |                  |                   |                     |                     |                 |  |  |  | Due and      |
|                                | 30-59<br>Days    | 60-89<br>Days    | 90+ Days         | Total Past        |                     |                     |                 |  |  |  | Still        |
|                                | Past Due         | Past Due         | Past Due         | Due               | Current             | Total Loans         | Accruing        |  |  |  |              |
| (In thousands)                 |                  |                  |                  |                   |                     |                     |                 |  |  |  |              |
| <b>Consumer</b>                |                  |                  |                  |                   |                     |                     |                 |  |  |  |              |
| Credit cards                   | 345              | 236              | 271              | 852               | 15,034              | 15,886              | -               |  |  |  |              |
| Overdrafts                     | 19               | 3                | 1                | 23                | 295                 | 318                 | -               |  |  |  |              |
| Personal lines of credit       | 57               | 1                | 129              | 187               | 1,789               | 1,976               | -               |  |  |  |              |
| Personal loans                 | 1,227            | 535              | 677              | 2,439             | 123,981             | 126,420             | -               |  |  |  |              |
| Cash collateral personal loans | 280              | 94               | 48               | 422               | 16,516              | 16,938              | -               |  |  |  |              |
|                                | <b>1,928</b>     | <b>869</b>       | <b>1,126</b>     | <b>3,923</b>      | <b>157,615</b>      | <b>161,538</b>      | -               |  |  |  |              |
| <b>Auto and leasing</b>        | 37,047           | 13,620           | 6,953            | <b>57,620</b>     | 450,414             | <b>508,034</b>      | -               |  |  |  |              |
| <b>Total</b>                   | <b>\$ 87,395</b> | <b>\$ 40,780</b> | <b>\$ 99,313</b> | <b>\$ 227,488</b> | <b>\$ 2,413,257</b> | <b>\$ 2,640,745</b> | <b>\$ 4,876</b> |  |  |  |              |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | December 31, 2013 |               |               |                |                |                |              |  |  |  |  |              |
|--|-------------------|---------------|---------------|----------------|----------------|----------------|--------------|--|--|--|--|--------------|
|  |                   |               |               |                |                |                |              |  |  |  |  | Loans<br>90+ |
|  |                   |               |               |                |                |                |              |  |  |  |  | Days<br>Past |
|  |                   |               |               |                |                |                |              |  |  |  |  | Due and      |
|  | 30-59<br>Days     | 60-89<br>Days | 90+ Days      | Total Past     |                |                |              |  |  |  |  | Still        |
|  | Past Due          | Past Due      | Past Due      | Due            | Current        | Total Loans    | Accruing     |  |  |  |  |              |
|  | (In thousands)    |               |               |                |                |                |              |  |  |  |  |              |
| <b>Mortgage</b>                          |                   |               |               |                |                |                |              |  |  |  |  |              |
| Traditional (by<br>origination year):    |                   |               |               |                |                |                |              |  |  |  |  |              |
| Up to the<br>year 2002                   | \$ 6,697          | \$ 1,635      | \$ 3,408      | \$ 11,740      | \$ 64,772      | \$ 76,512      | \$ 79        |  |  |  |  |              |
| Years 2003<br>and 2004                   | 4,722             | 2,163         | 1,845         | 8,730          | 56,387         | 65,117         | -            |  |  |  |  |              |
| Year 2005                                | 8,527             | 2,119         | 4,808         | 15,454         | 74,087         | 89,541         | -            |  |  |  |  |              |
| Year 2006                                | 12,055            | 4,312         | 4,418         | 20,785         | 99,537         | 120,322        | -            |  |  |  |  |              |
| Years 2007,<br>2008<br>and 2009          | 3,464             | 1,104         | 4,663         | 9,231          | 91,919         | 101,150        | 152          |  |  |  |  |              |
| Years 2010,<br>2011, 2012<br>and 2013    | 3,923             | 1,609         | 4,453         | 9,985          | 139,561        | 149,546        | 459          |  |  |  |  |              |
|  | 39,388            | 12,942        | 23,595        | 75,925         | 526,263        | 602,188        | 690          |  |  |  |  |              |
| Non-traditional                          | 3,217             | 1,162         | 2,311         | 6,690          | 35,412         | 42,102         | -            |  |  |  |  |              |
| Loss<br>mitigation<br>program            | 9,759             | 5,560         | 13,191        | 28,510         | 57,808         | 86,318         | 2,185        |  |  |  |  |              |
|  | 52,364            | 19,664        | 39,097        | 111,125        | 619,483        | 730,608        | 2,875        |  |  |  |  |              |
| Home equity<br>secured personal<br>loans | -                 | -             | 138           | 138            | 598            | 736            | -            |  |  |  |  |              |
| GNMA's<br>buy-back option<br>program     | -                 | -             | 34,921        | 34,921         | -              | 34,921         | -            |  |  |  |  |              |
|  | <b>52,364</b>     | <b>19,664</b> | <b>74,156</b> | <b>146,184</b> | <b>620,081</b> | <b>766,265</b> | <b>2,875</b> |  |  |  |  |              |

Edgar Filing: OFG BANCORP - Form 10-Q

| <b>Commercial</b>                  |              |              |               |               |                  |                  |   |  |  |  |  |  |
|------------------------------------|--------------|--------------|---------------|---------------|------------------|------------------|---|--|--|--|--|--|
| Commercial secured by real estate: |              |              |               |               |                  |                  |   |  |  |  |  |  |
| Corporate                          | -            | -            | -             | -             | 54,796           | 54,796           | - |  |  |  |  |  |
| Institutional                      | -            | -            | -             | -             | 4,050            | 4,050            | - |  |  |  |  |  |
| Middle market                      | 1,356        | -            | 10,294        | 11,650        | 149,933          | 161,583          | - |  |  |  |  |  |
| Retail                             | 4,253        | 1,015        | 3,190         | 8,458         | 158,184          | 166,642          | - |  |  |  |  |  |
| Floor plan                         | -            | -            | -             | -             | 1,835            | 1,835            | - |  |  |  |  |  |
| Real estate                        | -            | -            | -             | -             | 11,655           | 11,655           | - |  |  |  |  |  |
|                                    | 5,609        | 1,015        | 13,484        | 20,108        | 380,453          | 400,561          | - |  |  |  |  |  |
| Other commercial and industrial:   |              |              |               |               |                  |                  |   |  |  |  |  |  |
| Corporate                          | 236          | -            | -             | 236           | 32,362           | 32,598           | - |  |  |  |  |  |
| Institutional                      | -            | -            | -             | -             | 536,445          | 536,445          | - |  |  |  |  |  |
| Middle market                      | -            | 299          | 1,134         | 1,433         | 57,464           | 58,897           | - |  |  |  |  |  |
| Retail                             | 1,830        | 552          | 539           | 2,921         | 58,589           | 61,510           | - |  |  |  |  |  |
| Floor plan                         | 39           | -            | -             | 39            | 37,607           | 37,646           | - |  |  |  |  |  |
|                                    | 2,105        | 851          | 1,673         | 4,629         | 722,467          | 727,096          | - |  |  |  |  |  |
|                                    | <b>7,714</b> | <b>1,866</b> | <b>15,157</b> | <b>24,737</b> | <b>1,102,920</b> | <b>1,127,657</b> | - |  |  |  |  |  |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|                                | December 31, 2013 |                  |                  |                   |                     |                     |                 |  |  |  |  |  |              |
|--------------------------------|-------------------|------------------|------------------|-------------------|---------------------|---------------------|-----------------|--|--|--|--|--|--------------|
|                                |                   |                  |                  |                   |                     |                     |                 |  |  |  |  |  | Loans<br>90+ |
|                                |                   |                  |                  |                   |                     |                     |                 |  |  |  |  |  | Days<br>Past |
|                                |                   |                  |                  |                   |                     |                     |                 |  |  |  |  |  | Due and      |
|                                | 30-59<br>Days     | 60-89<br>Days    | 90+ Days         | Total Past        |                     |                     |                 |  |  |  |  |  | Still        |
|                                | Past Due          | Past Due         | Past Due         | Due               | Current             | Total Loans         | Accruing        |  |  |  |  |  |              |
|                                | (In thousands)    |                  |                  |                   |                     |                     |                 |  |  |  |  |  |              |
| <b>Consumer</b>                |                   |                  |                  |                   |                     |                     |                 |  |  |  |  |  |              |
| Credit cards                   | 287               | 168              | 232              | 687               | 14,554              | 15,241              | -               |  |  |  |  |  |              |
| Overdrafts                     | 46                | 4                | -                | 50                | 322                 | 372                 | -               |  |  |  |  |  |              |
| Personal lines of credit       | 33                | 38               | 66               | 137               | 1,844               | 1,981               | -               |  |  |  |  |  |              |
| Personal loans                 | 1,324             | 399              | 352              | 2,075             | 92,485              | 94,560              | -               |  |  |  |  |  |              |
| Cash collateral personal loans | 324               | 43               | -                | 367               | 15,223              | 15,590              | -               |  |  |  |  |  |              |
|                                | <b>2,014</b>      | <b>652</b>       | <b>650</b>       | <b>3,316</b>      | <b>124,428</b>      | <b>127,744</b>      | <b>-</b>        |  |  |  |  |  |              |
| <b>Auto and leasing</b>        | 25,531            | 9,437            | 5,089            | <b>40,057</b>     | 339,817             | <b>379,874</b>      | -               |  |  |  |  |  |              |
| <b>Total</b>                   | <b>\$ 87,623</b>  | <b>\$ 31,619</b> | <b>\$ 95,052</b> | <b>\$ 214,294</b> | <b>\$ 2,187,246</b> | <b>\$ 2,401,540</b> | <b>\$ 2,875</b> |  |  |  |  |  |              |

At June 30, 2014, the increase in delinquencies in the consumer and the auto and leasing portfolios compared to December 31, 2013 is mainly attributed to the fact that non-performing loans of acquired non-covered loan portfolio were accounted for under ASC 310-30. Such portfolios are increasing as new originations are ramping up the balances outstanding. More than a year from the BBVAPR Acquisition, those portfolios are beginning to reflect normal delinquency levels as seasoned portfolios. At June 30, 2014, the increase in delinquencies in the mortgage portfolio compared to December 31, 2013 is mainly attributed to local economic conditions.

At June 30, 2014 and December 31, 2013, the Company had \$476.3 million and \$515.4 million, respectively, in loans granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of the institutional commercial loan segment. This entire amount was current at June 30, 2014.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Acquired Loans Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)

Credit cards, retail and commercial revolving lines of credits, floor plans and performing auto loans with FICO scores over 660 acquired at a premium as part of the non-covered portfolio are accounted for under the guidance of ASC 310-20, which requires that any contractually required loan payment receivable in excess of the Company's initial investment in the loans be accreted into interest income on a level-yield basis over the life of the loan. Loans accounted for under ASC 310-20 are placed on non-accrual status when past due in accordance with the Company's non-accrual policy, and any accretion of discount or amortization of premium is discontinued. Loans acquired in the non-covered portfolio that were accounted for under the provisions of ASC 310-20 are removed from the acquired loan category at the end of the reporting period upon refinancing, renewal or normal re-underwriting.

The following tables present the aging of the recorded investment in gross acquired loans accounted for under ASC 310-20 as of June 30, 2014 and December 31, 2013, by class of loans:

|                                   |  |  |  |  |  |  |  |  |  |  |  | June 30, 2014  |               |          |            |         |    |     |    |             |    |       |    |              |    |   |  |  |  |
|-----------------------------------|--|--|--|--|--|--|--|--|--|--|--|----------------|---------------|----------|------------|---------|----|-----|----|-------------|----|-------|----|--------------|----|---|--|--|--|
|                                   |  |  |  |  |  |  |  |  |  |  |  |                |               |          |            |         |    |     |    |             |    |       |    | Loans<br>90+ |    |   |  |  |  |
|                                   |  |  |  |  |  |  |  |  |  |  |  |                |               |          |            |         |    |     |    |             |    |       |    | Days<br>Past |    |   |  |  |  |
|                                   |  |  |  |  |  |  |  |  |  |  |  |                |               |          |            |         |    |     |    |             |    |       |    | Due<br>and   |    |   |  |  |  |
|                                   |  |  |  |  |  |  |  |  |  |  |  | 30-59<br>Days  | 60-89<br>Days | 90+ Days | Total Past |         |    |     |    |             |    |       |    | Still        |    |   |  |  |  |
|                                   |  |  |  |  |  |  |  |  |  |  |  | Past Due       | Past Due      | Past Due | Due        | Current |    |     |    | Total Loans |    |       |    | Accruing     |    |   |  |  |  |
|                                   |  |  |  |  |  |  |  |  |  |  |  | (In thousands) |               |          |            |         |    |     |    |             |    |       |    |              |    |   |  |  |  |
| <b>Commercial</b>                 |  |  |  |  |  |  |  |  |  |  |  |                |               |          |            |         |    |     |    |             |    |       |    |              |    |   |  |  |  |
| Commercial secured by real estate |  |  |  |  |  |  |  |  |  |  |  |                |               |          |            |         |    |     |    |             |    |       |    |              |    |   |  |  |  |
| Corporate                         |  |  |  |  |  |  |  |  |  |  |  |                | \$            | -        | \$         | -       | \$ | -   | \$ | -           | \$ | 2,999 | \$ | 2,999        | \$ | - |  |  |  |
| Retail                            |  |  |  |  |  |  |  |  |  |  |  |                |               | -        |            | -       |    | 506 |    | 506         |    | 2,051 |    | 2,557        |    | - |  |  |  |
| Floor plan                        |  |  |  |  |  |  |  |  |  |  |  |                |               | -        |            | -       |    | 101 |    | 101         |    | 3,846 |    | 3,947        |    | - |  |  |  |
|                                   |  |  |  |  |  |  |  |  |  |  |  |                |               | -        |            | -       |    | 607 |    | 607         |    | 8,896 |    | 9,503        |    | - |  |  |  |
| Other commercial and industrial   |  |  |  |  |  |  |  |  |  |  |  |                |               |          |            |         |    |     |    |             |    |       |    |              |    |   |  |  |  |

## Edgar Filing: OFG BANCORP - Form 10-Q

|                   |                  |                 |                 |                  |                   |                   |             |
|-------------------|------------------|-----------------|-----------------|------------------|-------------------|-------------------|-------------|
| Corporate         | -                | -               | 94              | 94               | 2,916             | 3,010             | -           |
| Retail            | 254              | 92              | 556             | 902              | 10,518            | 11,420            | -           |
| Floor plan        | 51               | 68              | 119             | 238              | 14,431            | 14,669            | -           |
|                   | 305              | 160             | 769             | 1,234            | 27,865            | 29,099            | -           |
|                   | <b>305</b>       | <b>160</b>      | <b>1,376</b>    | <b>1,841</b>     | <b>36,761</b>     | <b>38,602</b>     | -           |
| <b>Consumer</b>   |                  |                 |                 |                  |                   |                   |             |
| Credit cards      | 1,520            | 835             | 1,320           | 3,675            | 42,263            | 45,938            | -           |
| Personal<br>loans | 218              | 82              | 32              | 332              | 3,334             | 3,666             | -           |
|                   | <b>1,738</b>     | <b>917</b>      | <b>1,352</b>    | <b>4,007</b>     | <b>45,597</b>     | <b>49,604</b>     | -           |
| <b>Auto</b>       | <b>11,603</b>    | <b>4,325</b>    | <b>1,566</b>    | <b>17,494</b>    | <b>220,905</b>    | <b>238,399</b>    | -           |
| <b>Total</b>      | <b>\$ 13,646</b> | <b>\$ 5,402</b> | <b>\$ 4,294</b> | <b>\$ 23,342</b> | <b>\$ 303,263</b> | <b>\$ 326,605</b> | <b>\$ -</b> |

20



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| December 31, 2013                 |                  |                 |                 |                  |                   |                   |             |  |  |              |
|-----------------------------------|------------------|-----------------|-----------------|------------------|-------------------|-------------------|-------------|--|--|--------------|
|                                   |                  |                 |                 |                  |                   |                   |             |  |  | Loans<br>90+ |
|                                   |                  |                 |                 |                  |                   |                   |             |  |  | Days<br>Past |
|                                   |                  |                 |                 |                  |                   |                   |             |  |  | Due<br>and   |
|                                   | 30-59<br>Days    | 60-89<br>Days   | 90+ Days        | Total Past       |                   |                   |             |  |  | Still        |
|                                   | Past Due         | Past Due        | Past Due        | Due              | Current           | Total Loans       | Accruing    |  |  |              |
| (In thousands)                    |                  |                 |                 |                  |                   |                   |             |  |  |              |
| <b>Commercial</b>                 |                  |                 |                 |                  |                   |                   |             |  |  |              |
| Commercial secured by real estate |                  |                 |                 |                  |                   |                   |             |  |  |              |
| Corporate                         | \$ -             | \$ -            | \$ -            | \$ -             | \$ 10,166         | \$ 10,166         | \$ -        |  |  |              |
| Retail                            | 431              | 331             | 868             | 1,630            | 4,140             | 5,770             | -           |  |  |              |
| Floor plan                        | -                | -               | 101             | 101              | 2,576             | 2,677             | -           |  |  |              |
|                                   | 431              | 331             | 969             | 1,731            | 16,882            | 18,613            | -           |  |  |              |
| Other commercial and industrial   |                  |                 |                 |                  |                   |                   |             |  |  |              |
| Corporate                         | 14               | 83              | -               | 97               | 9,696             | 9,793             | -           |  |  |              |
| Retail                            | 1,717            | 1,418           | 659             | 3,794            | 23,544            | 27,338            | -           |  |  |              |
| Floor plan                        | 35               | 193             | 18              | 246              | 21,691            | 21,937            | -           |  |  |              |
|                                   | 1,766            | 1,694           | 677             | 4,137            | 54,931            | 59,068            | -           |  |  |              |
|                                   | <b>2,197</b>     | <b>2,025</b>    | <b>1,646</b>    | <b>5,868</b>     | <b>71,813</b>     | <b>77,681</b>     | -           |  |  |              |
| <b>Consumer</b>                   |                  |                 |                 |                  |                   |                   |             |  |  |              |
| Credit cards                      | 2,217            | 1,200           | 2,068           | 5,485            | 46,714            | 52,199            | -           |  |  |              |
| Personal loans                    | 196              | 7               | 91              | 294              | 3,681             | 3,975             | -           |  |  |              |
|                                   | <b>2,413</b>     | <b>1,207</b>    | <b>2,159</b>    | <b>5,779</b>     | <b>50,395</b>     | <b>56,174</b>     | -           |  |  |              |
| <b>Auto</b>                       | <b>12,534</b>    | <b>3,616</b>    | <b>1,608</b>    | <b>17,758</b>    | <b>283,826</b>    | <b>301,584</b>    | -           |  |  |              |
| <b>Total</b>                      | <b>\$ 17,144</b> | <b>\$ 6,848</b> | <b>\$ 5,413</b> | <b>\$ 29,405</b> | <b>\$ 406,034</b> | <b>\$ 435,439</b> | <b>\$ -</b> |  |  |              |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Acquired Loans Accounted for under ASC 310-30 (including those accounted for under ASC 310-30 by analogy)

Acquired loans that are part of the non-covered portfolio, except for credit cards, retail and commercial revolving lines of credits, floor plans and performing auto loans with FICO scores over 660 acquired at a premium, are accounted for by the Company in accordance with ASC 310-30.

The carrying amount corresponding to non-covered loans acquired with deteriorated credit quality, including those accounted under ASC 310-30 by analogy, in the statements of financial condition at June 30, 2014 and December 31, 2013 is as follows:

|  | <b>June 30,</b>       |  | <b>December 31,</b> |
|--|-----------------------|--|---------------------|
|  | <b>2014</b>           |  | <b>2013</b>         |
|  | <b>(In thousands)</b> |  |                     |
| Contractual required payments receivable | \$ 2,676,008          |  | \$ 2,929,353        |
| Less: Non-accretable discount            | 554,724               |  | 579,587             |
| Cash expected to be collected            | 2,121,284             |  | 2,349,766           |
| Less: Accretable yield                   | 444,606               |  | 517,553             |
| Carrying amount                          | \$ 1,676,678          |  | \$ 1,832,213        |

At June 30, 2014 and December 31, 2013, the Company had \$179.1 million and \$180.5 million, respectively, in loans granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of its non-covered acquired loans accounted for under ASC 310-30. This entire amount was current at June 30, 2014.

The following tables describe the accretable yield and non-accretable discount activity of acquired loans accounted for under ASC 310-30 for the quarters and six-month periods ended June 30, 2014 and 2013, excluding covered loans:

|                                       | <b>Quarter Ended June 30,</b> |          |             |          | <b>Six-Month Period Ended June 30,</b> |          |             |           |
|---------------------------------------|-------------------------------|----------|-------------|----------|--|----------|-------------|-----------|
|                                       | <b>2014</b>                   |          | <b>2013</b> |          | <b>2014</b>                            |          | <b>2013</b> |           |
|                                       | <b>(In thousands)</b>         |          |             |          |  |          |             |           |
| <b>Accretable Yield Activity</b>      |                               |          |             |          |  |          |             |           |
| <b>Balance at beginning of period</b> | \$                            | 482,001  | \$          | 542,741  | \$                                     | 517,553  | \$          | 590,409   |
| Accretion                             |                               | (39,714) |             | (54,427) |  | (79,983) |             | (102,095) |

Edgar Filing: OFG BANCORP - Form 10-Q

|   |           |                               |           |                |           |  |           |                |
|---|-----------|-------------------------------|-----------|----------------|-----------|--|-----------|----------------|
| Transfer from non-accretable discount   |           | 2,319                         |           | 7,747          |           | 7,036                                  |           | 7,747          |
| <b>Balance at end of period</b>         | <b>\$</b> | <b>444,606</b>                | <b>\$</b> | <b>496,061</b> | <b>\$</b> | <b>444,606</b>                         | <b>\$</b> | <b>496,061</b> |
|   |           |                               |           |                |           |  |           |                |
|   |           | <b>Quarter Ended June 30,</b> |           |                |           | <b>Six-Month Period Ended June 30,</b> |           |                |
|   |           | <b>2014</b>                   |           | <b>2013</b>    |           | <b>2014</b>                            |           | <b>2013</b>    |
|   |           | <b>(In thousands)</b>         |           |                |           |  |           |                |
| <b>Non-Accretable Discount Activity</b> |           |                               |           |                |           |  |           |                |
| <b>Balance at beginning of period</b>   | <b>\$</b> | 563,294                       | <b>\$</b> | 733,126        | <b>\$</b> | 579,587                                | <b>\$</b> | 741,872        |
| Principal losses                        |           | (6,251)                       |           | (11,738)       |           | (17,827)                               |           | (20,484)       |
| Transfer to accretable yield            |           | (2,319)                       |           | (7,747)        |           | (7,036)                                |           | (7,747)        |
| <b>Balance at end of period</b>         | <b>\$</b> | <b>554,724</b>                | <b>\$</b> | <b>713,641</b> | <b>\$</b> | <b>554,724</b>                         | <b>\$</b> | <b>713,641</b> |

22

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Covered Loans*

The carrying amount of covered loans at June 30, 2014 and December 31, 2013 is as follows:

|   | June 30,       |                | December 31, |                |
|---|----------------|----------------|--------------|----------------|
|   | 2014           |                | 2013         |                |
|   | (In thousands) |                |              |                |
| Contractual required payments receivable          | \$             | 607,144        | \$           | 702,126        |
| Less: Non-accretable discount                     |                | 85,224         |              | 129,477        |
| Cash expected to be collected                     |                | 521,920        |              | 572,649        |
| Less: Accretable yield                            |                | 128,061        |              | 162,959        |
| Carrying amount, gross                            |                | 393,859        |              | 409,690        |
| Less: Allowance for covered loan and lease losses |                | 59,515         |              | 52,729         |
| <b>Carrying amount, net</b>                       | <b>\$</b>      | <b>334,344</b> | <b>\$</b>    | <b>356,961</b> |

The following tables describe the accretable yield and non-accretable discount activity of covered loans for the quarters and six-month periods ended June 30, 2014 and 2013:

|   | Quarter Ended June 30, |                |           |                | Six-Month Period Ended June 30, |                |           |                |
|---|------------------------|----------------|-----------|----------------|---------------------------------|----------------|-----------|----------------|
|   | 2014                   |                | 2013      |                | 2014                            |                | 2013      |                |
|   | (In thousands)         |                |           |                |                                 |                |           |                |
| <b>Accretable yield activity</b>        |                        |                |           |                |                                 |                |           |                |
| Balance at beginning of period          | \$                     | 147,767        | \$        | 174,107        | \$                              | 162,959        | \$        | 188,008        |
| Accretion                               |                        | (24,880)       |           | (23,999)       |                                 | (48,268)       |           | (44,228)       |
| Transfer from non-accretable discount   |                        | 5,174          |           | 17,024         |                                 | 13,370         |           | 23,352         |
| <b>Balance at end of period</b>         | <b>\$</b>              | <b>128,061</b> | <b>\$</b> | <b>167,132</b> | <b>\$</b>                       | <b>128,061</b> | <b>\$</b> | <b>167,132</b> |
|   |                        |                |           |                |                                 |                |           |                |
|   | Quarter Ended June 30, |                |           |                | Six-Month Period Ended June 30, |                |           |                |
|   | 2013                   |                | 2012      |                | 2014                            |                | 2013      |                |
|   | (In thousands)         |                |           |                |                                 |                |           |                |
| <b>Non-accretable discount activity</b> |                        |                |           |                |                                 |                |           |                |
| Balance at beginning of period          | \$                     | 107,323        | \$        | 214,236        | \$                              | 129,477        | \$        | 237,555        |

Edgar Filing: OFG BANCORP - Form 10-Q

|                                 |           |               |           |                |           |               |           |                |           |                |          |
|---------------------------------|-----------|---------------|-----------|----------------|-----------|---------------|-----------|----------------|-----------|----------------|----------|
| Principal losses                |           | (16,925)      |           |                | (4,953)   |               |           | (30,883)       |           |                | (21,944) |
| Transfer to accretable yield    |           | (5,174)       |           |                | (17,024)  |               |           | (13,370)       |           |                | (23,352) |
| <b>Balance at end of period</b> | <b>\$</b> | <b>85,224</b> | <b>\$</b> | <b>192,259</b> | <b>\$</b> | <b>85,224</b> | <b>\$</b> | <b>192,259</b> | <b>\$</b> | <b>192,259</b> |          |

23

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Non-accrual Loans*

The following table presents the recorded investment in loans in non-accrual status by class of loans as of June 30, 2014 and December 31, 2013:

|  | June 30,       |               | December 31, |               |
|--|----------------|---------------|--------------|---------------|
|  | 2014           |               | 2013         |               |
|  | (In thousands) |               |              |               |
| <b>Originated and other loans and leases held for investment</b> |                |               |              |               |
| <b>Mortgage</b>  |                |               |              |               |
| Traditional (by origination year):                               |                |               |              |               |
| Up to the year 2002  | \$             | 3,194         | \$           | 3,428         |
| Years 2003 and 2004  |                | 2,945         |              | 1,845         |
| Year 2005  |                | 6,905         |              | 4,922         |
| Year 2006  |                | 5,278         |              | 4,418         |
| Years 2007, 2008 and 2009  |                | 5,860         |              | 4,511         |
| Years 2010, 2011, 2012, 2013 and 2014                            |                | 9,379         |              | 7,818         |
|  |                | 33,561        |              | 26,942        |
| Non-traditional  |                | 2,655         |              | 2,311         |
| Loss mitigation program  |                | 16,084        |              | 18,792        |
|  |                | 52,300        |              | 48,045        |
| Home equity secured personal loans                               |                | 138           |              | 138           |
|  |                | <b>52,438</b> |              | <b>48,183</b> |
| <b>Commercial</b>  |                |               |              |               |
| Commercial secured by real estate                                |                |               |              |               |
| Middle market  |                | 10,345        |              | 11,895        |
| Retail   |                | 9,823         |              | 7,208         |
|  |                | 20,168        |              | 19,103        |
| Other commercial and industrial                                  |                |               |              |               |
| Middle market  |                | 760           |              | 1,134         |
| Retail   |                | 2,578         |              | 2,485         |
| Floor plan   |                | -             |              | 108           |
|  |                | 3,338         |              | 3,727         |
|  |                | <b>23,506</b> |              | <b>22,830</b> |
| <b>Consumer</b>  |                |               |              |               |
| Credit cards   |                | 271           |              | 232           |
| Overdrafts   |                | 1             |              | -             |

Edgar Filing: OFG BANCORP - Form 10-Q

|                                |    |               |  |    |               |
|--------------------------------|----|---------------|--|----|---------------|
| Personal lines of credit       |    | 139           |  |    | 84            |
| Personal loans                 |    | 985           |  |    | 485           |
| Cash collateral personal loans |    | 58            |  |    | 4             |
|                                |    | <b>1,454</b>  |  |    | <b>805</b>    |
| <b>Auto and leasing</b>        |    | <b>7,300</b>  |  |    | <b>5,089</b>  |
|                                | \$ | <b>84,698</b> |  | \$ | <b>76,907</b> |

24

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | June 30,       |               | December 31, |               |
|--|----------------|---------------|--------------|---------------|
|  | 2014           |               | 2013         |               |
|  | (In thousands) |               |              |               |
| <b>Acquired loans accounted under ASC 310-20</b> |                |               |              |               |
| <b>Commercial</b>                                |                |               |              |               |
| Commercial secured by real estate                |                |               |              |               |
| Retail   | \$             | 545           | \$           | 956           |
| Floor plan                                       |                | 101           |              | 101           |
|  |                | 646           |              | 1,057         |
| Other commercial and industrial                  |                |               |              |               |
| Corporate  |                | 94            |              | 97            |
| Retail   |                | 588           |              | 1,371         |
| Floor plan                                       |                | 120           |              | 18            |
|  |                | 802           |              | 1,486         |
|  |                | <b>1,448</b>  |              | <b>2,543</b>  |
| <b>Consumer</b>                                  |                |               |              |               |
| Credit cards                                     |                | 1,318         |              | 2,068         |
| Personal loans                                   |                | 34            |              | 151           |
|  |                | <b>1,352</b>  |              | <b>2,219</b>  |
| <b>Auto</b>                                      |                | <b>1,680</b>  |              | <b>1,608</b>  |
|  |                | <b>4,480</b>  |              | <b>6,370</b>  |
| <b>Total non-accrual loans</b>                   | \$             | <b>89,178</b> | \$           | <b>83,277</b> |

Loans accounted for under ASC 310-30 are excluded from the above table as they are considered to be performing due to the application of the accretion method, in which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analyses.

Effective April 24, 2013, delinquent residential mortgage loans insured or guaranteed under applicable FHA and VA programs are placed in non-accrual when they become 18 months or more past due, since they are insured loans. Before that date, they were placed in non-accrual when they became 90 days or more past due.

At June 30, 2014 and December 31, 2013, loans whose terms have been extended and which are classified as troubled-debt restructurings that are not included in non-accrual loans amounted to \$75.4 million and \$66.5 million, respectively, as they are performing under their new terms.





## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 5 – ALLOWANCE FOR LOAN AND LEASE LOSSES

The composition of the Company's allowance for loan and lease losses at June 30, 2014 and December 31, 2013 was as follows:

|   | June 30,       |                | December 31, |                |
|---|----------------|----------------|--------------|----------------|
|   | 2014           |                | 2013         |                |
|   | (In thousands) |                |              |                |
| <b>Allowance for loans and lease losses on non-covered loans:</b>   |                |                |              |                |
| <b>Originated and other loans and leases held for investment:</b>   |                |                |              |                |
| Mortgage  | \$             | 19,062         | \$           | 19,937         |
| Commercial  |                | 12,423         |              | 14,897         |
| Consumer  |                | 7,887          |              | 6,006          |
| Auto and leasing  |                | 11,127         |              | 7,866          |
| Unallocated   |                | 139            |              | 375            |
|   |                | <b>50,638</b>  |              | <b>49,081</b>  |
| <b>Acquired loans:</b>  |                |                |              |                |
| <b>Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b>                   |                |                |              |                |
| Commercial  |                | 464            |              | 926            |
| Consumer  |                | 338            |              | -              |
| Auto  |                | 2,642          |              | 1,428          |
|   |                | <b>3,444</b>   |              | <b>2,354</b>   |
| <b>Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)</b> |                |                |              |                |
| Commercial  |                | 6,216          |              | 1,713          |
| Consumer  |                | 62             |              | 418            |
| Auto  |                | -              |              | 732            |
|   |                | <b>6,278</b>   |              | <b>2,863</b>   |
|   |                | <b>60,360</b>  |              | <b>54,298</b>  |
| <b>Allowance for loans and lease losses on covered loans:</b>   |                |                |              |                |
| Loans secured by 1-4 family residential properties  |                | 14,924         |              | 12,495         |
| Commercial and other construction   |                | 43,976         |              | 39,619         |
| Consumer  |                | 615            |              | 615            |
|   |                | <b>59,515</b>  |              | <b>52,729</b>  |
| <b>Total allowance for loan and lease losses</b>  | \$             | <b>119,875</b> | \$           | <b>107,027</b> |

*Non-Covered Loans*

The Company maintains an allowance for loan and lease losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Company's allowance for loan and lease losses policy provides for a detailed quarterly analysis of probable losses. The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors. While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond the Company's control. We also maintain an allowance for loan losses on acquired loans when: (i) for loans accounted for under ASC 310-30, there is deterioration in credit quality subsequent to acquisition, and (ii) for loans accounted for under ASC 310-20, the inherent losses in the loans exceed the remaining credit discount recorded at the time of acquisition. As part of the Company's continuous enhancement to the allowance for loan and lease losses methodology, during the quarter ended March 31, 2014, an assessment of the look-back period and historical loss factor was performed for auto and leasing and consumer loan portfolios based on the trends observed and their relation with the economic cycle as of the period ended March 31, 2014. Same analysis was performed for the commercial portfolio during the quarter ended June 30, 2014. As a result, the period was changed to 24 months from the previously determined 12 months for auto and leasing and consumer. For the commercial portfolio, a look back period of 12 months was maintained. In addition, during the quarter ended June 30, 2014, an assessment of environmental factors was performed for commercial, auto, and consumer portfolios. As a result, more weight is been given to the environmental factors related to the economy, taking into consideration current evolution of the portfolio and expected impact, due to recent economic developments. These changes in the allowance for loan and lease losses' look back period for the consumer and auto and leasing portfolios, and

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

economic factors for the commercial, auto, and consumer portfolios are considered a change in accounting estimate as per ASC 250-10 provisions, where adjustments should be made prospectively.

Originated and Other Loans and Leases Held for Investment

The following tables present the activity in our allowance for loan and lease losses and the related recorded investment of the associated loans for our originated and other loans held for investment portfolio by segment for the periods indicated:

|  | Quarter Ended June 30, 2014          |               |    |               |    |              |          |               |    |                  |    |               |  |       |
|--|--------------------------------------|---------------|----|---------------|----|--------------|----------|---------------|----|------------------|----|---------------|--|-------|
|  | Mortgage                             |               |    | Commercial    |    |              | Consumer |               |    | Auto and Leasing |    | Unallocated   |  | Total |
|  | (In thousands)                       |               |    |               |    |              |          |               |    |                  |    |               |  |       |
| <b>Allowance for loan and lease losses for non-covered originated and other loans:</b> |                                      |               |    |               |    |              |          |               |    |                  |    |               |  |       |
| <b>Balance at beginning of period</b>  | \$                                   | 19,511        | \$ | 13,994        | \$ | 7,135        | \$       | 8,731         | \$ | 136              | \$ | 49,507        |  |       |
| Charge-offs  |                                      | (987)         |    | (543)         |    | (1,397)      |          | (5,956)       |    | -                |    | (8,883)       |  |       |
| Recoveries   |                                      | 88            |    | 115           |    | 244          |          | 2,136         |    | -                |    | 2,583         |  |       |
| Provision (recapture) for non-covered originated and other loan and lease losses       |                                      | 450           |    | (1,143)       |    | 1,905        |          | 6,216         |    | 3                |    | 7,431         |  |       |
| <b>Balance at end of period</b>  | \$                                   | <b>19,062</b> | \$ | <b>12,423</b> | \$ | <b>7,887</b> | \$       | <b>11,127</b> | \$ | <b>139</b>       | \$ | <b>50,638</b> |  |       |
|  |                                      |               |    |               |    |              |          |               |    |                  |    |               |  |       |
|  |                                      |               |    |               |    |              |          |               |    |                  |    |               |  |       |
|  | Six-Month Period Ended June 30, 2014 |               |    |               |    |              |          |               |    |                  |    |               |  |       |
|  | Mortgage                             |               |    | Commercial    |    |              | Consumer |               |    | Auto and Leasing |    | Unallocated   |  | Total |
|  | (In thousands)                       |               |    |               |    |              |          |               |    |                  |    |               |  |       |
|  |                                      |               |    |               |    |              |          |               |    |                  |    |               |  |       |

|  |    |               |    |               |    |              |    |               |    |            |    |               |  |
|--|----|---------------|----|---------------|----|--------------|----|---------------|----|------------|----|---------------|--|
| <b>Allowance for loan and lease losses for non-covered originated and other loans:</b> |    |               |    |               |    |              |    |               |    |            |    |               |  |
| <b>Balance at beginning of period</b>  | \$ | 19,937        | \$ | 14,897        | \$ | 6,006        | \$ | 7,866         | \$ | 375        | \$ | 49,081        |  |
| Charge-offs  |    | (2,201)       |    | (962)         |    | (2,235)      |    | (10,601)      |    | -          |    | (15,999)      |  |
| Recoveries   |    | 236           |    | 213           |    | 391          |    | 3,660         |    | -          |    | 4,500         |  |
| Provision (recapture) for non-covered originated and other loan and lease losses       |    | 1,090         |    | (1,725)       |    | 3,725        |    | 10,202        |    | (236)      |    | 13,056        |  |
| <b>Balance at end of period</b>  | \$ | <b>19,062</b> | \$ | <b>12,423</b> | \$ | <b>7,887</b> | \$ | <b>11,127</b> | \$ | <b>139</b> | \$ | <b>50,638</b> |  |

|   | <b>June 30, 2014</b>  |               |                   |               |                 |              |                         |               |                    |            |              |               |
|---|-----------------------|---------------|-------------------|---------------|-----------------|--------------|-------------------------|---------------|--------------------|------------|--------------|---------------|
|   | <b>Mortgage</b>       |               | <b>Commercial</b> |               | <b>Consumer</b> |              | <b>Auto and Leasing</b> |               | <b>Unallocated</b> |            | <b>Total</b> |               |
|   | <b>(In thousands)</b> |               |                   |               |                 |              |                         |               |                    |            |              |               |
| <b>Allowance for loan and lease losses on non-covered originated and other loans:</b> |                       |               |                   |               |                 |              |                         |               |                    |            |              |               |
| Ending allowance balance attributable to loans:                                       |                       |               |                   |               |                 |              |                         |               |                    |            |              |               |
| Individually evaluated for impairment   | \$                    | 7,730         | \$                | 2,114         | \$              | -            | \$                      | -             | \$                 | -          | \$           | 9,844         |
| Collectively evaluated for impairment   |                       | 11,332        |                   | 10,309        |                 | 7,887        |                         | 11,127        |                    | 139        |              | 40,794        |
| <b>Total ending allowance balance</b>   | \$                    | <b>19,062</b> | \$                | <b>12,423</b> | \$              | <b>7,887</b> | \$                      | <b>11,127</b> | \$                 | <b>139</b> | \$           | <b>50,638</b> |
| <b>Loans:</b>   |                       |               |                   |               |                 |              |                         |               |                    |            |              |               |
| Individually evaluated for impairment   | \$                    | 90,375        | \$                | 28,910        | \$              | -            | \$                      | -             | \$                 | -          | \$           | 119,285       |
| Collectively evaluated for impairment   |                       | 697,626       |                   | 1,154,262     |                 | 161,538      |                         | 508,034       |                    | -          |              | 2,521,460     |

|                                      |                   |                     |                   |                   |             |                     |
|--------------------------------------|-------------------|---------------------|-------------------|-------------------|-------------|---------------------|
| <b>Total<br/>ending loan balance</b> | <b>\$ 788,001</b> | <b>\$ 1,183,172</b> | <b>\$ 161,538</b> | <b>\$ 508,034</b> | <b>\$ -</b> | <b>\$ 2,640,745</b> |
|--------------------------------------|-------------------|---------------------|-------------------|-------------------|-------------|---------------------|

27



|                                 |    |               |    |               |    |              |    |              |    |            |    |               |  |  |
|---------------------------------|----|---------------|----|---------------|----|--------------|----|--------------|----|------------|----|---------------|--|--|
| losses                          |    |               |    |               |    |              |    |              |    |            |    |               |  |  |
| <b>Balance at end of period</b> | \$ | <b>21,375</b> | \$ | <b>17,623</b> | \$ | <b>2,342</b> | \$ | <b>3,641</b> | \$ | <b>720</b> | \$ | <b>45,701</b> |  |  |

|  | December 31, 2013 |                |            |                  |          |                |                  |                |             |            |       |                  |    |           |
|--|-------------------|----------------|------------|------------------|----------|----------------|------------------|----------------|-------------|------------|-------|------------------|----|-----------|
|  | Mortgage          |                | Commercial |                  | Consumer |                | Auto and Leasing |                | Unallocated |            | Total |                  |    |           |
|  | (In thousands)    |                |            |                  |          |                |                  |                |             |            |       |                  |    |           |
| <b>Allowance for loan and lease losses for non-covered originated and other loans:</b> |                   |                |            |                  |          |                |                  |                |             |            |       |                  |    |           |
| Ending allowance balance attributable to loans:  |                   |                |            |                  |          |                |                  |                |             |            |       |                  |    |           |
| Individually evaluated for impairment  | \$                | 8,708          | \$         | 1,431            | \$       | -              | \$               | -              | \$          | -          | \$    | -                | \$ | 10,139    |
| Collectively evaluated for impairment  |                   | 11,229         |            | 13,466           |          | 6,006          |                  | 7,866          |             | 375        |       |                  |    | 38,942    |
| <b>Total ending allowance balance</b>  | \$                | <b>19,937</b>  | \$         | <b>14,897</b>    | \$       | <b>6,006</b>   | \$               | <b>7,866</b>   | \$          | <b>375</b> | \$    | <b>49,081</b>    |    |           |
| <b>Loans:</b>  |                   |                |            |                  |          |                |                  |                |             |            |       |                  |    |           |
| Individually evaluated for impairment  | \$                | 84,494         | \$         | 28,145           | \$       | -              | \$               | -              | \$          | -          | \$    | -                | \$ | 112,639   |
| Collectively evaluated for impairment  |                   | 681,771        |            | 1,099,512        |          | 127,744        |                  | 379,874        |             | -          |       |                  |    | 2,288,901 |
| <b>Total ending loans balance</b>  | \$                | <b>766,265</b> | \$         | <b>1,127,657</b> | \$       | <b>127,744</b> | \$               | <b>379,874</b> | \$          | <b>-</b>   | \$    | <b>2,401,540</b> |    |           |



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Acquired Loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)

The following tables present the activity in our allowance for loan losses and related recorded investment of the associated loans in our non-covered acquired loan portfolio, excluding loans accounted for under ASC 310-30, for the periods indicated:

|   | Quarter Ended June 30, 2014          |            |          |            |      |              |             |          |       |              |
|---|--------------------------------------|------------|----------|------------|------|--------------|-------------|----------|-------|--------------|
|   | Commercial                           |            | Consumer |            | Auto |              | Unallocated |          | Total |              |
|   | (In thousands)                       |            |          |            |      |              |             |          |       |              |
| <b>Allowance for loan and lease losses</b>  |                                      |            |          |            |      |              |             |          |       |              |
| <b>for non-covered acquired loans</b>   |                                      |            |          |            |      |              |             |          |       |              |
| <b>accounted for under ASC 310-20:</b>  |                                      |            |          |            |      |              |             |          |       |              |
| <b>Balance at beginning of period</b>   | \$                                   | 867        | \$       | 504        | \$   | 2,247        | \$          | -        | \$    | 3,618        |
| Charge-offs   |                                      | (110)      |          | (1,952)    |      | (1,370)      |             | -        |       | (3,432)      |
| Recoveries  |                                      | 30         |          | 124        |      | 535          |             | -        |       | 689          |
| Provision (recapture) for non-covered acquired loan and lease losses accounted for under ASC 310-20 |                                      | (323)      |          | 1,662      |      | 1,230        |             | -        |       | 2,569        |
| <b>Balance at end of period</b>   | \$                                   | <b>464</b> | \$       | <b>338</b> | \$   | <b>2,642</b> | \$          | <b>-</b> | \$    | <b>3,444</b> |
|   |                                      |            |          |            |      |              |             |          |       |              |
|   |                                      |            |          |            |      |              |             |          |       |              |
|   |                                      |            |          |            |      |              |             |          |       |              |
|   | Six-Month Period Ended June 30, 2014 |            |          |            |      |              |             |          |       |              |
|   | Commercial                           |            | Consumer |            | Auto |              | Unallocated |          | Total |              |
|   | (In thousands)                       |            |          |            |      |              |             |          |       |              |
| <b>Allowance for loan and lease losses</b>  |                                      |            |          |            |      |              |             |          |       |              |



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|   | Quarter Ended June 30, 2013          |      |          |         |      |         |             |   |       |         |
|---|--------------------------------------|------|----------|---------|------|---------|-------------|---|-------|---------|
|   | Commercial                           |      | Consumer |         | Auto |         | Unallocated |   | Total |         |
|   | (In thousands)                       |      |          |         |      |         |             |   |       |         |
| Allowance for loan and lease losses for non-covered acquired loans accounted for under ASC 310-20:  |                                      |      |          |         |      |         |             |   |       |         |
| Balance at beginning of period  | \$                                   | 386  | \$       | -       | \$   | -       | \$          | - | \$    | 386     |
| Charge-offs   |                                      | (25) |          | (1,158) |      | (1,410) |             | - |       | (2,593) |
| Recoveries  |                                      | -    |          | 637     |      | 886     |             | - |       | 1,523   |
| Provision (recapture) for non-covered acquired loan and lease losses accounted for under ASC 310-20 |                                      | 563  |          | 521     |      | 524     |             | - |       | 1,608   |
| Balance at end of period  | \$                                   | 924  | \$       | -       | \$   | -       | \$          | - | \$    | 924     |
|   |                                      |      |          |         |      |         |             |   |       |         |
|   |                                      |      |          |         |      |         |             |   |       |         |
|   |                                      |      |          |         |      |         |             |   |       |         |
|   | Six-Month Period Ended June 30, 2013 |      |          |         |      |         |             |   |       |         |
|   | Commercial                           |      | Consumer |         | Auto |         | Unallocated |   | Total |         |
|   | (In thousands)                       |      |          |         |      |         |             |   |       |         |
| Allowance for loan and lease losses for non-covered acquired loans accounted for under ASC 310-20:  |                                      |      |          |         |      |         |             |   |       |         |
| Balance at beginning of period  | \$                                   | -    | \$       | -       | \$   | -       | \$          | - | \$    | -       |
| Charge-offs   |                                      | (25) |          | (2,614) |      | (3,125) |             | - |       | (5,764) |

Edgar Filing: OFG BANCORP - Form 10-Q

|   |    |            |    |          |    |          |    |          |    |            |
|---|----|------------|----|----------|----|----------|----|----------|----|------------|
| Recoveries  |    | -          |    | 844      |    | 2,116    |    | -        |    | 2,960      |
| Provision (recapture) for non-covered acquired loan and lease losses accounted for under ASC 310-20 |    |            |    |          |    |          |    | -        |    |            |
|   |    | 949        |    | 1,770    |    | 1,009    |    |          |    | 3,728      |
| <b>Balance at end of period</b>   | \$ | <b>924</b> | \$ | <b>-</b> | \$ | <b>-</b> | \$ | <b>-</b> | \$ | <b>924</b> |

30

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | December 31, 2013 |               |           |               |           |                |           |          |           |                |   |  |         |
|--|-------------------|---------------|-----------|---------------|-----------|----------------|-----------|----------|-----------|----------------|---|--|---------|
|  | Commercial        |               |           | Consumer      |           |                | Auto      |          |           | Unallocated    |   |  | Total   |
|  | (In thousands)    |               |           |               |           |                |           |          |           |                |   |  |         |
| <b>Allowance for loan and lease losses on non-covered acquired loans accounted for under ASC 310-20:</b> |                   |               |           |               |           |                |           |          |           |                |   |  |         |
| Ending allowance balance attributable to loans:  |                   |               |           |               |           |                |           |          |           |                |   |  |         |
| Collectively evaluated for impairment  |                   | 926           |           |               | -         |                |           | 1428     |           |                | - |  | 2,354   |
| <b>Total ending allowance balance</b>  | <b>\$</b>         | <b>926</b>    | <b>\$</b> | <b>-</b>      | <b>\$</b> | <b>1,428</b>   | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>2,354</b>   |   |  |         |
| <b>Loans:</b>  |                   |               |           |               |           |                |           |          |           |                |   |  |         |
| Collectively evaluated for impairment  |                   | 77,681        |           |               | 56,174    |                |           | 301,584  |           |                | - |  | 435,439 |
| <b>Total ending loan balance</b>   | <b>\$</b>         | <b>77,681</b> | <b>\$</b> | <b>56,174</b> | <b>\$</b> | <b>301,584</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>435,439</b> |   |  |         |

Acquired Loans Accounted for under ASC 310-30 (including those accounted for under ASC 310-30 by analogy)

The following tables present the activity in our allowance for loan losses and related recorded investment of the associated loans in our non-covered acquired loan portfolio accounted for under ASC 310-30, for the periods indicated:

|  | Quarter Ended June 30, 2014 |   |    |            |    |   |              |     |    |          |    |   |      |       |  |
|--|-----------------------------|---|----|------------|----|---|--------------|-----|----|----------|----|---|------|-------|--|
|  | Mortgage                    |   |    | Commercial |    |   | Construction |     |    | Consumer |    |   | Auto |       |  |
|  | (In thousands)              |   |    |            |    |   |              |     |    |          |    |   |      |       |  |
| <b>Allowance for loan and lease losses for non-covered loans accounted for under ASC 310-30:</b> |                             |   |    |            |    |   |              |     |    |          |    |   |      |       |  |
| Balance at beginning of period   | \$                          | - | \$ | 2,653      | \$ | - | \$           | 405 | \$ | -        | \$ | - | \$   | 3,058 |  |



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Impaired Loans*

The Company evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. The total investment in impaired commercial loans was \$29.1 million and \$28.4 million at June 30, 2014 and December 31, 2013, respectively. The impaired commercial loans were measured based on the fair value of collateral or the present value of cash flows, including those identified as troubled-debt restructurings. The valuation allowance for impaired commercial loans amounted to \$2.1 million and \$1.4 million at June 30, 2014 and December 31, 2013, respectively. The total investment in impaired mortgage loans was \$90.4 million and \$84.5 million at June 30, 2014 and December 31, 2013, respectively. Impairment on mortgage loans assessed as troubled-debt restructurings was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$7.7 million and \$8.7 million at June 30, 2014 and December 31, 2013, respectively.

The Company's recorded investment in non-covered commercial and mortgage loans categorized as originated and other loans and leases held for investment that were individually evaluated for impairment and the related allowance for loan and lease losses at June 30, 2014 and December 31, 2013 are as follows:

|  | June 30, 2014  |                |            |                |           |              |          |           |
|--|----------------|----------------|------------|----------------|-----------|--------------|----------|-----------|
|  | Unpaid         |                | Recorded   |                | Related   |              |          |           |
|  | Principal      |                | Investment |                | Allowance |              | Coverage |           |
|  | (In thousands) |                |            |                |           |              |          |           |
| Impaired loans with specific allowance:    |                |                |            |                |           |              |          |           |
| Commercial                                 | \$             | 4,580          | \$         | 4,459          | \$        | 2,114        |          | 47%       |
| Residential troubled-debt restructuring    |                | 95,652         |            | 90,375         |           | 7,730        |          | 9%        |
| Impaired loans with no specific allowance: |                |                |            |                |           |              |          |           |
| Commercial                                 |                | 31,599         |            | 24,451         |           | N/A          |          | N/A       |
| <b>Total investment in impaired loans</b>  | <b>\$</b>      | <b>131,831</b> | <b>\$</b>  | <b>119,285</b> | <b>\$</b> | <b>9,844</b> |          | <b>8%</b> |

|  | December 31, 2013 |  |            |  |           |  |          |  |
|--|-------------------|--|------------|--|-----------|--|----------|--|
|  | Unpaid            |  | Recorded   |  | Related   |  |          |  |
|  | Principal         |  | Investment |  | Allowance |  | Coverage |  |
|  | (In thousands)    |  |            |  |           |  |          |  |
| Impaired loans with specific allowance |                   |  |            |  |           |  |          |  |

Edgar Filing: OFG BANCORP - Form 10-Q

|   |           |                |           |                |           |               |           |
|---|-----------|----------------|-----------|----------------|-----------|---------------|-----------|
| Commercial                                | \$        | 6,600          | \$        | 5,553          | \$        | 1,431         | 26%       |
| Residential troubled-debt restructuring   |           | 89,539         |           | 84,494         |           | 8,708         | 10%       |
| Impaired loans with no specific allowance |           |                |           |                |           |               |           |
| Commercial                                |           | 27,914         |           | 22,592         |           | N/A           | N/A       |
| <b>Total investment in impaired loans</b> | <b>\$</b> | <b>124,053</b> | <b>\$</b> | <b>112,639</b> | <b>\$</b> | <b>10,139</b> | <b>9%</b> |

32



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company's recorded investment in non-covered commercial loans categorized as non-covered acquired loans accounted for under ASC 310-20 that were individually evaluated for impairment and the related allowance for loan and lease losses at June 30, 2014 and December 31, 2013 are as follows:

| June 30, 2014                             |           |            |            |            |           |     |          |           |
|---|-----------|------------|------------|------------|-----------|-----|----------|-----------|
|   | Unpaid    |            | Recorded   |            | Related   |     |          |           |
|   | Principal |            | Investment |            | Allowance |     | Coverage |           |
| (In thousands)                            |           |            |            |            |           |     |          |           |
| Impaired loans with no specific allowance |           |            |            |            |           |     |          |           |
| Commercial                                |           | 208        |            | 208        |           | N/A |          | N/A       |
| <b>Total investment in impaired loans</b> | \$        | <b>208</b> | \$         | <b>208</b> | \$        | -   |          | <b>0%</b> |
|   |           |            |            |            |           |     |          |           |
| December 31, 2013                         |           |            |            |            |           |     |          |           |
|   | Unpaid    |            | Recorded   |            | Specific  |     |          |           |
|   | Principal |            | Investment |            | Allowance |     | Coverage |           |
| (In thousands)                            |           |            |            |            |           |     |          |           |
| Impaired loans with no specific allowance |           |            |            |            |           |     |          |           |
| Commercial                                |           | 208        |            | 208        |           | N/A |          | N/A       |
| <b>Total investment in impaired loans</b> | \$        | <b>208</b> | \$         | <b>208</b> | \$        | -   |          | <b>0%</b> |

The Company's recorded investment in non-covered acquired loan pools accounted for under ASC 310-30 and their related allowance for non-covered loan and lease losses at June 30, 2014 and December 31, 2013 are as follows:

| June 30, 2014                    |           |         |            |         |           |       |          |    |
|----------------------------------|-----------|---------|------------|---------|-----------|-------|----------|----|
|                                  | Unpaid    |         | Recorded   |         | Allowance |       |          |    |
|                                  | Principal |         | Investment |         | Allowance |       | Coverage |    |
| (In thousands)                   |           |         |            |         |           |       |          |    |
| Impaired non-covered loan pools: |           |         |            |         |           |       |          |    |
| Mortgage                         | \$        | 4,793   | \$         | 4,277   | \$        | 57    |          | 1% |
| Commercial                       |           | 231,428 |            | 208,544 |           | 2,867 |          | 1% |

Edgar Filing: OFG BANCORP - Form 10-Q

|  |           |                |           |                |           |              |  |           |
|--|-----------|----------------|-----------|----------------|-----------|--------------|--|-----------|
| Construction   |           | 45,912         |           | 40,550         |           | 3,330        |  | 8%        |
| Consumer   |           | 51,145         |           | 43,824         |           | 24           |  | 0%        |
| <b>Total investment in impaired non-covered loan pools</b> | <b>\$</b> | <b>333,278</b> | <b>\$</b> | <b>297,195</b> | <b>\$</b> | <b>6,278</b> |  | <b>2%</b> |

|  | December 31, 2013 |                |            |                |           |              |          |           |
|--|-------------------|----------------|------------|----------------|-----------|--------------|----------|-----------|
|  | Unpaid            |                | Recorded   |                | Allowance |              | Coverage |           |
|  | Principal         |                | Investment |                |           |              |          |           |
|  | (In thousands)    |                |            |                |           |              |          |           |
| Impaired non-covered loan pools:                           |                   |                |            |                |           |              |          |           |
| Mortgage   | \$                | 5,183          | \$         | 4,718          | \$        | 57           |          | 1%        |
| Commercial   |                   | 48,100         |            | 40,411         |           | 394          |          | 1%        |
| Construction   |                   | 21,526         |            | 17,818         |           | 1,319        |          | 7%        |
| Consumer   |                   | 73,043         |            | 63,606         |           | 361          |          | 1%        |
| Auto   |                   | 379,236        |            | 377,316        |           | 732          |          | 0%        |
| <b>Total investment in impaired non-covered loan pools</b> | <b>\$</b>         | <b>527,088</b> | <b>\$</b>  | <b>503,869</b> | <b>\$</b> | <b>2,863</b> |          | <b>1%</b> |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the interest recognized in non-covered commercial and mortgage loans that were individually evaluated for impairment, excluding loans accounted for under ASC 310-30, for the quarters and six-month periods ended June 30, 2014 and 2013:

|  | Quarter Ended June 30,          |       |                             |    |         |                            |       |                             |    |         |
|--|---------------------------------|-------|-----------------------------|----|---------|----------------------------|-------|-----------------------------|----|---------|
|  | 2014                            |       |                             |    |         | 2013                       |       |                             |    |         |
|  | Interest Income Recognized      |       | Average Recorded Investment |    |         | Interest Income Recognized |       | Average Recorded Investment |    |         |
| (In thousands)                                   |                                 |       |                             |    |         |                            |       |                             |    |         |
| Impaired loans with specific allowance           |                                 |       |                             |    |         |                            |       |                             |    |         |
| Commercial                                       | \$                              | 39    |                             | \$ | 7,200   | \$                         | 255   |                             | \$ | 17,049  |
| Residential troubled-debt restructuring          |                                 | 663   |                             |    | 90,445  |                            | 682   |                             |    | 83,081  |
| Impaired loans with no specific allowance        |                                 |       |                             |    |         |                            |       |                             |    |         |
| Commercial                                       |                                 | 77    |                             |    | 21,951  |                            | 226   |                             |    | 23,304  |
| <b>Total interest income from impaired loans</b> | \$                              | 779   |                             | \$ | 119,596 | \$                         | 1,163 |                             | \$ | 123,434 |
|  |                                 |       |                             |    |         |                            |       |                             |    |         |
|  |                                 |       |                             |    |         |                            |       |                             |    |         |
|  | Six-Month Period Ended June 30, |       |                             |    |         |                            |       |                             |    |         |
|  | 2014                            |       |                             |    |         | 2013                       |       |                             |    |         |
|  | Interest Income Recognized      |       | Average Recorded Investment |    |         | Interest Income Recognized |       | Average Recorded Investment |    |         |
| (In thousands)                                   |                                 |       |                             |    |         |                            |       |                             |    |         |
| Impaired loans with specific allowance           |                                 |       |                             |    |         |                            |       |                             |    |         |
| Commercial                                       | \$                              | 78    |                             | \$ | 6,729   | \$                         | 322   |                             | \$ | 17,789  |
| Residential troubled-debt restructuring          |                                 | 1,270 |                             |    | 88,749  |                            | 1,273 |                             |    | 80,914  |
| Impaired loans with no specific allowance        |                                 |       |                             |    |         |                            |       |                             |    |         |
| Commercial                                       |                                 | 154   |                             |    | 21,790  |                            | 364   |                             |    | 25,304  |
| <b>Total interest income from impaired loans</b> | \$                              | 1,502 |                             | \$ | 117,268 | \$                         | 1,959 |                             | \$ | 124,007 |



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Modifications*

The following tables present the troubled-debt restructurings during the quarters and six-month periods ended June 30, 2014 and 2013:

| Quarter Ended June 30, 2014          |                     |  |  |  |   |   |   |  |
|--------------------------------------|---------------------|--|--|--|---|---|---|--|
|                                      | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |  |
| (Dollars in thousands)               |                     |  |  |  |   |   |   |  |
| Mortgage                             | 33                  | \$ 5,001   | 6%                                     | 353  | \$ 4,965  | 4.12%                                   |   |  |
| Commercial                           | 1                   | 73   | 7%                                     | 55   | 73  | 9.25%                                   |   |  |
| Consumer                             | 3                   | 24   | 14%                                    | 77   | 24  | 13.98%                                  |   |  |
|                                      |                     |  |  |  |   |   |   |  |
|                                      |                     |  |  |  |   |   |   |  |
| Six-Month Period Ended June 30, 2014 |                     |  |  |  |   |   |   |  |
|                                      | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |  |
| (Dollars in thousands)               |                     |  |  |  |   |   |   |  |
| Mortgage                             | 88                  | \$ 11,813  | 6%                                     | 349  | \$ 11,446   | 4.26%                                   |   |  |
| Commercial                           | 1                   | 73   | 7%                                     | 55   | 73  | 9.25%                                   |   |  |
| Consumer                             | 8                   | 66   | 13%                                    | 70   | 68  | 13.31%                                  |   |  |
|                                      |                     |  |  |  |   |   |   |  |
|                                      |                     |  |  |  |   |   |   |  |
| Quarter Ended June 30, 2013          |                     |  |  |  |   |   |   |  |
|                                      | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |  |
| (Dollars in thousands)               |                     |  |  |  |   |   |   |  |
| Mortgage                             | 42                  | \$ 5,372   | 6%                                     | 355  | \$ 5,715  | 4.26%                                   |   |  |
| Commercial                           | 2                   | 1,842  | 9%                                     | 87   | 1,842   | 4.00%                                   |   |  |
| Consumer                             | 2                   | 18   | 14%                                    | 41   | 18  | 13.67%                                  |   |  |
|                                      |                     |  |  |  |   |   |   |  |
|                                      |                     |  |  |  |   |   |   |  |

| Six-Month Period Ended June 30, 2013 |                     |  |  |  |   |   |  |  |  |
|--------------------------------------|---------------------|--|--|--|---|---|--|--|--|
|                                      | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term Months |  |  |
| (Dollars in thousands)               |                     |  |  |  |   |   |  |  |  |
| Mortgage                             | 86                  | \$ 10,555  | 7%                                     | 342  | \$ 11,288   | 4.59%                                   |  |  |  |
| Commercial                           | 2                   | 1,842  | 9%                                     | 87   | 1,842   | 4.00%                                   |  |  |  |
| Consumer                             | 2                   | 18   | 14%                                    | 41   | 18  | 13.67%                                  |  |  |  |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents troubled-debt restructurings for which there was a payment default during the twelve-month periods ended June 30, 2014 and 2013:

|          | Twelve-Month Period Ended June 30, |  |                        |       |                        |    |                        |    |       |
|----------|------------------------------------|--|------------------------|-------|------------------------|----|------------------------|----|-------|
|          | 2014                               |  |                        |       | 2013                   |    |                        |    |       |
|          | Number of<br>Contracts             |  | Recorded<br>Investment |       | Number of<br>Contracts |    | Recorded<br>Investment |    |       |
|          | (Dollars in thousands)             |  |                        |       |                        |    |                        |    |       |
| Mortgage | 22                                 |  | \$                     | 2,703 |                        | 48 |                        | \$ | 6,414 |
| Consumer | 5                                  |  | \$                     | 101   |                        | 2  |                        | \$ | 29    |

*Credit Quality Indicators*

The Company categorizes non-covered originated and other loans and acquired loans accounted for under ASC 310-20 into risk categories based on relevant information about the ability of borrowers to service their debt, such as economic conditions, portfolio risk characteristics, prior loss experience, and the results of periodic credit reviews of individual loans.

The Company uses the following definitions for risk ratings:

**Pass:** Loans classified as “pass” have a well defined primary source of repayment very likely to be sufficient, with no apparent risk, strong financial position, minimal operating risk, profitability, liquidity and capitalization better than industry standards.

**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 or of the institution’s credit position 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, questionable and improbable.

**Loss:** Loans classified as “loss” are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this worthless loan even though partial recovery may be effected in the future.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As of June 30, 2014 and December 31, 2013, and based on the most recent analysis performed, the risk category of gross non-covered originated and other loans and acquired loans accounted for under ASC 310-20 subject to risk rating by class of loans is as follows:

|  | June 30, 2014  |  |           |  |  |         |             |          |  |  |  |              |
|--|----------------|--|-----------|--|--|---------|-------------|----------|--|--|--|--------------|
|  | Risk Ratings   |  |           |  |  |         |             |          |  |  |  |              |
|  | Balance        |  |           |  |  | Special |             |          |  |  |  | Individually |
|  | Outstanding    |  | Pass      |  |  | Mention | Substandard | Doubtful |  |  |  | Measured for |
|  | (In thousands) |  |           |  |  |         |             |          |  |  |  |              |
| <b>Commercial - originated and other loans held for investment</b> |                |  |           |  |  |         |             |          |  |  |  |              |
| Commercial secured by real estate:                                 |                |  |           |  |  |         |             |          |  |  |  |              |
| Corporate  | \$ 90,886      |  | \$ 90,886 |  |  | \$ -    | \$ -        | \$ -     |  |  |  | \$ -         |
| Institutional  | 30,701         |  | 20,581    |  |  | 10,120  | -           | -        |  |  |  | -            |
| Middle market  | 141,225        |  | 121,532   |  |  | 6,726   | -           | -        |  |  |  | 12,967       |
| Retail   | 157,188        |  | 142,415   |  |  | 1,382   | 2,233       | -        |  |  |  | 11,158       |
| Floor plan   | 1,680          |  | 1,579     |  |  | 101     | -           | -        |  |  |  | -            |
| Real estate  | 11,878         |  | 11,878    |  |  | -       | -           | -        |  |  |  | -            |
|  | 433,558        |  | 388,871   |  |  | 18,329  | 2,233       | -        |  |  |  | 24,125       |
| Other commercial and industrial:                                   |                |  |           |  |  |         |             |          |  |  |  |              |
| Corporate  | 61,329         |  | 61,329    |  |  | -       | -           | -        |  |  |  | -            |
| Institutional  | 487,725        |  | 287,734   |  |  | 199,991 | -           | -        |  |  |  | -            |
| Middle market  | 80,794         |  | 73,967    |  |  | 3,428   | 389         | -        |  |  |  | 3,010        |
| Retail   | 77,756         |  | 73,753    |  |  | 259     | 1,969       | -        |  |  |  | 1,775        |
| Floor plan   | 42,010         |  | 40,910    |  |  | 299     | 801         | -        |  |  |  | -            |
|  | 749,614        |  | 537,693   |  |  | 203,977 | 3,159       | -        |  |  |  | 4,785        |
| Total  | 1,183,172      |  | 926,564   |  |  | 222,306 | 5,392       | -        |  |  |  | 28,910       |
| <b>Commercial - acquired loans (under ASC 310-20)</b>              |                |  |           |  |  |         |             |          |  |  |  |              |

Edgar Filing: OFG BANCORP - Form 10-Q

|                                    |           |                  |           |                |           |                |           |              |           |          |           |               |  |   |
|------------------------------------|-----------|------------------|-----------|----------------|-----------|----------------|-----------|--------------|-----------|----------|-----------|---------------|--|---|
| Commercial secured by real estate: |           |                  |           |                |           |                |           |              |           |          |           |               |  |   |
| Corporate                          |           | 2,999            |           | 2,999          |           | -              |           | -            |           | -        |           |               |  | - |
| Retail                             |           | 2,557            |           | 2,091          |           | -              |           | 466          |           | -        |           |               |  | - |
| Floor plan                         |           | 3,947            |           | 3,947          |           | -              |           | -            |           | -        |           |               |  | - |
|                                    |           | 9,503            |           | 9,037          |           | -              |           | 466          |           | -        |           |               |  | - |
| Other commercial and industrial:   |           |                  |           |                |           |                |           |              |           |          |           |               |  |   |
| Corporate                          |           | 3,010            |           | 2,916          |           | 94             |           | -            |           | -        |           |               |  | - |
| Retail                             |           | 11,420           |           | 10,871         |           | 100            |           | 449          |           | -        |           |               |  | - |
| Floor plan                         |           | 14,669           |           | 14,669         |           | -              |           | -            |           | -        |           |               |  | - |
|                                    |           | 29,099           |           | 28,456         |           | 194            |           | 449          |           | -        |           |               |  | - |
| Total                              |           | 38,602           |           | 37,493         |           | 194            |           | 915          |           | -        |           |               |  | - |
| <b>Total</b>                       | <b>\$</b> | <b>1,221,774</b> | <b>\$</b> | <b>964,057</b> | <b>\$</b> | <b>222,500</b> | <b>\$</b> | <b>6,307</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>28,910</b> |  |   |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| December 31, 2013  |             |    |           |    |         |             |       |          |   |    |   |    |              |
|--|-------------|----|-----------|----|---------|-------------|-------|----------|---|----|---|----|--------------|
| Risk Ratings   |             |    |           |    |         |             |       |          |   |    |   |    |              |
|  |             |    |           |    |         |             |       |          |   |    |   |    | Individually |
|  | Balance     |    |           |    | Special |             |       |          |   |    |   |    | Measured for |
|  | Outstanding |    | Pass      |    | Mention | Substandard |       | Doubtful |   |    |   |    | Impairment   |
| (In thousands)   |             |    |           |    |         |             |       |          |   |    |   |    |              |
| <b>Commercial - originated and other loans held for investment</b> |             |    |           |    |         |             |       |          |   |    |   |    |              |
| Commercial secured by real estate:                                 |             |    |           |    |         |             |       |          |   |    |   |    |              |
| Corporate  | \$ 54,796   | \$ | 54,796    | \$ | -       | \$          | -     | \$       | - | \$ | - | \$ | -            |
| Institutional  | 4,050       |    | 4,050     |    | -       |             | -     |          | - |    | - |    | -            |
| Middle market  | 161,583     |    | 133,061   |    | 16,627  |             | 118   |          | - |    | - |    | 11,777       |
| Retail   | 166,642     |    | 149,018   |    | 2,182   |             | 2,258 |          | - |    | - |    | 13,184       |
| Floor plan   | 1,835       |    | 1,835     |    | -       |             | -     |          | - |    | - |    | -            |
| Real estate  | 11,655      |    | 11,655    |    | -       |             | -     |          | - |    | - |    | -            |
|  | 400,561     |    | 354,415   |    | 18,809  |             | 2,376 |          | - |    | - |    | 24,961       |
| Other commercial and industrial:                                   |             |    |           |    |         |             |       |          |   |    |   |    |              |
| Corporate  | 32,598      |    | 32,598    |    | -       |             | -     |          | - |    | - |    | -            |
| Institutional  | 536,445     |    | 536,445   |    | -       |             | -     |          | - |    | - |    | -            |
| Middle market  | 58,897      |    | 53,868    |    | 3,466   |             | 198   |          | - |    | - |    | 1,365        |
| Retail   | 61,510      |    | 58,742    |    | 257     |             | 691   |          | - |    | - |    | 1,820        |
| Floor plan   | 37,646      |    | 37,350    |    | 188     |             | 108   |          | - |    | - |    | -            |
|  | 727,096     |    | 719,003   |    | 3,911   |             | 997   |          | - |    | - |    | 3,185        |
| Total  | 1,127,657   |    | 1,073,418 |    | 22,720  |             | 3,373 |          | - |    | - |    | 28,146       |
| <b>Commercial - acquired loans (under ASC 310-20)</b>              |             |    |           |    |         |             |       |          |   |    |   |    |              |
| Commercial secured by real estate:                                 |             |    |           |    |         |             |       |          |   |    |   |    |              |
| Corporate  | 10,166      |    | 10,166    |    | -       |             | -     |          | - |    | - |    | -            |

Edgar Filing: OFG BANCORP - Form 10-Q

|                                     |           |                  |           |                  |           |               |           |              |           |          |           |               |
|-------------------------------------|-----------|------------------|-----------|------------------|-----------|---------------|-----------|--------------|-----------|----------|-----------|---------------|
| Retail                              |           | 5,770            |           | 4,378            |           | 443           |           | 949          |           | -        |           | -             |
| Floor plan                          |           | 2,677            |           | 2,576            |           | -             |           | 101          |           | -        |           | -             |
|                                     |           | 18,613           |           | 17,120           |           | 443           |           | 1,050        |           | -        |           | -             |
| Other commercial<br>and industrial: |           |                  |           |                  |           |               |           |              |           |          |           |               |
| Corporate                           |           | 9,793            |           | 9,696            |           | -             |           | 97           |           | -        |           | -             |
| Retail                              |           | 27,338           |           | 26,044           |           | 150           |           | 1,144        |           | -        |           | -             |
| Floor plan                          |           | 21,937           |           | 21,769           |           | 168           |           | -            |           | -        |           | -             |
|                                     |           | 59,068           |           | 57,509           |           | 318           |           | 1,241        |           | -        |           | -             |
| Total                               |           | 77,681           |           | 74,629           |           | 761           |           | 2,291        |           | -        |           | -             |
| <b>Total</b>                        | <b>\$</b> | <b>1,205,338</b> | <b>\$</b> | <b>1,148,047</b> | <b>\$</b> | <b>23,481</b> | <b>\$</b> | <b>5,664</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>28,146</b> |

38

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

At June 30, 2014 and December 31, 2013, we had approximately \$670.9 million and \$763.4 million, respectively, of credit facilities granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities, of which \$655.4 million and \$696.0, respectively, were outstanding as of such dates. A substantial portion of our credit exposure to the government of Puerto Rico consists of collateralized loans or obligations that have a specific source of income or revenues identified for its repayment. Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services, such as water and electric power utilities. Public corporations have varying degrees of independence from the central government and many have received appropriations or are due other payments from it. We also have loans to various municipalities for which the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment. These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all their general obligation bonds and notes. Another portion of these loans consists of special obligations of various municipalities that are payable from the basic real and personal property taxes collected within such municipalities. The good faith and credit obligations of the municipalities have a first lien on the basic property taxes.

In the second quarter of 2014, the government enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”), which establishes procedures for the adjustment of certain public corporations’ debts. The Recovery Act states in its preamble that it further promotes the central government’s public policy objectives of no longer providing financial support to public corporations and promoting their economic independence. The Recovery Act, which is without precedent and is being challenged in federal court on constitutional grounds, has increased the level of uncertainty as to the rights of the affected public corporation’s creditors. As of June 30, 2014, we had approximately \$382.9 million of credit facilities granted to public corporations authorized to initiate proceedings under the Recovery Act.

Oriental Bank is part of a four bank syndicate providing a \$550 million dollar revolving line of credit to finance the purchase of fuel for the day to day power generation activities of the Puerto Rico Electric Power Authority (“PREPA”), a public corporation authorized to seek relief under the Recovery Act. The Bank’s participation in the line of credit has an unpaid principal balance of \$200.0 million as of June 30, 2014, which matures on August 14, 2014 and is currently accruing. The bank syndicate and PREPA have executed a short term forbearance agreement that expires at the maturity of the line of credit pursuant to which the bank syndicate agreed to not exercise remedies in connection with certain defaults under the loan agreement to facilitate a dialogue with PREPA, which is actively ongoing, regarding the future of the line of credit. As of June 30, 2014, this credit facility has a rating of special mention.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

For residential and consumer loan classes, the Company evaluates credit quality based on the delinquency status of the loan. As of June 30, 2014 and December 31, 2013, and based on the most recent analysis performed, the risk category of non-covered gross originated and other loans and acquired loans accounted for under ASC 310-20 not subject to risk rating by class of loans is as follows:

|  | June 30, 2014  |           |            |            |             |              |           |        |  |                           |
|--|----------------|-----------|------------|------------|-------------|--------------|-----------|--------|--|---------------------------|
|  | Delinquency    |           |            |            |             |              |           |        |  |                           |
|  | Balance        |           |            |            |             |              |           |        |  | Individually Measured for |
|  | Outstanding    | 0-29 days | 30-59 days | 60-89 days | 90-119 days | 120-364 days | 365+ days |        |  | Impairment                |
|  | (In thousands) |           |            |            |             |              |           |        |  |                           |
| <b>Originated and other loans and leases held for investment</b> |                |           |            |            |             |              |           |        |  |                           |
| <b>Mortgage</b>  |                |           |            |            |             |              |           |        |  |                           |
| Traditional<br>(by origination year)                             |                |           |            |            |             |              |           |        |  |                           |
| Up to the year 2002  | \$ 70,373      | \$ 59,428 | \$ 5,181   | \$ 2,498   | \$ 693      | \$ 649       | \$ 1,840  | \$ 84  |  |                           |
| Years 2003 and 2004  | 62,282         | 51,929    | 5,503      | 1,905      | 232         | 1,267        | 1,126     | 320    |  |                           |
| Year 2005  | 85,869         | 69,305    | 6,611      | 2,959      | 775         | 3,029        | 2,806     | 384    |  |                           |
| Year 2006  | 114,386        | 94,669    | 10,562     | 3,781      | 1,561       | 1,813        | 1,808     | 192    |  |                           |
| Years 2007, 2008 and 2009  | 94,343         | 82,470    | 3,962      | 2,051      | 1,130       | 2,186        | 2,143     | 401    |  |                           |
| Years 2010, 2011, 2012   | 195,672        | 173,113   | 1,979      | 1,515      | 246         | 1,843        | 1,344     | 15,632 |  |                           |







## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| December 31, 2013  |             |           |            |            |             |              |           |        |  |                                      |
|--|-------------|-----------|------------|------------|-------------|--------------|-----------|--------|--|--------------------------------------|
| Delinquency  |             |           |            |            |             |              |           |        |  |                                      |
|  | Balance     |           |            |            |             |              |           |        |  | Individually Measured for Impairment |
|  | Outstanding | 0-29 days | 30-59 days | 60-89 days | 90-119 days | 120-364 days | 365+ days |        |  |                                      |
| (In thousands)   |             |           |            |            |             |              |           |        |  |                                      |
| <b>Originated and other loans and leases held for investment</b> |             |           |            |            |             |              |           |        |  |                                      |
| <b>Mortgage</b>  |             |           |            |            |             |              |           |        |  |                                      |
| Traditional<br>(by origination year)                             |             |           |            |            |             |              |           |        |  |                                      |
| Up to the year 2002  | \$ 76,512   | \$ 64,743 | \$ 6,594   | \$ 1,634   | \$ 868      | \$ 1,082     | \$ 1,458  | \$ 133 |  |                                      |
| Years 2003 and 2004  | 65,117      | 56,283    | 4,722      | 1,938      | 56          | 1,437        | 352       |        |  | 329                                  |
| Year 2005  | 89,541      | 74,016    | 8,414      | 2,119      | 1,198       | 3,037        | 573       |        |  | 184                                  |
| Year 2006  | 120,322     | 99,243    | 12,055     | 4,312      | 1,148       | 2,755        | 515       |        |  | 294                                  |
| Years 2007, 2008 and 2009  | 101,150     | 91,920    | 3,464      | 1,104      | 1,264       | 2,844        | 554       |        |  | -                                    |
| Years 2010, 2011, 2012 and 2013                                  | 149,546     | 134,577   | 3,192      | 1,609      | 115         | 974          | 989       |        |  | 8,090                                |
|  | 602,188     | 520,782   | 38,441     | 12,716     | 4,649       | 12,129       | 4,441     |        |  | 9,030                                |
| Non-traditional  | 42,102      | 35,168    | 3,217      | 1,162      | -           | 1,324        | 833       |        |  | 398                                  |
| Loss mitigation program  | 86,318      | 7,762     | 1,376      | 149        | 624         | 312          | 1,029     |        |  | 75,066                               |

## Edgar Filing: OFG BANCORP - Form 10-Q

|  |                     |                     |                  |                  |                  |                  |                  |                  |
|--|---------------------|---------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|  | 730,608             | 563,712             | 43,034           | 14,027           | 5,273            | 13,765           | 6,303            | 84,494           |
| Home equity secured                                    |                     |                     |                  |                  |                  |                  |                  |                  |
| personal loans   | 736                 | 598                 | -                | -                | -                | 126              | 12               | -                |
| GNMA's buy-back  |                     |                     |                  |                  |                  |                  |                  |                  |
| option program   | 34,921              | -                   | -                | -                | 7,670            | 14,425           | 12,826           | -                |
|  | <b>766,265</b>      | <b>564,310</b>      | <b>43,034</b>    | <b>14,027</b>    | <b>12,943</b>    | <b>28,316</b>    | <b>19,141</b>    | <b>84,494</b>    |
| <b>Consumer</b>  |                     |                     |                  |                  |                  |                  |                  |                  |
| Credit cards   | 15,241              | 14,555              | 287              | 168              | 118              | 113              | -                | -                |
| Overdrafts   | 372                 | 322                 | 46               | 4                | -                | -                | -                | -                |
| Unsecured personal lines of credit                     | 1,981               | 1,844               | 33               | 38               | 25               | 34               | 7                | -                |
| Unsecured personal loans                               | 94,560              | 92,102              | 1,272            | 399              | 300              | 39               | 13               | 435              |
| Cash collateral personal loans                         | 15,590              | 15,223              | 324              | 43               | -                | -                | -                | -                |
|  | <b>127,744</b>      | <b>124,046</b>      | <b>1,962</b>     | <b>652</b>       | <b>443</b>       | <b>186</b>       | <b>20</b>        | <b>435</b>       |
| <b>Auto and Leasing</b>                                | <b>379,874</b>      | 339,817             | 25,532           | 9,437            | 3,397            | 1,691            | -                | -                |
|  | <b>1,273,883</b>    | <b>1,028,173</b>    | <b>70,528</b>    | <b>24,116</b>    | <b>16,783</b>    | <b>30,193</b>    | <b>19,161</b>    | <b>84,929</b>    |
| <b>Acquired loans (accounted for under ASC 310-20)</b> |                     |                     |                  |                  |                  |                  |                  |                  |
| <b>Consumer</b>  |                     |                     |                  |                  |                  |                  |                  |                  |
| Credit cards   | 52,199              | 46,713              | 2,217            | 1,200            | 828              | 1,241            | -                | -                |
| Personal loans   | 3,975               | 3,681               | 196              | 7                | 60               | 31               | -                | -                |
|  | <b>56,174</b>       | <b>50,394</b>       | <b>2,413</b>     | <b>1,207</b>     | <b>888</b>       | <b>1,272</b>     | -                | -                |
| <b>Auto</b>  | <b>301,584</b>      | 283,825             | 12,534           | 3,616            | 1,095            | 514              | -                | -                |
|  | <b>357,758</b>      | <b>334,219</b>      | <b>14,947</b>    | <b>4,823</b>     | <b>1,983</b>     | <b>1,786</b>     | -                | -                |
| <b>Total</b>   | <b>\$ 1,631,641</b> | <b>\$ 1,362,392</b> | <b>\$ 85,475</b> | <b>\$ 28,939</b> | <b>\$ 18,766</b> | <b>\$ 31,979</b> | <b>\$ 19,161</b> | <b>\$ 84,929</b> |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Covered Loans*

For covered loans, as part of the evaluation of actual versus expected cash flows, the Company assesses on a quarterly basis the credit quality of these loans based on delinquency, severity factors and risk ratings, among other assumptions. Migration and credit quality trends are assessed at the pool level, by comparing information from the latest evaluation period through the end of the reporting period.

The changes in the allowance for loan and lease losses on covered loans for the quarters and six-month periods ended June 30, 2014 and 2013 were as follows:

|  | Quarter Ended June 30, |               |           |               | Six-Month Period Ended June 30, |               |           |               |
|--|------------------------|---------------|-----------|---------------|---------------------------------|---------------|-----------|---------------|
|  | 2014                   |               | 2013      |               | 2014                            |               | 2013      |               |
|  | (In thousands)         |               |           |               |                                 |               |           |               |
| <b>Balance at beginning of the period</b>                | \$                     | 54,398        | \$        | 52,974        | \$                              | 52,729        | \$        | 54,124        |
| Provision for covered loan and lease losses, net         |                        | 1,595         |           | 1,211         |                                 | 3,224         |           | 1,883         |
| FDIC shared-loss portion of provision for (recapture of) |                        |               |           |               |                                 |               |           |               |
| covered loan and lease losses, net                       |                        | 3,522         |           | (192)         |                                 | 3,562         |           | (2,014)       |
| <b>Balance at end of the period</b>                      | <b>\$</b>              | <b>59,515</b> | <b>\$</b> | <b>53,993</b> | <b>\$</b>                       | <b>59,515</b> | <b>\$</b> | <b>53,993</b> |

FDIC shared-loss portion of provision for (recapture of) covered loans and lease losses net, represents the credit impairment losses to be covered under the FDIC loss-share agreement which is increasing (decreasing) the FDIC loss-share indemnification asset.

Net provision for covered loans includes both additional reserves and reserve releases for different pools. The pools for which there were releases are also subject to a reduction to the FDIC shared-loss indemnification asset because of lower expected losses which are recognized as recaptures.

The Company's recorded investment in covered loan pools that have recorded impairments and their related allowance for covered loan and lease losses as of June 30, 2014 and December 31, 2013 are as follows:

|   | June 30, 2014  |                |            |                |           |               |          |            |
|---|----------------|----------------|------------|----------------|-----------|---------------|----------|------------|
|   | Unpaid         |                | Recorded   |                | Allowance |               | Coverage |            |
|   | Principal      |                | Investment |                |           |               |          |            |
|   | (In thousands) |                |            |                |           |               |          |            |
| Impaired covered loan pools:  |                |                |            |                |           |               |          |            |
| Loans secured by 1-4 family residential properties                        | \$             | 141,951        | \$         | 108,884        | \$        | 14,923        |          | 14%        |
| Construction and development secured by 1-4 family residential properties |                | 63,615         |            | 18,566         |           | 7,799         |          | 42%        |
| Commercial and other construction   |                | 124,506        |            | 77,980         |           | 36,178        |          | 46%        |
| Consumer  |                | 9,184          |            | 4,912          |           | 615           |          | 13%        |
| <b>Total investment in impaired covered loan pools</b>                    | <b>\$</b>      | <b>339,256</b> | <b>\$</b>  | <b>210,342</b> | <b>\$</b> | <b>59,515</b> |          | <b>28%</b> |

|   | December 31, 2013 |                |            |                |           |               |          |            |
|---|-------------------|----------------|------------|----------------|-----------|---------------|----------|------------|
|   | Unpaid            |                | Recorded   |                | Specific  |               | Coverage |            |
|   | Principal         |                | Investment |                | Allowance |               |          |            |
|   | (In thousands)    |                |            |                |           |               |          |            |
| Impaired covered loan pools with specific allowance                       |                   |                |            |                |           |               |          |            |
| Loans secured by 1-4 family residential properties                        | \$                | 52,142         | \$         | 38,179         | \$        | 12,495        |          | 33%        |
| Construction and development secured by 1-4 family residential properties |                   | 66,037         |            | 17,304         |           | 6,866         |          | 40%        |
| Commercial and other construction   |                   | 209,566        |            | 111,946        |           | 32,753        |          | 29%        |
| Consumer  |                   | 10,512         |            | 5,857          |           | 615           |          | 11%        |
| <b>Total investment in impaired covered loan pools</b>                    | <b>\$</b>         | <b>338,257</b> | <b>\$</b>  | <b>173,286</b> | <b>\$</b> | <b>52,729</b> |          | <b>30%</b> |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 6- FDIC INDEMNIFICATION ASSET AND TRUE-UP PAYMENT OBLIGATION

In connection with the FDIC assisted acquisition, the Bank and the FDIC entered into shared-loss agreements pursuant which the FDIC covers a substantial portion of any losses on loans (and related unfunded loan commitments), foreclosed real estate and other repossessed properties covered by the agreements.

The acquired loans, foreclosed real estate, and other repossessed properties subject to the shared-loss agreements are collectively referred to as “covered assets.” Under the terms of the shared-loss agreements, the FDIC absorbs 80% of losses and shares in 80% of loss recoveries on covered assets. The term of the shared-loss agreement covering single family residential mortgage loans is ten years with respect to losses and loss recoveries, while the term of the shared-loss agreement covering commercial loans is five years with respect to losses and eight years with respect to loss recoveries, from the April 30, 2010 acquisition date. The shared-loss agreements also provide for certain costs directly related to the collection and preservation of covered assets to be reimbursed at an 80% level. The FDIC indemnification asset represents the portion of estimated losses covered by the shared-loss agreements between the Bank and the FDIC.

The following table presents the activity in the FDIC indemnification asset and true-up payment obligation for the quarters ended June 30, 2014 and 2013:

|   | Quarter ended June 30, |                |      |                | Six-Month Period Ended June 30, |                |      |                |
|---|------------------------|----------------|------|----------------|---------------------------------|----------------|------|----------------|
|   | 2014                   |                | 2013 |                | 2014                            |                | 2013 |                |
| (In thousands)  |                        |                |      |                |                                 |                |      |                |
| <b>FDIC indemnification asset:</b>  |                        |                |      |                |                                 |                |      |                |
| <b>Balance at beginning of period</b>   | \$                     | 166,194        | \$   | 283,124        | \$                              | 189,240        | \$   | 302,295        |
| Shared-loss agreements reimbursements from the FDIC   |                        | (10,464)       |      | (12,046)       |                                 | (18,700)       |      | (18,696)       |
| Increase (decrease) in expected credit losses to be covered under shared-loss agreements, net |                        | 3,522          |      | (193)          |                                 | 3,562          |      | (2,015)        |
| FDIC shared-loss expense  |                        | (17,499)       |      | (19,225)       |                                 | (35,121)       |      | (31,425)       |
| Incurring expenses to be reimbursed under shared-loss agreements                              |                        | 1,907          |      | 1,719          |                                 | 4,679          |      | 3,220          |
| <b>Balance at end of period</b>   | \$                     | <b>143,660</b> | \$   | <b>253,379</b> | \$                              | <b>143,660</b> | \$   | <b>253,379</b> |

|                                       |    |               |    |               |  |    |               |    |               |
|---------------------------------------|----|---------------|----|---------------|--|----|---------------|----|---------------|
|                                       |    |               |    |               |  |    |               |    |               |
| <b>True-up payment obligation:</b>    |    |               |    |               |  |    |               |    |               |
| <b>Balance at beginning of period</b> | \$ | 19,375        | \$ | 16,167        |  | \$ | 18,510        | \$ | 15,496        |
| FDIC shared-loss expense              |    | 856           |    | 740           |  |    | 1,721         |    | 1,411         |
| <b>Balance at end of period</b>       | \$ | <b>20,231</b> | \$ | <b>16,907</b> |  | \$ | <b>20,231</b> | \$ | <b>16,907</b> |

The FDIC shared-loss expense increased as the Company continues to forecast better performance and cash flows from covered loans than previously expected resulting in a minor increase in the amortization of the FDIC indemnification asset.

The FDIC shared-loss expense of \$18.4 million and \$36.8 million for the quarter and six-month period ended June 30, 2014 compared to \$20.0 million and \$32.8 million for the same periods in 2013. These changes were caused by the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced projected losses expected to be collected from the FDIC and the improved accretable yield on the covered loans. Forecasted losses show a decreasing trend during the six-month period ended June 30, 2014 as compared to the projections in 2013. The reduction in claimable losses amortizes the FDIC indemnification asset through the shorter of the life of the shared loss agreement or the loan holding period. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value. During the quarter and six-month period ended June 30, 2014, the net amortization included \$1.6 million and \$5.1 million of additional amortization of the FDIC indemnification asset from stepped up cost recoveries on certain construction, commercial, and leasing loan pools. Additional amortization of the FDIC indemnification asset may be recorded, should the Company continue to experience reduced expected losses. The majority of the FDIC indemnification asset, \$98.9 million, is recorded for projected claimable losses on non-single family residential loans whose loss share period ends in the second quarter of 2015, although the period during which recoveries are shared extends for an additional three-years.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Also in connection with the FDIC assisted acquisition, the Bank agreed to make a true-up payment, also known as clawback liability or clawback provision, to the FDIC on the date that is 45 days following the last day (such day, the “True-Up Measurement Date”) of the final shared-loss month, or upon the final disposition of all covered assets under the shared-loss agreements in the event losses thereunder fail to reach expected levels. Under the shared-loss agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of \$906.0 million (or \$181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or \$227.5 million); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the shared-loss agreements during which the shared-loss provisions of the applicable shared-loss agreement is in effect (defined as the product of the simple average of the principal amount of shared-loss loans and shared-loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of \$20.2 million and \$18.5 million, net of discount, as of June 30, 2014 and December 31, 2013, respectively. The estimated liability is included within other liabilities in the unaudited consolidated statements of financial condition.

## NOTE 7 — DERIVATIVE ACTIVITIES

During the quarter and six-month period ended June 30, 2014, losses of \$247 thousand and \$470 thousand, respectively, were recognized and reflected as “Derivative Activities” in the unaudited consolidated statements of operations. During the quarter and six-month period ended June 30, 2013, losses of \$164 thousand and \$934 thousand, respectively, were recognized.

The following table presents the Company’s derivative assets and liabilities at June 30, 2014 and December 31, 2013:

|  | June 30,       |              | December 31, |               |
|--|----------------|--------------|--------------|---------------|
|  | 2014           |              | 2013         |               |
|  | (In thousands) |              |              |               |
| <b>Derivative assets:</b>                          |                |              |              |               |
| Options tied to S&P 500 Index                      | \$             | 6,580        | \$           | 16,430        |
| Interest rate swaps designated as cash flow hedges |                | -            |              | 850           |
| Interest rate swaps not designated as hedges       |                | 2,728        |              | 2,861         |
| Interest rate caps                                 |                | 249          |              | 319           |
| Other  |                | 1            |              | 42            |
|  | \$             | <b>9,558</b> | \$           | <b>20,502</b> |

|  |    |               |  |    |               |
|--|----|---------------|--|----|---------------|
| <b>Derivative liabilities:</b>                     |    |               |  |    |               |
| Interest rate swaps designated as cash flow hedges |    | 10,515        |  |    | 11,757        |
| Interest rate swaps not designated as hedges       |    | 2,728         |  |    | 2,861         |
| Interest rate caps                                 |    | 249           |  |    | 319           |
| Other  |    | 125           |  |    | -             |
|  | \$ | <b>13,617</b> |  | \$ | <b>14,937</b> |

### *Interest Rate Swaps*

The Company enters into interest rate swap contracts to hedge the variability of future interest cash flows of forecasted wholesale borrowings attributable to changes in a predetermined variable index rate. The interest rate swaps effectively fix the Company's interest payments on an amount of forecasted interest expense attributable to the variable index rate corresponding to the swap notional stated rate. These swaps are designated as cash flow hedges for the forecasted wholesale borrowing transactions, are properly documented as such, and therefore, qualify for cash flow hedge accounting. Any gain or loss associated with the effective portion of our cash flow hedges was recognized in other comprehensive income and is subsequently reclassified into earnings in the period during which the hedged forecasted transactions affect earnings. Changes in the fair value of these derivatives are recorded in accumulated other comprehensive income to the extent there is no significant ineffectiveness in the cash flow hedging relationships. Currently, the Company does not expect to reclassify any amount included in other comprehensive income related to these interest rate swaps to earnings in the next twelve months.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table shows a summary of these swaps and their terms at June 30, 2014:

| Type                | Notional<br>Amount | Fixed<br>Rate | Variable<br>Rate Index | Trade<br>Date | Settlement<br>Date | Maturity<br>Date |
|---------------------|--------------------|---------------|------------------------|---------------|--------------------|------------------|
| (In thousands)      |                    |               |                        |               |                    |                  |
| Interest Rate Swaps | \$ 25,000          | 2.4365%       | 1-Month LIBOR          | 05/05/11      | 05/04/12           | 05/04/16         |
|                     | 25,000             | 2.6200%       | 1-Month LIBOR          | 05/05/11      | 07/24/12           | 07/24/16         |
|                     | 25,000             | 2.6350%       | 1-Month LIBOR          | 05/05/11      | 07/30/12           | 07/30/16         |
|                     | 50,000             | 2.6590%       | 1-Month LIBOR          | 05/05/11      | 08/10/12           | 08/10/16         |
|                     | 100,000            | 2.6750%       | 1-Month LIBOR          | 05/05/11      | 08/16/12           | 08/16/16         |
|                     | 39,961             | 2.4210%       | 1-Month LIBOR          | 07/03/13      | 07/03/13           | 08/01/23         |
|                     | \$ 264,961         |               |                        |               |                    |                  |

An unrealized loss of \$10.5 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at June 30, 2014, and the related asset and liability are being reflected in the accompanying unaudited consolidated statements of financial condition.

At June 30, 2014 and December 31, 2013, interest rate swaps not designated as hedging instruments that were offered to clients represented an asset of \$2.7 million and \$2.9 million, respectively, and were included as part of derivative assets in the unaudited consolidated statements of financial position. The credit risk to these clients stemming from these derivatives, if any, is not material. At June 30, 2014 and December 31, 2013, interest rate swaps not designated as hedging instruments that are the mirror-images of the derivatives offered to clients represented a liability of \$2.7 million and \$2.9 million, respectively, and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition.

The following table shows a summary of these interest rate swaps not designated as hedging instruments and their terms at June 30, 2014:

| Type   | Notional<br>Amount | Fixed<br>Rate | Variable<br>Rate Index | Settlement<br>Date | Maturity<br>Date |
|--|--------------------|---------------|------------------------|--------------------|------------------|
| (In thousands)                                       |                    |               |                        |                    |                  |
| Interest Rate Swaps - Derivatives Offered to Clients | \$ 4,049           | 5.1300%       | 1-Month LIBOR          | 07/03/06           | 07/03/16         |

Edgar Filing: OFG BANCORP - Form 10-Q

|   |    |               |         |               |          |          |
|---|----|---------------|---------|---------------|----------|----------|
|   |    | 12,500        | 5.5050% | 1-Month LIBOR | 04/11/09 | 04/11/19 |
|   | \$ | <b>16,549</b> |         |               |          |          |
|   |    |               |         |               |          |          |
| <b>Interest Rate Swaps -<br/>Mirror Image<br/>Derivatives</b> | \$ | 4,049         | 5.1300% | 1-Month LIBOR | 07/03/06 | 07/03/16 |
|   |    | 12,500        | 5.5050% | 1-Month LIBOR | 04/11/09 | 04/11/19 |
|   | \$ | <b>16,549</b> |         |               |          |          |

45

**OFG BANCORP****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)*****Options Tied to Standard & Poor's 500 Stock Market Index***

The Company has offered its customers certificates of deposit with an option tied to the performance of the S&P 500 Index. The Company uses option agreements with major broker-dealers to manage its exposure to changes in this index. Under the terms of the option agreements, the Company receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. At June 30, 2014 and December 31, 2013, the purchased options used to manage exposure to the S&P 500 Index on stock indexed deposits represented an asset of \$6.6 million (notional amount of \$14.0 million) and \$16.4 million (notional amount of \$28.0 million), respectively, and the options sold to customers embedded in the certificates of deposit and recorded as deposits in the unaudited consolidated statements of financial condition, represented a liability of \$6.4 million (notional amount of \$13.4 million) and \$15.7 million (notional amount of \$26.9 million), respectively.

***Interest rate caps***

The Company has entered into interest rate cap transactions with various clients with floating-rate debt who wish to protect their financial results against increases in interest rates. In these cases, the Company simultaneously enters into mirror-image interest rate cap transactions with financial counterparties. None of these cap transactions qualify for hedge accounting, and therefore, they are marked to market through earnings. The outstanding total notional amount of interest rate caps was \$110.0 million at both June 30, 2014 and December 31, 2013. At June 30, 2014 and December 31, 2013, the interest rate caps sold to clients represented a liability of \$249 thousand and \$319 thousand, respectively, and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition. At June 30, 2014 and December 31, 2013, the interest rate caps purchased as mirror-images represented an asset of \$249 thousand and \$319 thousand, respectively, and were included as part of derivative assets in the unaudited consolidated statements of financial condition.

**NOTE 8 — ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS**

Accrued interest receivable at June 30, 2014 and December 31, 2013 consists of the following:

|  | <b>June 30,</b>       |  | <b>December 31,</b> |
|--|-----------------------|--|---------------------|
|  | <b>2014</b>           |  | <b>2013</b>         |
|  | <b>(In thousands)</b> |  |                     |

Edgar Filing: OFG BANCORP - Form 10-Q

|                   |    |               |    |               |
|-------------------|----|---------------|----|---------------|
| Non-covered loans | \$ | 18,098        | \$ | 13,378        |
| Investments       |    | 4,410         |    | 5,356         |
|                   | \$ | <b>22,508</b> | \$ | <b>18,734</b> |

Other assets at June 30, 2014 and December 31, 2013 consist of the following:

|  |    | <b>June 30,</b> |    | <b>December 31,</b> |
|--|----|-----------------|----|---------------------|
|  |    | <b>2014</b>     |    | <b>2013</b>         |
| <b>(In thousands)</b>                              |    |                 |    |                     |
| Prepaid expenses                                   | \$ | 17,423          | \$ | 15,439              |
| Core deposit and customer relationship intangibles |    | 10,829          |    | 11,912              |
| Other repossessed assets                           |    | 16,875          |    | 12,583              |
| Mortgage tax credits                               |    | 2,621           |    | 8,706               |
| Investment in Statutory Trust                      |    | 1,083           |    | 1,083               |
| Accounts receivable and other assets               |    | 41,165          |    | 48,717              |
|  | \$ | <b>89,996</b>   | \$ | <b>98,440</b>       |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Prepaid expenses amounting to \$19.6 million and \$15.4 million at June 30, 2014 and December 31, 2013, respectively, include prepaid municipal, property and income taxes aggregating to \$14.2 million and \$9.6 million, respectively.

In connection with the FDIC-assisted acquisition and the BBVAPR Acquisition, the Company recorded a core deposit intangible representing the value of checking and savings deposits acquired. At June 30, 2014 and December 31, 2013, this core deposit intangible amounted to \$7.1 million and \$7.8 million, respectively. In addition, the Company recorded a customer relationship intangible amounting to \$5.0 million representing the value of customer relationships acquired with the acquisition of the securities broker-dealer and insurance agency in the BBVAPR Acquisition as of December 31, 2012. At June 30, 2014 and December 31, 2013, this customer relationship intangible amounted to \$3.7 million and \$4.1 million, respectively.

Other repossessed assets totaled \$16.9 million and \$12.6 million at June 30, 2014 and December 31, 2013, respectively, include repossessed automobiles amounting to \$16.8 million and \$12.3 million, respectively.

At June 30, 2014 and December 31, 2013, tax credits for the Company totaled \$2.6 million and \$8.7 million, respectively. These tax credits do not have an expiration date.

## NOTE 9 — DEPOSITS AND RELATED INTEREST

Total deposits as of June 30, 2014 and December 31, 2013 consist of the following:

|  | June 30,       |                  | December 31, |                  |
|--|----------------|------------------|--------------|------------------|
|  | 2014           |                  | 2013         |                  |
|  | (In thousands) |                  |              |                  |
| Non-interest bearing demand deposits         | \$             | 731,294          | \$           | 744,327          |
| Interest-bearing savings and demand deposits |                | 2,540,229        |              | 2,489,971        |
| Individual retirement accounts               |                | 323,127          |              | 347,262          |
| Retail certificates of deposit               |                | 519,150          |              | 598,367          |
| Institutional certificates of deposit        |                | 308,958          |              | 375,224          |
| <b>Total core deposits</b>                   |                | <b>4,422,758</b> |              | <b>4,555,151</b> |
| Brokered deposits                            |                | 718,475          |              | 828,114          |

|                       |    |                  |    |                  |
|-----------------------|----|------------------|----|------------------|
| <b>Total deposits</b> | \$ | <b>5,141,233</b> | \$ | <b>5,383,265</b> |
|-----------------------|----|------------------|----|------------------|

Brokered deposits include \$627.9 million in certificates of deposits and \$90.6 million in money market accounts at June 30, 2014, and \$729.8 million in certificates of deposits and \$98.3 million in money market accounts at December 31, 2013.

The weighted average interest rate of the Company's deposits was 0.70% at June 30, 2014 and 0.73% at December 31, 2013, inclusive of non-interest bearing deposits of \$731.3 million and \$744.3 million, respectively. Interest expense for the quarters and six-month periods ended June 30, 2014 and 2013 was as follows:

|                             | Quarter Ended June 30, |              |      |              | Six-Month Period Ended June 30, |               |      |               |
|-----------------------------|------------------------|--------------|------|--------------|---------------------------------|---------------|------|---------------|
|                             | 2014                   |              | 2013 |              | 2014                            |               | 2013 |               |
| (In thousands)              |                        |              |      |              |                                 |               |      |               |
| Demand and savings deposits | \$                     | 4,804        | \$   | 5,435        | \$                              | 9,832         | \$   | 11,398        |
| Certificates of deposit     |                        | 4,361        |      | 4,052        |                                 | 8,311         |      | 8,025         |
|                             | \$                     | <b>9,165</b> | \$   | <b>9,487</b> | \$                              | <b>18,143</b> | \$   | <b>19,423</b> |

**OFG BANCORP****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

At June 30, 2014 and December 31, 2013, demand and interest-bearing deposits and certificates of deposit included deposits of Puerto Rico Cash & Money Market Fund, Inc., which amounted to \$101.8 million and \$93.1 million, respectively, with a weighted average rate of 0.77% in both years, and were collateralized with investment securities with a fair value of \$81.8 million and \$67.5 million, respectively.

At June 30, 2014 and December 31, 2013, time deposits in denominations of \$100 thousand or higher, excluding accrued interest and unamortized discounts, amounted to \$719.2 million and \$845.8 million, including public fund time deposits from various Puerto Rico government municipalities, agencies, and corporations of \$22.1 million and \$26.7 million, respectively, at a weighted average rate of 0.53% at June 30, 2014 and 0.32% at December 31, 2013.

At June 30, 2014 and December 31, 2013, total public fund deposits from various Puerto Rico government municipalities, agencies, and corporations amounted to \$362.8 million and \$328.6 million, respectively. These public funds were collateralized with commercial loans amounting to \$454.5 million at June 30, 2014, and with investment securities with a fair value of \$97.8 million and commercial loans amounting to \$549.0 million at December 31, 2013.

Excluding equity indexed options in the amount of \$5.2 million, which are used by the Company to manage its exposure to the S&P 500 Index, and also excluding accrued interest of \$2.1 million and unamortized deposit discount in the amount of \$2.5 million, the scheduled maturities of certificates of deposit at June 30, 2014 are as follows:

|                              | <b>June 30, 2014</b>  |                  |
|------------------------------|-----------------------|------------------|
|                              | <b>(In thousands)</b> |                  |
| Within one year:             |                       |                  |
| Three (3) months or less     | \$                    | 372,809          |
| Over 3 months through 1 year |                       | 701,493          |
|                              |                       | 1,074,302        |
| Over 1 through 2 years       |                       | 421,047          |
| Over 2 through 3 years       |                       | 200,607          |
| Over 3 through 4 years       |                       | 56,095           |
| Over 4 through 5 years       |                       | 17,202           |
|                              | <b>\$</b>             | <b>1,769,253</b> |

The table of scheduled maturities of certificates of deposits above includes brokered deposits.

The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans amounted to \$861 thousand and \$1.8 million as of June 30, 2014 and December 31, 2013, respectively.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 10 — BORROWINGS

*Securities Sold under Agreements to Repurchase*

At June 30, 2014, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to the Company the same or similar securities at the maturity of these agreements.

At June 30, 2014 and December 31, 2013, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of \$2.2 million and \$2.6 million, respectively, were as follows:

|                                    | June 30,            |           |                                     |           | December 31,     |           |                                     |  |
|------------------------------------|---------------------|-----------|-------------------------------------|-----------|------------------|-----------|-------------------------------------|--|
|                                    | 2014                |           |                                     |           | 2013             |           |                                     |  |
|                                    | Borrowing           |           | Fair Value of Underlying Collateral |           | Borrowing        |           | Fair Value of Underlying Collateral |  |
|                                    | Balance             |           |                                     |           | Balance          |           |                                     |  |
| (In thousands)                     |                     |           |                                     |           |                  |           |                                     |  |
| JP Morgan Chase Bank NA            | 255,000             |           | 274,471                             |           | 255,000          |           | 273,250                             |  |
| Credit Suisse Securities (USA) LLC | 755,000             |           | 859,061                             |           | 755,000          |           | 864,232                             |  |
| Deutsche Bank                      | -                   |           | -                                   |           | 255,000          |           | 272,053                             |  |
| <b>Total</b>                       | <b>\$ 1,010,000</b> | <b>\$</b> | <b>1,133,532</b>                    | <b>\$</b> | <b>1,265,000</b> | <b>\$</b> | <b>1,409,535</b>                    |  |

The following table shows a summary of the Company's repurchase agreements and their terms, excluding accrued interest in the amount of \$2.2 million, at June 30, 2014:

|                  | Borrowing | Weighted-Average Coupon | Settlement Date | Maturity Date |
|------------------|-----------|-------------------------|-----------------|---------------|
| Year of Maturity | Balance   |                         |                 |               |
| (In thousands)   |           |                         |                 |               |
| 2014             | \$ 85,000 | 0.675%                  | 12/3/2012       | 12/3/2014     |

Edgar Filing: OFG BANCORP - Form 10-Q

|      |    |                  |              |            |           |
|------|----|------------------|--------------|------------|-----------|
|      |    |                  |              |            |           |
| 2015 |    | 255,000          | 0.840%       | 12/10/2012 | 6/13/2015 |
|      |    |                  |              |            |           |
| 2016 |    | 170,000          | 1.500%       | 12/6/2012  | 12/8/2016 |
|      |    |                  |              |            |           |
| 2017 |    | 500,000          | 4.78%        | 3/2/2007   | 3/2/2017  |
|      | \$ | <b>1,010,000</b> | <b>2.89%</b> |            |           |
|      |    |                  |              |            |           |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the repurchase liability associated with the repurchase agreement transactions (excluding accrued interest) by maturity. Also, it includes the carrying value and approximate market value of collateral (excluding accrued interest) at June 30, 2014 and December 31, 2013. The information excludes repurchase agreement transactions which were collateralized with securities or cash, or securities purchased under agreements to resell.

| June 30, 2014                         |                     |              |                     |                 |                    |                    |              |             |  |                     |
|---------------------------------------|---------------------|--------------|---------------------|-----------------|--------------------|--------------------|--------------|-------------|--|---------------------|
| Market Value of Underlying Collateral |                     |              |                     |                 |                    |                    |              |             |  |                     |
|                                       |                     |              |                     |                 |                    |                    | CMOs         | Obligations |  |                     |
|                                       |                     | Weighted     | FNMA and            |                 |                    |                    | issued by US | of US       |  |                     |
|                                       | Repurchase          | Average      | FHLMC               | GNMA            | Government         | Government         |              |             |  |                     |
|                                       | Liability           | Rate         | Certificates        | Certificates    | Sponsored Agencies | Sponsored Agencies |              |             |  | Total               |
| (Dollars in thousands)                |                     |              |                     |                 |                    |                    |              |             |  |                     |
| Over 90 days                          | 1,010,000           | 2.89%        | 1,062,938           | 2,194           | -                  | 68,400             |              |             |  | 1,133,532           |
| <b>Total</b>                          | <b>\$ 1,010,000</b> | <b>2.89%</b> | <b>\$ 1,062,938</b> | <b>\$ 2,194</b> | <b>\$ -</b>        | <b>\$ 68,400</b>   |              |             |  | <b>\$ 1,133,532</b> |

| December 31, 2013                     |                     |              |                     |                 |                    |                    |              |             |  |                     |
|---------------------------------------|---------------------|--------------|---------------------|-----------------|--------------------|--------------------|--------------|-------------|--|---------------------|
| Market Value of Underlying Collateral |                     |              |                     |                 |                    |                    |              |             |  |                     |
|                                       |                     |              |                     |                 |                    |                    | CMOs         | Obligations |  |                     |
|                                       |                     | Weighted     | FNMA and            |                 |                    |                    | issued by US | of US       |  |                     |
|                                       | Repurchase          | Average      | FHLMC               | GNMA            | Government         | Government         |              |             |  |                     |
|                                       | Liability           | Rate         | Certificates        | Certificates    | Sponsored Agencies | Sponsored Agencies |              |             |  | Total               |
| (Dollars in thousands)                |                     |              |                     |                 |                    |                    |              |             |  |                     |
| Within 30 days                        | \$ 255,000          | 0.50%        | \$ 216,201          | \$ -            | \$ 48,923          | \$ 6,929           |              |             |  | \$ 272,053          |
| Over 90 days                          | 1,010,000           | 2.89%        | 1,018,632           | 3,000           | 45,100             | 3,720              |              |             |  | 1,070,452           |
| <b>Total</b>                          | <b>\$ 1,265,000</b> | <b>2.41%</b> | <b>\$ 1,234,833</b> | <b>\$ 3,000</b> | <b>\$ 94,023</b>   | <b>\$ 10,649</b>   |              |             |  | <b>\$ 1,342,505</b> |

*Advances from the Federal Home Loan Bank of New York*

Advances are received from the Federal Home Loan Bank of New York (the “FHLB-NY”) under an agreement whereby the Company is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At June 30, 2014 and December 31, 2013, these advances were secured by mortgage and commercial loans amounting to \$1.2 billion and \$1.3 billion, respectively. Also, at June 30, 2014 and December 31, 2013 the Company had an additional borrowing capacity with the FHLB-NY of \$629.1 million and \$674.2 million, respectively. At June 30, 2014 and December 31, 2013, the weighted average remaining maturity of FHLB’s advances was 9.4 months and 11.3 months, respectively. The original terms of these advances range between one day and seven years, and the FHLB-NY does not have the right to exercise put options at par on any advances outstanding as of June 30, 2014.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$328 thousand, at June 30, 2014:

|                         |    | <b>Borrowing</b> | <b>Weighted-<br/>Average</b> |                        |                          |
|-------------------------|----|------------------|------------------------------|------------------------|--------------------------|
| <b>Year of Maturity</b> |    | <b>Balance</b>   | <b>Coupon</b>                | <b>Settlement Date</b> | <b>Maturity<br/>Date</b> |
|                         |    | (In thousands)   |                              |                        |                          |
| 2014                    | \$ | 25,000           | 0.42%                        | 6/30/2014              | 7/1/2014                 |
|                         |    | 25,000           | 0.35%                        | 6/4/2014               | 7/7/2014                 |
|                         |    | 50,000           | 0.37%                        | 6/10/2014              | 7/10/2014                |
|                         |    | 100,000          | 0.38%                        | 6/16/2014              | 7/16/2014                |
|                         |    | 25,000           | 0.37%                        | 6/24/2014              | 7/24/2014                |
|                         |    | 25,000           | 0.38%                        | 6/30/2014              | 7/30/2014                |
|                         |    | 39,961           | 0.35%                        | 6/2/2014               | 7/1/2014                 |
|                         |    | 289,961          |                              |                        |                          |
| 2017                    |    | 4,615            | 1.24%                        | 4/3/2012               | 4/3/2017                 |
| 2018                    |    | 30,000           | 2.19%                        | 1/16/2013              | 1/16/2018                |
|                         |    | 25,000           | 2.18%                        | 1/16/2013              | 1/16/2018                |
|                         |    | 55,000           |                              |                        |                          |
| 2020                    |    | 10,336           | 2.59%                        | 7/19/2013              | 7/20/2020                |
|                         | \$ | <b>359,912</b>   | <b>0.73%</b>                 |                        |                          |

All of the advances referred to above with maturity dates up to the date of this report were renewed as one-month short-term advances.

*Subordinated Capital Notes*

Subordinated capital notes amounted to \$100.8 million at June 30, 2014 and \$100.0 million at December 31, 2013.

Under the requirements of Puerto Rico Banking Act, the Bank must establish a redemption fund for the subordinated capital notes by transferring from undivided profits pre-established amounts as follows:

|                                 | <b>Redemption fund</b> |               |
|---------------------------------|------------------------|---------------|
|                                 | <b>(In thousands)</b>  |               |
| Redemption fund - June 30, 2014 | \$                     | 51,925        |
| 2014                            |                        | 3,350         |
| 2015                            |                        | 6,700         |
| 2016                            |                        | 5,025         |
|                                 | \$                     | <b>67,000</b> |

*Other borrowings*

Other borrowings, presented in the unaudited consolidated statement of financial condition amounted to \$3.8 million and \$3.7 million at June 30, 2014 and December 31, 2013, respectively, which mainly consists of unsecured fixed-rate borrowings and term notes tied to the appreciation of the S&P index. For both periods, the unsecured fixed rate borrowings amounted to \$1.7 million at a fixed rate of 3.0%. The term notes tied to the S&P index amounted to \$1.0 million at both June 30, 2014 and December 31, 2013 with an index appreciation of \$1.1 million and \$957 thousand, respectively.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 11 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

The Company's derivatives are subject to agreements which allow a right of set-off with each respective counterparty. In addition, the Company's securities purchased under agreements to resell and securities sold under agreements to repurchase have a right of set-off with the respective counterparty under the supplemental terms of the master repurchase agreements. In an event of default, each party has a right of set-off against the other party for amounts owed in the related agreements and any other amount or obligation owed in respect of any other agreement or transaction between them. Security collateral posted to open and maintain a master netting agreement with a counterparty, in the form of cash and securities, may from time to time be segregated in an account at a third-party custodian pursuant to a an account control agreement.

The following table presents the potential effect of rights of set-off associated with the Company's recognized financial assets and liabilities at June 30, 2014 and December 31, 2013:

| June 30, 2014     |           |              |           |               |                  |              |           |              |             |  |            |              |  |
|-------------------|-----------|--------------|-----------|---------------|------------------|--------------|-----------|--------------|-------------|--|------------|--------------|--|
|                   |           |              |           |               |                  |              |           |              |             | Gross Amounts Not Offset in the Statement of Financial Condition |            |              |  |
|                   |           |              |           | Gross Amounts | Net Amount of    |              |           |              |             |  |            |              |  |
|                   |           |              |           | Offset in the | Assets Presented |              |           |              |             |  |            |              |  |
|                   |           |              |           | Statement of  | in               |              |           |              | Cash        |  |            |              |  |
|                   |           |              |           | Financial     | Statement        |              |           |              | Financial   |  | Collateral |              |  |
|                   |           |              |           | Condition     | of Financial     |              |           |              | Instruments |  | Received   |              |  |
|                   |           |              |           | Assets        | Condition        |              |           |              |             |  | Net        |              |  |
|                   |           |              |           | Condition     | Condition        |              |           |              |             |  | Amount     |              |  |
| (In thousands)    |           |              |           |               |                  |              |           |              |             |  |            |              |  |
| Derivatives       | \$        | 9,558        | \$        | -             | \$               | 9,558        | \$        | 2,004        | \$          | -  | \$         | 7,554        |  |
| <b>Total</b>      | <b>\$</b> | <b>9,558</b> | <b>\$</b> | <b>-</b>      | <b>\$</b>        | <b>9,558</b> | <b>\$</b> | <b>2,004</b> | <b>\$</b>   | <b>-</b>   | <b>\$</b>  | <b>7,554</b> |  |
| December 31, 2013 |           |              |           |               |                  |              |           |              |             |  |            |              |  |
|                   |           |              |           |               |                  |              |           |              |             | Gross Amounts Not Offset in the Statement of Financial Condition |            |              |  |
|                   |           |              |           | Gross Amounts | Net amount of    |              |           |              |             |  |            |              |  |

|  |           |                  |           | Offset in<br>the |           | Assets<br>Presented |           |               |           |              |           |  |              |
|--|-----------|------------------|-----------|------------------|-----------|---------------------|-----------|---------------|-----------|--------------|-----------|--|--------------|
|  |           | Gross<br>Amount  |           | Statement<br>of  |           | in<br>Statement     |           |               |           | Cash         |           |  |              |
|  |           | of<br>Recognized |           | Financial        |           | of Financial        |           | Financial     |           | Collateral   |           |  | Net          |
|  |           | Assets           |           | Condition        |           | Condition           |           | Instruments   |           | Received     |           |  | Amount       |
| (In thousands)   |           |                  |           |                  |           |                     |           |               |           |              |           |  |              |
| Derivatives  | \$        | 20,502           | \$        | -                | \$        | 20,502              | \$        | 2,450         | \$        | 6,780        | \$        |  | 11,272       |
| Securities<br>purchased under<br>agreements to<br>resell |           | 60,000           |           | -                |           | 60,000              |           | 64,587        |           | -            |           |  | (4,587)      |
| <b>Total</b>   | <b>\$</b> | <b>80,502</b>    | <b>\$</b> | <b>-</b>         | <b>\$</b> | <b>80,502</b>       | <b>\$</b> | <b>67,037</b> | <b>\$</b> | <b>6,780</b> | <b>\$</b> |  | <b>6,685</b> |



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| June 30, 2014                                  |           |                  |           |          |           |                  |  |                  |           |              |           |                  |
|--|-----------|------------------|-----------|----------|-----------|------------------|--|------------------|-----------|--------------|-----------|------------------|
|  |           |                  |           |          |           |                  | Gross Amounts Not Offset in the Statement of Financial Condition |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Net Amount of  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Liabilities  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Presented  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Cash   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Collateral   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Provided   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Net  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Amount   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | (In thousands)   |                  |           |              |           |                  |
| Derivatives                                    | \$        | 19,985           | \$        | -        | \$        | 19,985           | \$   | -                | \$        | 2,980        | \$        | 17,005           |
| Securities sold under agreements to repurchase |           | 1,010,000        |           | -        |           | 1,010,000        |  | 1,133,532        |           | -            |           | (123,532)        |
| <b>Total</b>                                   | <b>\$</b> | <b>1,029,985</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>1,029,985</b> | <b>\$</b>  | <b>1,133,532</b> | <b>\$</b> | <b>2,980</b> | <b>\$</b> | <b>(106,527)</b> |
| December 31, 2013                              |           |                  |           |          |           |                  |  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Gross Amounts Not Offset in the Statement of Financial Condition |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Net Amount of  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Liabilities  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Presented  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Cash   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Collateral   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Provided   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Net  |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | Amount   |                  |           |              |           |                  |
|  |           |                  |           |          |           |                  | (In thousands)   |                  |           |              |           |                  |
| Derivatives                                    | \$        | 30,672           | \$        | -        | \$        | 30,672           | \$   | -                | \$        | 2,349        | \$        | 28,323           |

|  |           |                  |           |          |           |                  |           |                  |           |               |           |                 |
|--|-----------|------------------|-----------|----------|-----------|------------------|-----------|------------------|-----------|---------------|-----------|-----------------|
| Securities sold under agreements to repurchase |           | 1,265,000        |           | -        |           | 1,265,000        |           | 1,277,919        |           | 67,029        |           | (79,948)        |
| <b>Total</b>                                   | <b>\$</b> | <b>1,295,672</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>1,295,672</b> | <b>\$</b> | <b>1,277,919</b> | <b>\$</b> | <b>69,378</b> | <b>\$</b> | <b>(51,625)</b> |

**NOTE 12 — RELATED PARTY TRANSACTIONS**

The Bank grants loans to its directors, executive officers and to certain related individuals or organizations in the ordinary course of business. These loans are offered at the same terms as loans to unrelated third parties. As of June 30, 2014 and December 31, 2013, these loan balances amounted to \$24.2 million and \$19.0 million, respectively. The activity and balance of these loans for the quarters ended June 30, 2014 and 2013 were as follows:

|   | Quarter Ended June 30, |               |           |              | Six-Month Period Ended June 30, |               |           |              |
|---|------------------------|---------------|-----------|--------------|---------------------------------|---------------|-----------|--------------|
|   | 2014                   |               | 2013      |              | 2014                            |               | 2013      |              |
| (In thousands)  |                        |               |           |              |                                 |               |           |              |
| <b>Balance at the beginning of year</b>                 | \$                     | 19,267        | \$        | 8,688        | \$                              | 18,963        | \$        | 6,055        |
| New loans   |                        | 13,847        |           | -            |                                 | 13,847        |           | 4,234        |
| Repayments and sales                                    |                        | (8,963)       |           | (657)        |                                 | (8,659)       |           | (2,026)      |
| Credits of persons no longer considered related parties |                        | -             |           | -            |                                 | -             |           | (232)        |
| <b>Balance at the end of year</b>                       | <b>\$</b>              | <b>24,151</b> | <b>\$</b> | <b>8,031</b> | <b>\$</b>                       | <b>24,151</b> | <b>\$</b> | <b>8,031</b> |

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**NOTE 13 — INCOME TAXES**

At June 30, 2014 and December 31, 2013, the Company's net deferred tax asset amounted to \$123.3 million and \$137.6 million, respectively. In assessing the realizability of the deferred tax asset, management considers whether it is more likely than not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of the deferred tax asset is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax asset are deductible, management believes it is more likely than not that the Company will realize the entire deferred tax asset, net of the existing valuation allowances recorded at June 30, 2014 and December 31, 2013. The amount of the deferred tax asset that is considered realizable could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

At June 30, 2014 and December 31, 2013, Oriental International Bank Inc. ("OIB"), the Bank's international banking entity subsidiary, had \$209 thousand and \$356 thousand, respectively, in income tax effect of unrecognized gain on available-for-sale securities included in other comprehensive income. Following the change in OIB's applicable tax rate from 5% to 0% as a result of a Puerto Rico law adopted in 2011, this remaining tax balance will flow through income as these securities are repaid or sold in future periods. During the quarters ended June 30, 2014 and 2013, \$10 thousand and \$43 thousand, respectively, related to this residual tax effect from OIB was reclassified from accumulated other comprehensive income into income tax provision. During the six-month period ended June 30, 2014 and 2013, \$147 thousand and \$89 thousand, respectively, related to the residual effect from OIB was reclassified from accumulated other comprehensive income to income tax provision.

The Company classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. The balance of unrecognized tax benefits at June 30, 2014 was \$3.6 million (December 31, 2013 - \$4.0 million). The Company had accrued \$1.6 million at June 30, 2014 (December 31, 2013 - \$1.2 million) for the payment of interest and penalties relating to unrecognized tax benefits.

Income tax expense was \$10.6 million for the quarter ended June 30, 2014, compared to an income tax benefit of \$31.9 million for the same periods in 2013. During the quarter ended June 30, 2013, the income tax benefit was the result of the increase in the enacted tax rate from 30% to 39%, which was retroactively implemented to January 1, 2013.

**NOTE 14 — STOCKHOLDERS' EQUITY AND EARNINGS PER COMMON SHARE**

*Regulatory Capital Requirements*

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal and Puerto Rico banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Pursuant to the Dodd-Frank Act, federal banking regulators have adopted new capital rules that became effective January 1, 2014 for advanced approaches banking organizations and will become effective January 1, 2015 for all other covered organizations (subject to certain phase-in periods through January 1, 2019) and that will replace their general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules.

Quantitative measures established by regulation to ensure capital adequacy currently require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average total assets (as defined in the regulations). As of June 30, 2014 and December 31, 2013, the Company and the Bank met all capital adequacy requirements to which they are subject. As of June 30, 2014 and December 31, 2013, the Bank is "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the tables presented below.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company's and the Bank's actual capital amounts and ratios as of June 30, 2014 and December 31, 2013 are as follows:

|  | Actual     |        | Minimum Capital Requirement |       | Minimum to be Well Capitalized |        |
|--|------------|--------|-----------------------------|-------|--------------------------------|--------|
|  | Amount     | Ratio  | Amount                      | Ratio | Amount                         | Ratio  |
| (Dollars in thousands)                 |            |        |                             |       |                                |        |
| <b>Company Ratios</b>                  |            |        |                             |       |                                |        |
| <b>As of June 30, 2014</b>             |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets  | \$ 863,790 | 17.30% | \$ 399,550                  | 8.00% | \$ 499,438                     | 10.00% |
| Tier 1 capital to risk-weighted assets | \$ 773,824 | 15.49% | \$ 199,775                  | 4.00% | \$ 299,663                     | 6.00%  |
| Tier 1 capital to average total assets | \$ 773,824 | 10.26% | \$ 301,829                  | 4.00% | \$ 377,286                     | 5.00%  |
| <b>As of December 31, 2013</b>         |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets  | \$ 827,460 | 16.16% | \$ 409,514                  | 8.00% | \$ 511,893                     | 10.00% |
| Tier 1 capital to risk-weighted assets | \$ 736,930 | 14.35% | \$ 204,757                  | 4.00% | \$ 307,136                     | 6.00%  |
| Tier 1 capital to average total assets | \$ 736,930 | 9.11%  | \$ 324,910                  | 4.00% | \$ 406,138                     | 5.00%  |

|  | Actual     |        | Minimum Capital Requirement |       | Minimum to be Well Capitalized |        |
|--|------------|--------|-----------------------------|-------|--------------------------------|--------|
|  | Amount     | Ratio  | Amount                      | Ratio | Amount                         | Ratio  |
| (Dollars in thousands)                 |            |        |                             |       |                                |        |
| <b>Bank Ratios</b>                     |            |        |                             |       |                                |        |
| <b>As of June 30, 2014</b>             |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets  | \$ 812,267 | 16.34% | \$ 397,593                  | 8.00% | \$ 496,991                     | 10.00% |
| Tier 1 capital to risk-weighted assets | \$ 722,603 | 14.54% | \$ 198,796                  | 4.00% | \$ 298,195                     | 6.00%  |
| Tier 1 capital to average total assets | \$ 722,603 | 9.65%  | \$ 299,657                  | 4.00% | \$ 374,571                     | 5.00%  |
| <b>As of December 31, 2013</b>         |            |        |                             |       |                                |        |

|  |    |         |               |    |         |              |    |         |               |
|--|----|---------|---------------|----|---------|--------------|----|---------|---------------|
| Total capital to risk-weighted assets  | \$ | 779,413 | <b>15.30%</b> | \$ | 407,637 | <b>8.00%</b> | \$ | 509,547 | <b>10.00%</b> |
| Tier 1 capital to risk-weighted assets | \$ | 688,350 | <b>13.51%</b> | \$ | 203,819 | <b>4.00%</b> | \$ | 305,728 | <b>6.00%</b>  |
| Tier 1 capital to average total assets | \$ | 688,350 | <b>8.54%</b>  | \$ | 322,395 | <b>4.00%</b> | \$ | 402,993 | <b>5.00%</b>  |

***Additional Paid-in Capital***

Additional paid-in capital represents contributed capital in excess of par value of common and preferred stock net of the costs of issuance. As of June 30, 2014, accumulated issuance costs charged against additional paid in capital amounted to \$10.1 million and \$13.6 million for preferred and common stock, respectively.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Earnings Per Common Share*

The calculation of earnings per common share for the quarters and six-month periods ended June 30, 2014 and 2013 is as follows:

|  | Quarter ended June 30 , |               |      |               | Six-Month Period Ended June 30, |               |      |               |
|--|-------------------------|---------------|------|---------------|---------------------------------|---------------|------|---------------|
|  | 2014                    |               | 2013 |               | 2014                            |               | 2013 |               |
| (In thousands, except per share data)  |                         |               |      |               |                                 |               |      |               |
| <b>Net income</b>  | \$                      | 21,309        | \$   | 37,539        | \$                              | 45,056        | \$   | 58,731        |
| Less: Dividends on preferred stock   |                         |               |      |               |                                 |               |      |               |
| Non-convertible preferred stock (Series A, B, and D)                               |                         | (1,628)       |      | (1,628)       |                                 | (3,256)       |      | (3,256)       |
| Convertible preferred stock (Series C)   |                         | (1,838)       |      | (1,838)       |                                 | (3,675)       |      | (3,675)       |
| <b>Income available to common shareholders</b>                                     | \$                      | <b>17,843</b> | \$   | <b>34,073</b> | \$                              | <b>38,125</b> | \$   | <b>51,800</b> |
| Effect of assumed conversion of the convertible preferred stock                    |                         | 1,838         |      | 1,838         |                                 | 3,675         |      | 3,675         |
| <b>Income available to common shareholders assuming conversion</b>                 | \$                      | <b>19,681</b> | \$   | <b>35,911</b> | \$                              | <b>41,800</b> | \$   | <b>55,475</b> |
|  |                         |               |      |               |                                 |               |      |               |
| <b>Weighted average common shares and share equivalents:</b>                       |                         |               |      |               |                                 |               |      |               |
| Average common shares outstanding  |                         | 45,014        |      | 45,630        |                                 | 45,170        |      | 45,613        |
| Effect of dilutive securities:   |                         |               |      |               |                                 |               |      |               |
| Average potential common shares-options  |                         | 200           |      | 200           |                                 | 168           |      | 178           |
| Average potential common shares-assuming conversion of convertible preferred stock |                         | 7,138         |      | 7,138         |                                 | 7,138         |      | 7,138         |
| <b>Total weighted average common shares outstanding and equivalents</b>            |                         | <b>52,352</b> |      | <b>52,968</b> |                                 | <b>52,476</b> |      | <b>52,929</b> |

|  |    |             |  |    |             |  |    |             |  |    |             |
|--|----|-------------|--|----|-------------|--|----|-------------|--|----|-------------|
| <b>Earnings per common share - basic</b>   | \$ | <b>0.40</b> |  | \$ | <b>0.75</b> |  | \$ | <b>0.84</b> |  | \$ | <b>1.14</b> |
| <b>Earnings per common share - diluted</b> | \$ | <b>0.38</b> |  | \$ | <b>0.68</b> |  | \$ | <b>0.80</b> |  | \$ | <b>1.05</b> |

In computing diluted earnings per common share, the 84,000 shares of convertible preferred stock, which remain outstanding at June 30, 2014, with a conversion rate, subject to certain conditions, of 84.9798 shares of common stock per share, were included as average potential common shares from the date they were issued and outstanding.

Moreover, in computing diluted earnings per common share, the dividends declared during the quarters ended June 30, 2014 and 2013 on the convertible preferred stock were added back as income available to common shareholders.

For the quarters ended June 30, 2014 and 2013, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 364,604 and 243,721, respectively. For the six-month periods ended June 30, 2014 and 2013, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 304,491 and 578,393, respectively.

### *Treasury Stock*

Under the Company's current stock repurchase program it is authorized to purchase in the open market up to \$70 million of its outstanding shares of common stock, of which approximately \$23.1 million of authority remains. The shares of common stock repurchased are to be held by the Company as treasury shares. During the six-month period ended June 30, 2014, the Company purchased 707,400 shares under this program for a total of \$10.4 million, at an average price of \$14.66 per share. There were no repurchases during 2013.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the shares repurchased for each month in the six-month period ended June 30, 2014, excluding the months of March, April, May, and June of 2014, during which no shares were purchased as part of the stock repurchase program:

|   | Total number of     |                | Average   | Dollar amount of  |                    |
|---|---------------------|----------------|-----------|-------------------|--------------------|
|   | shares purchased as | part of stock  |           | price paid        | shares repurchased |
|   | repurchase programs |                | per share | commissions paid) |                    |
|   |                     |                |           |                   | (In thousands)     |
| <b>Period</b>                               |                     |                |           |                   |                    |
| January 2014                                |                     | 57,700         | \$        | 14.73             | \$ 850             |
| February 2014                               |                     | 649,700        | \$        | 14.66             | \$ 9,522           |
| <b>Six-Month Period Ended June 30, 2014</b> |                     | <b>707,400</b> |           | <b>14.66</b>      | <b>10,372</b>      |

The number of shares that may yet be purchased under the \$70 million program is estimated at 1,252,136 and was calculated by dividing the remaining balance of \$23.1 million by \$18.41 (closing price of the Company common stock at June 30, 2014). The Company did not purchase any shares of its common stock other than through its publicly announced stock repurchase program during the six-months ended June 30, 2014.

The activity in connection with common shares held in treasury by the Company for the six-month periods ended June 30, 2014 and 2013 is set forth below:

|   | Six-Month Period Ended June 30,    |        |        |           |        |        |
|---|------------------------------------|--------|--------|-----------|--------|--------|
|   | 2014                               |        |        | 2013      |        |        |
|   | Shares                             | Dollar |        | Shares    | Dollar |        |
|   |                                    | Amount |        |           | Amount |        |
|   | (In thousands, except shares data) |        |        |           |        |        |
| <b>Beginning of period</b>  | 7,030,101                          | \$     | 80,642 | 7,090,597 | \$     | 81,275 |
| Common shares used upon lapse of restricted stock units           | (30,552)                           |        | (323)  | (34,800)  |        | (364)  |
| Common shares repurchased as part of the stock repurchase program | 707,400                            |        | 10,393 | -         |        | -      |
| Common shares used to match defined contribution plan, net        | -                                  |        | -      | (7,318)   |        | (77)   |

|                      |                  |           |               |                  |           |               |
|----------------------|------------------|-----------|---------------|------------------|-----------|---------------|
| <b>End of period</b> | <b>7,706,949</b> | <b>\$</b> | <b>90,712</b> | <b>7,048,479</b> | <b>\$</b> | <b>80,834</b> |
|----------------------|------------------|-----------|---------------|------------------|-----------|---------------|

*Accumulated Other Comprehensive Income*

Accumulated other comprehensive income, net of income tax, as of June 30, 2014 and December 31, 2013 consisted of:

|   | <b>June 30,</b>       |               | <b>December 31,</b> |              |
|---|-----------------------|---------------|---------------------|--------------|
|   | <b>2014</b>           |               | <b>2013</b>         |              |
|   | <b>(In thousands)</b> |               |                     |              |
| Unrealized gain on securities available-for-sale which are not<br>other-than-temporarily impaired     | \$                    | 33,404        | \$                  | 13,267       |
| Income tax effect of unrealized gain on securities available-for-sale                                 |                       | (3,645)       |                     | (1,834)      |
| Net unrealized gain on securities available-for-sale which are not<br>other-than-temporarily impaired |                       | 29,759        |                     | 11,433       |
| Unrealized loss on cash flow hedges   |                       | (10,515)      |                     | (10,907)     |
| Income tax effect of unrealized loss on cash flow hedges  |                       | 2,511         |                     | 2,665        |
| Net unrealized loss on cash flow hedges   |                       | (8,004)       |                     | (8,242)      |
| Accumulated other comprehensive income, net of taxes  | \$                    | <b>21,755</b> | \$                  | <b>3,191</b> |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents changes in accumulated other comprehensive income by component, net of taxes, for the quarters and six-month periods ended June 30, 2014 and 2013:

|  | Quarter Ended June 30,          |                |               |                    |                |                |               |               |    |                |    |               |
|--|---------------------------------|----------------|---------------|--------------------|----------------|----------------|---------------|---------------|----|----------------|----|---------------|
|  | 2014                            |                |               |                    |                | 2013           |               |               |    |                |    |               |
|  | Net unrealized                  | Net unrealized | Accumulated   |                    | Net unrealized | Net unrealized | Accumulated   |               |    |                |    |               |
|  | gains on                        | loss on        | other         |                    | gains on       | loss on        | other         |               |    |                |    |               |
|  | securities                      | cash flow      | comprehensive |                    | securities     | cash flow      | comprehensive |               |    |                |    |               |
| available-for-sale   | hedges                          | income         |               | available-for-sale | hedges         | income         |               |               |    |                |    |               |
|  | (In thousands)                  |                |               |                    |                |                |               |               |    |                |    |               |
| <b>Beginning balance</b>   | \$                              | 16,035         | \$            | (8,013)            | \$             | 8,022          | \$            | 58,393        | \$ | (11,342)       | \$ | 47,051        |
| Other comprehensive income (loss) before reclassifications         |                                 | 13,714         |               | (1,633)            |                | 12,081         |               | (33,036)      |    | 292            |    | (32,744)      |
| Amounts reclassified out of accumulated other comprehensive income |                                 | 10             |               | 1,642              |                | 1,652          |               | 43            |    | 1,416          |    | 1,459         |
| Other comprehensive income (loss)                                  |                                 | 13,724         |               | 9                  |                | 13,733         |               | (32,993)      |    | 1,708          |    | (31,285)      |
| <b>Ending balance</b>  | \$                              | <b>29,759</b>  | \$            | <b>(8,004)</b>     | \$             | <b>21,755</b>  | \$            | <b>25,400</b> | \$ | <b>(9,634)</b> | \$ | <b>15,766</b> |
|  |                                 |                |               |                    |                |                |               |               |    |                |    |               |
|  |                                 |                |               |                    |                |                |               |               |    |                |    |               |
|  | Six-Month Period Ended June 30, |                |               |                    |                |                |               |               |    |                |    |               |
|  | 2014                            |                |               |                    |                | 2013           |               |               |    |                |    |               |
|  | Net unrealized                  | Net unrealized | Accumulated   |                    | Net unrealized | Net unrealized | Accumulated   |               |    |                |    |               |
|  | gains on                        | loss on        | other         |                    | gains on       | loss on        | other         |               |    |                |    |               |
|  | securities                      | cash flow      | comprehensive |                    | securities     | cash flow      | comprehensive |               |    |                |    |               |
| available-for-sale   | hedges                          | income         |               | available-for-sale | hedges         | income         |               |               |    |                |    |               |
|  | (In thousands)                  |                |               |                    |                |                |               |               |    |                |    |               |
| <b>Beginning balance</b>   | \$                              | 11,433         | \$            | (8,242)            | \$             | 3,191          | \$            | 68,245        | \$ | (12,365)       | \$ | 55,880        |
| Other comprehensive income before reclassifications                |                                 | 18,179         |               | (3,025)            |                | 15,154         |               | (42,934)      |    | (21)           |    | (42,955)      |
| Amounts reclassified out of accumulated                            |                                 | 147            |               | 3,263              |                | 3,410          |               | 89            |    | 2,752          |    | 2,841         |

|                                   |           |               |           |                |           |               |           |               |           |                |           |               |          |
|-----------------------------------|-----------|---------------|-----------|----------------|-----------|---------------|-----------|---------------|-----------|----------------|-----------|---------------|----------|
| other comprehensive income        |           |               |           |                |           |               |           |               |           |                |           |               |          |
| Other comprehensive income (loss) |           | 18,326        |           | 238            |           | 18,564        |           | (42,845)      |           | 2,731          |           |               | (40,114) |
| <b>Ending balance</b>             | <b>\$</b> | <b>29,759</b> | <b>\$</b> | <b>(8,004)</b> | <b>\$</b> | <b>21,755</b> | <b>\$</b> | <b>25,400</b> | <b>\$</b> | <b>(9,634)</b> | <b>\$</b> | <b>15,766</b> |          |

The following table presents reclassifications out of accumulated other comprehensive income for the quarter and six-month period ended June 30, 2014:

|   | Amount reclassified out of accumulated<br>other comprehensive income |              |           |   | Affected Line Item<br>in<br>Consolidated<br>Statement<br>of Operations |
|---|--|--------------|-----------|---|--|
|   | Quarter<br>Ended<br>June 30, 2014                                    |              |           | Six-Month<br>Period<br>Ended June<br>30, 2014 |  |
|   | (In thousands)   |              |           |   |  |
| <b>Cash flow hedges:</b>  |  |              |           |   |  |
| Interest-rate contracts   | \$   | 1,642        | \$        | 3,263   | Net interest expense   |
| <b>Available-for-sale securities:</b>                           |  |              |           |   |  |
| Residual tax effect from OIB's change<br>in applicable tax rate |  | 10           |           | 147   | Income tax expense   |
|   | <b>\$</b>  | <b>1,652</b> | <b>\$</b> | <b>3,410</b>                                  |  |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 15 – GUARANTEES

At June 30, 2014, the unamortized balance of the obligations undertaken in issuing the guarantees under standby letters of credit represented a liability of \$38.5 million (December 31, 2013 - \$38.6 million).

As a result of the BBVAPR Acquisition, the Company assumed a liability for residential mortgage loans sold subject to credit recourse, pursuant to FNMA's residential mortgage loan sales and securitization programs. At June 30, 2014 and December 31, 2013, the unpaid principal balance of residential mortgage loans sold subject to credit recourse was \$113.5 million and \$122.3 million, respectively.

The following table shows the changes in the Company's liability for estimated losses from these credit recourse agreements, included in the unaudited consolidated statements of financial condition during the quarters and six-month periods ended June 30, 2014 and 2013.

|                                       | Quarter Ended June 30, |              |      |              | Six-Month Period Ended June 30, |              |      |              |
|---------------------------------------|------------------------|--------------|------|--------------|---------------------------------|--------------|------|--------------|
|                                       | 2014                   |              | 2013 |              | 2014                            |              | 2013 |              |
|                                       | (In thousands)         |              |      |              |                                 |              |      |              |
| <b>Balance at beginning of period</b> | \$                     | 1,549        | \$   | 2,460        | \$                              | 1,955        | \$   | 2,460        |
| Net charge-offs/terminations          |                        | (239)        |      | -            |                                 | (645)        |      | -            |
| <b>Balance at end of period</b>       | \$                     | <b>1,310</b> | \$   | <b>2,460</b> | \$                              | <b>1,310</b> | \$   | <b>2,460</b> |

The estimated losses to be absorbed under the credit recourse arrangements were recorded as a liability when the credit recourse was assumed, and are updated on a quarterly basis. The expected loss, which represents the amount expected to be lost on a given loan, considers the probability of default and loss severity. The probability of default represents the probability that a loan in good standing would become 120 days delinquent, in which case the Company is obligated to repurchase the loan. At June 30, 2014, \$83.2 million or 73% of the recourse obligation will be extinguished during the next two years.

If a borrower defaults, pursuant to the credit recourse provided, the Company is required to repurchase the loan or reimburse the third party investor for the incurred loss. The maximum potential amount of future payments that the Company would be required to make under the recourse arrangements is equivalent to the total outstanding balance of the residential mortgage loans serviced with recourse and interest, if applicable. During the quarter and six-month period ended June 30, 2014, the Company repurchased approximately \$2.1 million and \$3.7 million of unpaid principal balance in mortgage loans subject to the credit recourse provisions. If a borrower defaults, the Company has rights to the underlying collateral securing the mortgage loan. The Company suffers losses on these mortgage loans

when the proceeds from a foreclosure sale of the collateral property are less than the outstanding principal balance of the loan, any uncollected interest advanced, and the costs of holding and disposing the related property. At June 30, 2014 and December 31, 2013, the Company's liability for estimated credit losses related to loans sold with credit recourse amounted to \$1.3 million (December 31, 2013 – \$2.0 million).

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

When the Company sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. The Company's mortgage operations division groups conforming mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or are sold directly to FNMA or other private investors for cash. As required under such mortgage backed securities programs, quality review procedures are performed by the Company to ensure that asset guideline qualifications are met. To the extent the loans do not meet specified characteristics, the Company may be required to repurchase such loans or indemnify for losses and bear any subsequent loss related to the loans. Repurchases during the six-month period ended June 30, 2014 under the Company's representation and warranty arrangements, excluding mortgage loans subject to credit recourse provisions referred to above, approximated \$5.1 million in unpaid principal balance (December 31, 2013 - \$12.5 million). A substantial amount of these loans are reinstated to performing status or have mortgage insurance, and thus the ultimate losses on the loans are not deemed significant.

During the quarter and six-month period ended June 30, 2014, the Company recognized \$95 thousand and \$145 thousand in losses from the repurchase of residential mortgage loans sold subject to credit recourse, and \$494 thousand and \$929 thousand in losses from the repurchase of residential mortgage loans as a result of breaches of the customary representations and warranties. During the quarter and six-month period ended June 30, 2013, the Company did not recognize any losses from the repurchase of residential mortgage loans sold subject to credit recourse, but recognized \$303 thousand and \$477 thousand in losses from the repurchase of residential mortgage loans as a result of breaches of the customary representations and warranties.

Servicing agreements relating to the mortgage-backed securities programs of FNMA and GNMA, and to mortgage loans sold or serviced to certain other investors, including the Federal Home Loan Mortgage Corporation ("FHLMC"), require the Company to advance funds to make scheduled payments of principal, interest, taxes and insurance, if such payments have not been received from the borrowers. At June 30, 2014, the Company serviced \$1.1 billion in mortgage loans for third-parties. The Company generally recovers funds advanced pursuant to these arrangements from the mortgage owner, from liquidation proceeds when the mortgage loan is foreclosed or, in the case of FHA/VA loans, under the applicable FHA and VA insurance and guarantees programs. However, in the meantime, the Company must absorb the cost of the funds it advances during the time the advance is outstanding. The Company must also bear the costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a defaulted loan is not cured, the mortgage loan would be canceled as part of the foreclosure proceedings and the Company would not receive any future servicing income with respect to that loan. At June 30, 2014, the outstanding balance of funds advanced by the Company under such mortgage loan servicing agreements was approximately \$347 thousand (December 31, 2013 - \$243 thousand). To the extent the mortgage loans underlying the Company's servicing portfolio experience increased delinquencies, the Company would be required to dedicate additional cash resources to comply with its obligation to advance funds as well as incur additional administrative costs related to increases in collection efforts.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 16 — COMMITMENTS AND CONTINGENCIES

*Loan Commitments*

In the normal course of business, the Company becomes a party to credit-related financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby and commercial letters of credit, and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated statements of financial condition. The contract or notional amount of those instruments reflects the extent of the Company's involvement in particular types of financial instruments.

The Company's exposure to credit losses in the event of nonperformance by the counterparty to the financial instrument for commitments to extend credit, including commitments under credit card arrangements, and commercial letters of credit is represented by the contractual notional amounts of those instruments, which do not necessarily represent the amounts potentially subject to risk. In addition, the measurement of the risks associated with these instruments is meaningful only when all related and offsetting transactions are identified. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Credit-related financial instruments at June 30, 2014 and December 31, 2013 were as follows:

|                              | June 30,       |         | December 31, |         |
|------------------------------|----------------|---------|--------------|---------|
|                              | 2014           |         | 2013         |         |
|                              | (In thousands) |         |              |         |
| Commitments to extend credit | \$             | 441,793 | \$           | 520,269 |
| Commercial letters of credit |                | 1,544   |              | 1,096   |

Commitments to extend credit represent agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon the extension of credit, is based on management's credit evaluation of the counterparty.

At June 30, 2014 and December 31, 2013, commitments to extend credit consisted mainly of undisbursed available amounts on commercial lines of credit, construction loans, and revolving credit card arrangements. Since many of the unused commitments are expected to expire unused or be only partially used, the total amount of these unused commitments does not necessarily represent future cash requirements. These lines of credit had a reserve of \$900



thousand at both June 30, 2014 and December 31, 2013.

Commercial letters of credit are issued or confirmed to guarantee payment of customers' payables or receivables in short-term international trade transactions. Generally, drafts will be drawn when the underlying transaction is consummated as intended. However, the short-term nature of this instrument serves to mitigate the risk associated with these contracts.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The summary of instruments that are considered financial guarantees in accordance with the authoritative guidance related to guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others, at June 30, 2014 and December 31, 2013, is as follows:

|  | June 30,       |         | December 31, |         |
|--|----------------|---------|--------------|---------|
|  | 2014           |         | 2013         |         |
|  | (In thousands) |         |              |         |
| Standby letters of credit and financial guarantees | \$             | 38,451  | \$           | 38,577  |
| Loans sold with recourse                           |                | 113,547 |              | 122,291 |
| Commitments to sell or securitize mortgage loans   |                | 63,558  |              | 80,307  |

Standby letters of credit and financial guarantees are written conditional commitments issued by the Company to guarantee the payment and/or performance of a customer to a third party ("beneficiary"). If the customer fails to comply with the agreement, the beneficiary may draw on the standby letter of credit or financial guarantee as a remedy. The amount of credit risk involved in issuing letters of credit in the event of nonperformance is the face amount of the letter of credit or financial guarantee. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer.

*Lease Commitments*

The Company has entered into various operating lease agreements for branch facilities and administrative offices. Rent expense for the quarters ended June 30, 2014 and 2013 amounted to \$2.4 million and \$2.6 million, respectively, and is included in the "occupancy and equipment" caption in the unaudited consolidated statements of operations. For the six-month periods ended June 30, 2014 and 2013, rent expense amounted to \$4.9 million and \$5.2 million, respectively. Future rental commitments under leases in effect at June 30, 2014, exclusive of taxes, insurance, and maintenance expenses payable by the Company, are summarized as follows:

| Year Ending December 31,     | Minimum Rent   |       |
|------------------------------|----------------|-------|
|                              | (In thousands) |       |
| 2014 (July 1 to December 31) | \$             | 4,210 |
| 2015                         |                | 7,980 |

Edgar Filing: OFG BANCORP - Form 10-Q

|            |    |               |
|------------|----|---------------|
| 2016       |    | 7,388         |
| 2017       |    | 6,761         |
| 2018       |    | 5,881         |
| Thereafter |    | 22,004        |
|            | \$ | <b>54,224</b> |

62

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

***Contingencies***

The Company and its subsidiaries are defendants in a number of legal proceedings incidental to their business. In the ordinary course of business, the Company and its subsidiaries are also subject to governmental and regulatory examinations. Certain subsidiaries of the Company, including the Bank (and its subsidiary OIB), Oriental Financial Services, and Oriental Insurance, are subject to regulation by various U.S., Puerto Rico and other regulators.

The Company seeks to resolve all litigation and regulatory matters in the manner management believes is in the best interests of the Company and its shareholders, and contests allegations of liability or wrongdoing and, where applicable, the amount of damages or scope of any penalties or other relief sought as appropriate in each pending matter.

Subject to the accounting and disclosure framework under the provisions of ASC 450, it is the opinion of the Company's management, based on current knowledge and after taking into account its current legal accruals, that the eventual outcome of all matters would not be likely to have a material adverse effect on the consolidated statements of financial condition of the Company. Nonetheless, given the substantial or indeterminate amounts sought in certain of these matters, and the inherent unpredictability of such matters, an adverse outcome in certain of these matters could, from time to time, have a material adverse effect on the Company's consolidated results of operations or cash flows in particular quarterly or annual periods. The Company has evaluated all litigation and regulatory matters where the likelihood of a potential loss is deemed reasonably possible. The Company has determined that the estimate of the reasonably possible loss is not significant.

**NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company follows the fair value measurement framework under GAAP.

***Fair Value Measurement***

The fair value measurement framework defines fair value 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. This framework also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable

inputs when measuring fair value. The standard describes three levels of inputs previously described that may be used to measure fair value.

***Money market investments***

The fair value of money market investments is based on the carrying amounts reflected in the consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.

***Investment securities***

The fair value of investment securities is based on quoted market prices, when available, or market prices provided by recognized broker-dealers. Such securities are classified as level 1 or level 2 depending on the basis for determining fair value. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument, and such securities are classified as level 3. At December 31, 2013, the Company held two securities categorized as other debt that are classified as Level 3. The estimated fair value of the other debt securities was determined by using a third-party model to calculate the present value of projected future cash flows. The assumptions are highly uncertain and include primarily market discount rates, current spreads, and an indicative pricing.

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

*Derivative instruments*

The fair value of the interest rate swaps is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future. The fair value of most of these derivative instruments is based on observable market parameters, which include discounting the instruments' cash flows using the U.S. dollar LIBOR-based discount rates, and also applying yield curves that account for the industry sector and the credit rating of the counterparty and/or the Company.

Certain other derivative instruments with limited market activity are valued using externally developed models that consider unobservable market parameters. Based on their valuation methodology, derivative instruments are classified as Level 2 or Level 3. The Company has offered its customers certificates of deposit with an option tied to the performance of the S&P Index and uses equity indexed option agreements with major broker-dealers to manage its exposure to changes in this index. Their fair value is obtained through the use of an external based valuation that was thoroughly evaluated and adopted by management as its measurement tool for these options. The payoff of these options is linked to the average value of the S&P Index on a specific set of dates during the life of the option. The methodology uses an average rate option or a cash-settled option whose payoff is based on the difference between the expected average value of the S&P Index during the remaining life of the option and the strike price at inception. The assumptions, which are uncertain and require a degree of judgment, include primarily S&P Index volatility, forward interest rate projections, estimated index dividend payout, and leverage.

*Servicing assets*

Servicing assets do not trade in an active market with readily observable prices. Servicing assets are priced using a discounted cash flow model. The valuation model considers servicing fees, portfolio characteristics, prepayment assumptions, delinquency rates, late charges, other ancillary revenues, cost to service and other economic factors. Due to the unobservable nature of certain valuation inputs, the servicing rights are classified as Level 3.

*Loans receivable considered impaired that are collateral dependent*

The impairment is measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations, in accordance with the provisions of ASC 310-10-35. Currently, the associated loans considered impaired are classified as Level 3.

***Foreclosed real estate***

Foreclosed real estate includes real estate properties securing residential mortgage and commercial loans. The fair value of foreclosed real estate may be determined using an external appraisal, broker price option or an internal valuation. These foreclosed assets are classified as Level 3 given certain internal adjustments that may be made to external appraisals

***Other repossessed assets***

Other repossessed assets include repossessed automobile loans and leases. The fair value of the repossessed automobiles may be determined using internal valuation and an external appraisal. These repossessed assets are classified as Level 3 given certain internal adjustments that may be made to external appraisals.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Assets and liabilities measured at fair value on a recurring and non-recurring basis, including financial liabilities for which the Company has elected the fair value option, are summarized below:

|  | June 30, 2014           |              |         |                  |         |                |       |                  |  |  |
|--|-------------------------|--------------|---------|------------------|---------|----------------|-------|------------------|--|--|
|  | Fair Value Measurements |              |         |                  |         |                |       |                  |  |  |
|  | Level 1                 |              | Level 2 |                  | Level 3 |                | Total |                  |  |  |
|  | (In thousands)          |              |         |                  |         |                |       |                  |  |  |
| Recurring fair value measurements:       |                         |              |         |                  |         |                |       |                  |  |  |
| Investment securities available-for-sale | \$                      | -            | \$      | 1,418,958        | \$      | -              | \$    | 1,418,958        |  |  |
| Money market investments                 |                         | 8,228        |         | -                |         | -              |       | 8,228            |  |  |
| Derivative assets                        |                         | -            |         | 2,978            |         | 6,580          |       | 9,558            |  |  |
| Servicing assets                         |                         | -            |         | -                |         | 13,655         |       | 13,655           |  |  |
| Derivative liabilities                   |                         | -            |         | (13,617)         |         | (6,368)        |       | (19,985)         |  |  |
|  | \$                      | <b>8,228</b> | \$      | <b>1,408,319</b> | \$      | <b>13,867</b>  | \$    | <b>1,430,414</b> |  |  |
| Non-recurring fair value measurements:   |                         |              |         |                  |         |                |       |                  |  |  |
| Impaired commercial loans                | \$                      | -            | \$      | -                | \$      | 29,118         | \$    | 29,118           |  |  |
| Foreclosed real estate                   |                         | -            |         | -                |         | 102,235        |       | 102,235          |  |  |
| Other repossessed assets                 |                         | -            |         | -                |         | 16,875         |       | 16,875           |  |  |
|  | \$                      | -            | \$      | -                | \$      | <b>148,228</b> | \$    | <b>148,228</b>   |  |  |

|   | December 31, 2013       |              |         |                  |         |               |       |                  |  |  |
|---|-------------------------|--------------|---------|------------------|---------|---------------|-------|------------------|--|--|
|   | Fair Value Measurements |              |         |                  |         |               |       |                  |  |  |
|   | Level 1                 |              | Level 2 |                  | Level 3 |               | Total |                  |  |  |
|   | (In thousands)          |              |         |                  |         |               |       |                  |  |  |
| Recurring fair value measurements:              |                         |              |         |                  |         |               |       |                  |  |  |
| Investment securities available-for-sale        | \$                      | -            | \$      | 1,568,745        | \$      | 19,680        | \$    | 1,588,425        |  |  |
| Securities purchased under agreements to resell |                         | -            |         | 60,000           |         | -             |       | 60,000           |  |  |
| Money market investments                        |                         | 6,967        |         | -                |         | -             |       | 6,967            |  |  |
| Derivative assets                               |                         | -            |         | 4,072            |         | 16,430        |       | 20,502           |  |  |
| Servicing assets                                |                         | -            |         | -                |         | 13,801        |       | 13,801           |  |  |
| Derivative liabilities                          |                         | -            |         | (14,937)         |         | (15,736)      |       | (30,673)         |  |  |
|   | \$                      | <b>6,967</b> | \$      | <b>1,617,880</b> | \$      | <b>34,175</b> | \$    | <b>1,659,022</b> |  |  |



Edgar Filing: OFG BANCORP - Form 10-Q

|  |    |   |    |   |    |                |    |                |  |
|--|----|---|----|---|----|----------------|----|----------------|--|
| Non-recurring fair value measurements: |    |   |    |   |    |                |    |                |  |
| Impaired commercial loans              | \$ | - | \$ | - | \$ | 28,353         | \$ | 28,353         |  |
| Foreclosed real estate                 |    | - |    | - |    | 90,024         |    | 90,024         |  |
| Other repossessed assets               |    | - |    | - |    | 12,583         |    | 12,583         |  |
|  | \$ | - | \$ | - | \$ | <b>130,960</b> | \$ | <b>130,960</b> |  |

65



Edgar Filing: OFG BANCORP - Form 10-Q

|  |    |          |    |              |    |               |    |                |    |               |  |  |
|--|----|----------|----|--------------|----|---------------|----|----------------|----|---------------|--|--|
|  |    |          |    |              |    |               |    |                |    |               |  |  |
| <b>Balance at beginning of period</b>  | \$ | 19,680   | \$ | 16,430       | \$ | 13,801        | \$ | (15,736)       | \$ | 34,175        |  |  |
| Gains (losses) included in earnings  |    | -        |    | (9,850)      |    | -             |    | 8,964          |    | (886)         |  |  |
| Changes in fair value of investment securities available for sale included in other comprehensive income |    | 320      |    | -            |    | -             |    | -              |    | 320           |  |  |
| New instruments acquired   |    | -        |    | -            |    | 1,053         |    | -              |    | 1,053         |  |  |
| Principal repayments   |    | (20,000) |    | -            |    | (465)         |    | -              |    | (20,465)      |  |  |
| Amortization   |    | -        |    | -            |    | -             |    | 404            |    | 404           |  |  |
| Changes in fair value of servicing assets  |    | -        |    | -            |    | (734)         |    | -              |    | (734)         |  |  |
| <b>Balance at end of period</b>  | \$ | -        | \$ | <b>6,580</b> | \$ | <b>13,655</b> | \$ | <b>(6,368)</b> | \$ | <b>13,867</b> |  |  |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| Quarter Ended June 30, 2013  |                    |            |           |             |           |  |  |  |  |       |
|--|--------------------|------------|-----------|-------------|-----------|--|--|--|--|-------|
|  | Other              | Derivative |           | Derivative  |           |  |  |  |  |       |
|  | debt               | asset      |           | liability   |           |  |  |  |  |       |
|  | securities         | (S&P       |           | (S&P        |           |  |  |  |  |       |
|  | available-for-sale | Purchased  |           | Embedded    |           |  |  |  |  |       |
| Level 3 Instruments Only   |                    | Options)   |           | Options)    |           |  |  |  |  | Total |
|  |                    |            |           |             |           |  |  |  |  |       |
| Balance at beginning of period   | \$ 20,042          | \$ 15,404  | \$ 11,543 | \$ (14,839) | \$ 32,150 |  |  |  |  |       |
| Gains (losses) included in earnings  | -                  | 616        | -         | (516)       | 100       |  |  |  |  |       |
| Changes in fair value of investment securities available for sale included in other comprehensive income | 16                 | -          | -         | -           | 16        |  |  |  |  |       |
| New instruments acquired   | -                  | -          | 1,301     | -           | 1,301     |  |  |  |  |       |
| Principal repayments   | -                  | -          | (489)     | -           | (489)     |  |  |  |  |       |
| Amortization   | -                  | -          | -         | 40          | 40        |  |  |  |  |       |
| Changes in fair value of servicing assets  | -                  | -          | 639       | -           | 639       |  |  |  |  |       |
| Balance at end of period   | \$ 20,058          | \$ 16,020  | \$ 12,994 | \$ (15,315) | \$ 33,757 |  |  |  |  |       |
|  |                    |            |           |             |           |  |  |  |  |       |
| Six-Month Period Ended June 30, 2013   |                    |            |           |             |           |  |  |  |  |       |
|  | Other              | Derivative |           | Derivative  |           |  |  |  |  |       |
|  | debt               | asset      |           | liability   |           |  |  |  |  |       |
|  | securities         | (S&P       |           | (S&P        |           |  |  |  |  |       |
|  | available-for-sale | Purchased  |           | Embedded    |           |  |  |  |  |       |
|  |                    | Options)   |           | Options)    |           |  |  |  |  | Total |
|  |                    |            |           |             |           |  |  |  |  |       |

| <b>Level 3 Instruments Only</b>  | <b>available-for-sale</b> | <b>Options)</b>  | <b>assets</b>    | <b>Options)</b>    | <b>Total</b>     |
|--|---------------------------|------------------|------------------|--------------------|------------------|
| <b>Balance at beginning of period</b>  | \$ 20,012                 | \$ 13,233        | \$ 10,795        | \$ (12,707)        | \$ 31,333        |
| Gains (losses) included in earnings  | -                         | 2,787            | -                | (2,923)            | (136)            |
| Changes in fair value of investment securities available for sale included in other comprehensive income | 46                        | -                | -                | -                  | 46               |
| New instruments acquired   | -                         | -                | 1,994            | -                  | 1,994            |
| Principal repayments   | -                         | -                | (557)            | -                  | (557)            |
| Amortization   | -                         | -                | -                | 315                | 315              |
| Changes in fair value of servicing assets  | -                         | -                | 762              | -                  | 762              |
| <b>Balance at end of period</b>  | <b>\$ 20,058</b>          | <b>\$ 16,020</b> | <b>\$ 12,994</b> | <b>\$ (15,315)</b> | <b>\$ 33,757</b> |

During the quarters and the six-month periods ended June 30, 2014 and 2013, there were purchases and sales of assets and liabilities measured at fair value on a recurring basis. There were no transfers into and out of Level 1 and Level 2 fair value measurements during such periods.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The table below presents quantitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at June 30, 2014:

|   |    | June 30, 2014  |  |                                      |  |  |                 |
|---|----|----------------|--|--------------------------------------|--|--|-----------------|
|   |    | Fair Value     |  | Valuation Technique                  |  | Unobservable Input   | Range           |
|   |    | (In thousands) |  |                                      |  |  |                 |
| Derivative assets (S&P Purchased Options)   | \$ | 6,580          |  | Option pricing model                 |  | Implied option volatility  | 23.23% - 35.94% |
|   |    |                |  |                                      |  | Counterparty credit risk<br>(based on 5-year credit default swap ("CDS") spread) | 57.00% - 65.17% |
| Servicing assets                            | \$ | 13,655         |  | Cash flow valuation                  |  | Constant prepayment rate   | 5.60% - 11.24%  |
|   |    |                |  |                                      |  | Discount rate  | 10.00% - 12.00% |
| Derivative liability (S&P Embedded Options) | \$ | (6,838)        |  | Option pricing model                 |  | Implied option volatility  | 23.23% - 35.94% |
|   |    |                |  |                                      |  | Counterparty credit risk (based on 5-year CDS spread)                            | 57.00% - 65.17% |
| Collateral dependant impaired loans         | \$ | 29,118         |  | Fair value of property or collateral |  | Appraised value less disposition costs   | 22.20% - 29.20% |



**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

***Information about Sensitivity to Changes in Significant Unobservable Inputs***

Other debt securities – The significant unobservable inputs used in the fair value measurement of one of the Company’s other debt securities are indicative comparable pricing, option adjusted spread (“OAS”), yield to maturity, and spread to maturity. Significant changes in any of those inputs in isolation would result in a significantly different fair value measurement. Generally, a change in the assumption used for indicative comparable pricing is accompanied by a directionally opposite change in the assumption used for OAS and a directionally, although not equally proportional, opposite change in the assumptions used for yield to maturity and spread to maturity.

Derivative asset (S&P Purchased Options) – The significant unobservable inputs used in the fair value measurement of the Company’s derivative assets related to S&P purchased options are implied option volatility and counterparty credit risk. Significant changes in any of those inputs in isolation would result in a significantly different fair value measurement. Generally, a change in the assumption used for implied option volatility is not necessarily accompanied by directionally similar or opposite changes in the assumption used for counterparty credit risk.

Servicing assets – The significant unobservable inputs used in the fair value measurement of the Company’s servicing assets are constant prepayment rates and discount rates. Changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or offset the sensitivities. Mortgage banking activities, a component of total banking and financial service revenue in the consolidated statements of operations, include the changes from period to period in the fair value of the mortgage loan servicing rights, which may result from changes in the valuation model inputs or assumptions (principally reflecting changes in discount rates and prepayment speed assumptions) and other changes, including changes due to collection/realization of expected cash flows.

Derivative liability (S&P Embedded Options) – The significant unobservable inputs used in the fair value measurement of the Company’s derivative liability related to S&P purchased options are implied option volatility and counterparty credit risk. Significant changes in any of those inputs in isolation would result in a significantly different fair value measurement. Generally, a change in the assumption used for implied option volatility is not necessarily accompanied by directionally similar or opposite changes in the assumption used for counterparty credit risk.

***Fair Value of Financial Instruments***

The information about the estimated fair value of financial instruments required by GAAP is presented hereunder. The aggregate fair value amounts presented do not necessarily represent management’s estimate of the underlying value of the Company.

The estimated fair value is subjective in nature, involves uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could affect these fair value estimates. The



fair value estimates do not take into consideration the value of future business and the value of assets and liabilities that are not financial instruments. Other significant tangible and intangible assets that are not considered financial instruments are the value of long-term customer relationships of retail deposits, and premises and equipment.

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The estimated fair value and carrying value of the Company's financial instruments at June 30, 2014 and December 31, 2013 is as follows:

|   | June 30, |           |          |           | December 31, |           |          |           |
|---|----------|-----------|----------|-----------|--------------|-----------|----------|-----------|
|   | 2014     |           |          |           | 2013         |           |          |           |
|   | Fair     |           | Carrying |           | Fair         |           | Carrying |           |
|   | Value    |           | Value    |           | Value        |           | Value    |           |
| (In thousands)                                  |          |           |          |           |              |           |          |           |
| <b>Level 1</b>                                  |          |           |          |           |              |           |          |           |
| <b>Financial Assets:</b>                        |          |           |          |           |              |           |          |           |
| Cash and cash equivalents                       | \$       | 596,485   | \$       | 596,485   | \$           | 621,269   | \$       | 621,269   |
| Restricted cash                                 |          | 15,170    |          | 15,170    |              | 82,199    |          | 82,199    |
| <b>Level 2</b>                                  |          |           |          |           |              |           |          |           |
| <b>Financial Assets:</b>                        |          |           |          |           |              |           |          |           |
| Securities purchased under agreements to resell |          | -         |          | -         |              | 60,000    |          | 60,000    |
| Trading securities                              |          | 1,613     |          | 1,613     |              | 1,869     |          | 1,869     |
| Investment securities available-for-sale        |          | 1,418,958 |          | 1,418,958 |              | 1,568,745 |          | 1,568,745 |
| Investment securities held-to-maturity          |          | 26,844    |          | 26,706    |              | -         |          | -         |
| Federal Home Loan Bank (FHLB) stock             |          | 24,381    |          | 24,381    |              | 24,450    |          | 24,450    |
| Derivative assets                               |          | 2,978     |          | 2,978     |              | 4,072     |          | 4,072     |
| <b>Financial Liabilities:</b>                   |          |           |          |           |              |           |          |           |
| Derivative liabilities                          |          | 13,617    |          | 13,617    |              | 14,937    |          | 14,937    |
| <b>Level 3</b>                                  |          |           |          |           |              |           |          |           |
| <b>Financial Assets:</b>                        |          |           |          |           |              |           |          |           |
| Investment securities available-for-sale        |          | -         |          | -         |              | 19,680    |          | 19,680    |
| Total loans (including loans held-for-sale)     |          |           |          |           |              |           |          |           |
| Non-covered loans, net                          |          | 4,527,811 |          | 4,601,696 |              | 4,857,505 |          | 4,662,458 |
| Covered loans, net                              |          | 397,262   |          | 334,344   |              | 459,444   |          | 356,961   |
| Derivative assets                               |          | 6,580     |          | 6,580     |              | 16,430    |          | 16,430    |
| FDIC indemnification asset                      |          | 94,653    |          | 143,660   |              | 152,965   |          | 189,240   |
| Accrued interest receivable                     |          | 22,508    |          | 22,508    |              | 18,734    |          | 18,734    |
| Servicing assets                                |          | 13,655    |          | 13,655    |              | 13,801    |          | 13,801    |
| <b>Financial Liabilities:</b>                   |          |           |          |           |              |           |          |           |
| Deposits  |          | 5,076,996 |          | 5,141,233 |              | 5,409,540 |          | 5,383,265 |

## Edgar Filing: OFG BANCORP - Form 10-Q

|  |  |           |  |  |           |  |  |           |  |  |           |
|--|--|-----------|--|--|-----------|--|--|-----------|--|--|-----------|
| Securities sold under agreements to repurchase |  | 1,065,181 |  |  | 1,012,233 |  |  | 1,323,903 |  |  | 1,267,618 |
| Advances from FHLB                             |  | 365,808   |  |  | 360,240   |  |  | 335,324   |  |  | 336,143   |
| Term notes                                     |  | 3,741     |  |  | 3,837     |  |  | 3,638     |  |  | 3,663     |
| Subordinated capital notes                     |  | 88,243    |  |  | 100,797   |  |  | 99,316    |  |  | 100,010   |
| Accrued expenses and other liabilities         |  | 135,406   |  |  | 135,406   |  |  | 144,424   |  |  | 144,424   |

70

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The following methods and assumptions were used to estimate the fair values of significant financial instruments at June 30, 2014 and December 31, 2013:

- Cash and cash equivalents (including money market investments and time deposits with other banks), restricted cash, accrued interest receivable, securities purchased under agreements to resell, accrued expenses and other liabilities have been valued at the carrying amounts reflected in the consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.
- Investments in FHLB-NY stock are valued at their redemption value.
- The fair value of investment securities, including trading securities, is based on quoted market prices, when available, or market prices provided by recognized broker-dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument. The estimated fair value of the structured credit investments is determined by using a third-party cash flow valuation model to calculate the present value of projected future cash flows. The assumptions used which are highly uncertain and require a high degree of judgment, include primarily market discount rates, current spreads, duration, leverage, default, home price depreciation, and loss rates. The assumptions used are drawn from a wide array of data sources, including the performance of the collateral underlying each deal. The external-based valuation, which is obtained at least on a quarterly basis, is analyzed and its assumptions are evaluated and incorporated in either an internal-based valuation model when deemed necessary, or compared to counterparties' prices and agreed by management.
- The fair value of the FDIC indemnification asset represents the present value of the net estimated cash payments expected to be received from the FDIC for future losses on covered assets based on the credit assumptions on estimated cash flows for each covered asset pool and the loss sharing percentages. The ultimate collectability of the FDIC indemnification asset is dependent upon the performance of the underlying covered loans, the passage of time and claims paid by the FDIC which are impacted by the Bank's adherence to certain guidelines established by the FDIC.
- The fair value of servicing assets is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions.

- The fair values of the derivative instruments are provided by valuation experts and counterparties. Certain derivatives with limited market activity are valued using externally developed models that consider unobservable market parameters. The Company has offered its customers certificates of deposit with an option tied to the performance of the S&P Index, and uses equity indexed option agreements with major broker-dealers to manage its exposure to changes in this index. Their fair value is obtained through the use of an external based valuation that was thoroughly evaluated and adopted by management as its measurement tool for these options. The payoff of these options is linked to the average value of the S&P Index on a specific set of dates during the life of the option. The methodology uses an average rate option or a cash-settled option whose payoff is based on the difference between the expected average value of the S&P Index during the remaining life of the option and the strike price at inception. The assumptions, which are uncertain and require a degree of judgment, include primarily S&P Index volatility, forward interest rate projections, estimated index dividend payout, and leverage.
- Fair value of derivative liabilities, which include interest rate swaps and forward-settlement swaps, are based on the net discounted value of the contractual projected cash flows of both the pay-fixed receive-variable legs of the contracts. The projected cash flows are based on the forward yield curve, and discounted using current estimated market rates.
- The fair value of the covered and non-covered loan portfolio (including loans held-for-sale) is estimated by segregating by type, such as mortgage, commercial, consumer, auto and leasing. Each loan segment is further segmented into fixed and adjustable interest rates and by performing and non-performing categories. The fair value of performing loans is calculated by discounting contractual cash flows, adjusted for prepayment estimates (voluntary and involuntary), if any, using estimated current market discount rates that reflect the credit and interest rate risk inherent in the loan. This fair value is not currently an indication of an exit price as that type of assumption could result in a different fair value estimate.
- The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is based on the discounted value of the contractual cash flows, using estimated current market discount rates for deposits of similar remaining maturities.

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

- The fair value of long-term borrowings, which include securities sold under agreements to repurchase, advances from FHLB-NY, and subordinated capital notes, is based on the discounted value of the contractual cash flows using current estimated market discount rates for borrowings with similar terms, remaining maturities and put dates.
- The fair value of commitments to extend credit and unused lines of credit is based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

**NOTE 18 – BUSINESS SEGMENTS**

The Company segregates its businesses into the following major reportable segments of business: Banking, Wealth Management, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Company's organization, nature of its products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The Company measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, net interest income, loan production, and fees generated. The Company's methodology for allocating non-interest expenses among segments is based on several factors such as revenue, employee headcount, occupied space, dedicated services or time, among others. These factors are reviewed on a periodical basis and may change if the conditions warrant.

Banking includes the Bank's branches and traditional banking products such as deposits and commercial, consumer and mortgage loans. Mortgage banking activities are carried out by the Bank's mortgage banking division, whose principal activity is to originate mortgage loans for the Company's own portfolio. As part of its mortgage banking activities, the Company may sell loans directly into the secondary market or securitize conforming loans into mortgage-backed securities.

Wealth Management is comprised of the Bank's trust division, Oriental Financial Services, Oriental Insurance, and CPC. The core operations of this segment are financial planning, money management and investment banking, brokerage services, insurance sales activity, corporate and individual trust and retirement services, as well as pension plan administration services.

The Treasury segment encompasses all of the Company's asset/liability management activities, such as purchases and sales of investment securities, interest rate risk management, derivatives, and borrowings. Intersegment sales and transfers, if any, are accounted for as if the sales or transfers were to third parties, that is, at current market prices.



## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Following are the results of operations and the selected financial information by operating segment for the quarters and six-month periods ended June 30, 2014 and 2013:

|   | Quarter Ended June 30, 2014 |            |              |              |              |              |              |
|---|-----------------------------|------------|--------------|--------------|--------------|--------------|--------------|
|   |                             | Wealth     |              |              | Total Major  |              | Consolidated |
|   | Banking                     | Management | Treasury     | Segments     | Eliminations | Total        |              |
| (In thousands)                                  |                             |            |              |              |              |              |              |
| Interest income                                 | \$ 112,971                  | \$ 46      | \$ 12,883    | \$ 125,900   | \$ -         | \$ 125,900   |              |
| Interest expense                                | (10,828)                    | -          | (8,994)      | (19,822)     | -            | (19,822)     |              |
| Net interest income                             | 102,143                     | 46         | 3,889        | 106,078      | -            | 106,078      |              |
| Provision for non-covered loan and lease losses | (13,220)                    | -          | -            | (13,220)     | -            | (13,220)     |              |
| Provision for covered loan and lease losses     | (1,595)                     | -          | -            | (1,595)      | -            | (1,595)      |              |
| Non-interest income (loss)                      | (6,507)                     | 7,502      | (488)        | 507          | -            | 507          |              |
| Non-interest expenses                           | (49,651)                    | (6,367)    | (3,830)      | (59,848)     | -            | (59,848)     |              |
| Intersegment revenue                            | 435                         | -          | -            | 435          | (435)        | -            |              |
| Intersegment expenses                           | -                           | (327)      | (108)        | (435)        | 435          | -            |              |
| Income before income taxes                      | \$ 31,605                   | \$ 854     | \$ (537)     | \$ 31,922    | \$ -         | \$ 31,922    |              |
| Total assets                                    | \$ 6,508,432                | \$ 25,345  | \$ 2,089,516 | \$ 8,623,293 | \$ (913,148) | \$ 7,710,145 |              |
|   |                             |            |              |              |              |              |              |
|   |                             |            |              |              |              |              |              |
|   |                             |            |              |              |              |              |              |
| Quarter Ended June 30, 2013                     |                             |            |              |              |              |              |              |
|   | Wealth                      |            |              | Total Major  |              | Consolidated |              |
| Banking   | Management                  | Treasury   | Segments     | Eliminations | Total        |              |              |
| (In thousands)                                  |                             |            |              |              |              |              |              |
| Interest income                                 | \$ 115,541                  | \$ 96      | \$ 10,665    | \$ 126,302   | \$ -         | \$ 126,302   |              |



## Edgar Filing: OFG BANCORP - Form 10-Q

|   |                     |                  |                     |                     |                     |                     |
|---|---------------------|------------------|---------------------|---------------------|---------------------|---------------------|
| Interest expense                                | (9,840)             | -                | (10,167)            | (20,007)            | -                   | (20,007)            |
| Net interest income                             | 105,701             | 96               | 498                 | 106,295             | -                   | 106,295             |
| Provision for non-covered loan and lease losses | (37,527)            | -                | -                   | (37,527)            | -                   | (37,527)            |
| Provision for covered loan and lease losses     | (1,211)             | -                | -                   | (1,211)             | -                   | (1,211)             |
| Non-interest income (loss)                      | (5,258)             | 8,100            | 3,893               | 6,735               | -                   | 6,735               |
| Non-interest expenses                           | (57,783)            | (6,650)          | (4,254)             | (68,687)            | -                   | (68,687)            |
| Intersegment revenue                            | 579                 | -                | -                   | 579                 | (579)               | -                   |
| Intersegment expenses                           | -                   | (485)            | (94)                | (579)               | 579                 | -                   |
| <b>Income before income taxes</b>               | <b>\$ 4,501</b>     | <b>\$ 1,061</b>  | <b>\$ 43</b>        | <b>\$ 5,605</b>     | <b>\$ -</b>         | <b>\$ 5,605</b>     |
| <b>Total assets</b>                             | <b>\$ 6,746,902</b> | <b>\$ 39,960</b> | <b>\$ 2,527,039</b> | <b>\$ 9,313,901</b> | <b>\$ (877,967)</b> | <b>\$ 8,435,934</b> |

## OFG BANCORP

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | Six-Month Period Ended June 30, 2014 |                 |                 |  |                  |              |                  |
|--|--------------------------------------|-----------------|-----------------|--|------------------|--------------|------------------|
|  |                                      | Wealth          |                 |  | Total Major      |              | Consolidated     |
|  | Banking                              | Management      | Treasury        |  | Segments         | Eliminations | Total            |
|  | (In thousands)                       |                 |                 |  |                  |              |                  |
| Interest income                                  | \$ 221,602                           | \$ 86           | \$ 27,286       |  | \$ 248,974       | \$ -         | \$ 248,974       |
| Interest expense                                 | (18,344)                             | -               | (21,154)        |  | (39,498)         | -            | (39,498)         |
| Net interest income                              | 203,258                              | 86              | 6,132           |  | 209,476          | -            | 209,476          |
| Provision for non-covered loan and lease losses  | (23,282)                             | -               | -               |  | (23,282)         | -            | (23,282)         |
| Provision for covered loan and lease losses, net | (3,224)                              | -               | -               |  | (3,224)          | -            | (3,224)          |
| Non-interest income(loss)                        | (11,603)                             | 14,024          | 3,315           |  | 5,736            | -            | 5,736            |
| Non-interest expenses                            | (103,198)                            | (11,146)        | (6,908)         |  | (121,252)        | -            | (121,252)        |
| Intersegment revenue                             | 979                                  | -               | -               |  | 979              | (979)        | -                |
| Intersegment expenses                            | -                                    | (759)           | (220)           |  | (979)            | 979          | -                |
| <b>Income before income taxes</b>                | <b>\$ 62,930</b>                     | <b>\$ 2,205</b> | <b>\$ 2,319</b> |  | <b>\$ 67,454</b> | <b>\$ -</b>  | <b>\$ 67,454</b> |
|  |                                      |                 |                 |  |                  |              |                  |
|  |                                      |                 |                 |  |                  |              |                  |
|  |                                      |                 |                 |  |                  |              |                  |
|  | Six-Month Period Ended June 30, 2013 |                 |                 |  |                  |              |                  |
|  |                                      | Wealth          |                 |  | Total Major      |              | Consolidated     |
|  | Banking                              | Management      | Treasury        |  | Segments         | Eliminations | Total            |
|  | (In thousands)                       |                 |                 |  |                  |              |                  |
| Interest income                                  | \$ 217,609                           | \$ 182          | \$ 22,683       |  | \$ 240,474       | \$ -         | \$ 240,474       |
| Interest expense                                 | (20,497)                             | -               | (20,068)        |  | (40,565)         | -            | (40,565)         |
| Net interest income                              | 197,112                              | 182             | 2,615           |  | 199,909          | -            | 199,909          |
| Provision for non-covered loan and lease losses  | (45,443)                             | -               | -               |  | (45,443)         | -            | (45,443)         |
| Provision for covered loan and lease losses, net | (1,883)                              | -               | -               |  | (1,883)          | -            | (1,883)          |
| Non-interest income(loss)                        | (3,193)                              | 15,801          | 4,030           |  | 16,638           | -            | 16,638           |

Edgar Filing: OFG BANCORP - Form 10-Q

|                                   |           |               |           |              |           |              |           |               |           |          |           |               |
|-----------------------------------|-----------|---------------|-----------|--------------|-----------|--------------|-----------|---------------|-----------|----------|-----------|---------------|
| Non-interest expenses             |           | (115,501)     |           | (12,777)     |           | (7,020)      |           | (135,298)     |           | -        |           | (135,298)     |
| Intersegment revenue              |           | (624)         |           | -            |           | -            |           | (624)         |           | 624      |           | -             |
| Intersegment expenses             |           | -             |           | (786)        |           | 1,410        |           | 624           |           | (624)    |           | -             |
| <b>Income before income taxes</b> | <b>\$</b> | <b>30,468</b> | <b>\$</b> | <b>2,420</b> | <b>\$</b> | <b>1,035</b> | <b>\$</b> | <b>33,923</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>33,923</b> |

74

**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**NOTE 19 – SUBSEQUENT EVENTS**

On July 1, 2014, the Governor of the Commonwealth of Puerto Rico signed House Bill 1919 into law, which became Act 77-2014 (the Act). The Act, which amends the Puerto Rico Internal Revenue Code of 2011 and Act 73-2008, also known as the “Economic Incentives for the Development of Puerto Rico Act”, includes several new tax measures applicable to financial and non financial entities. The main provisions of the Act include:

- A mechanism to impose a 10% tax on a deemed dividend amount resulting from the holding of certain foreign assets, as defined.
- The exclusion of loans or credit transactions between affiliates, with some limited exceptions for purposes of determining the Puerto Rico net assets as part of the computation of the dividend equivalent amount of foreign corporations subject to the branch profits tax.
- Elimination of the former Gross Income Tax as a component of the alternative minimum tax (AMT) for non financial institutions for taxable years commencing on January 1, 2014. Effective for taxable years commencing after December 31, 2013, a tax on gross income is imposed in addition to the regular income tax, the AMT or the alternative basic tax at graduated rates ranging from .20% to .85%. This gross income tax is deductible in arriving at taxable income.
- Limitation of the amount of the tax credit to be claimed against the current year regular tax with respect to the AMT paid in prior years (AMT Credit) to 25% of the current net regular tax over the AMT for such taxable year.
- Increase in tax rates on: (a) net long term capital gains for corporations from 15% to 20%, and (b) dividends from certain corporations from 10% to 15%.
- The holding period to determine whether a gain or loss from the sale of capital assets is considered long-term is increased from six-months to one year.

The Company has made an evaluation of the impact of these amendments and considered the impact immaterial.



**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**INTRODUCTION**

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the "Selected Financial Data" and the Company's unaudited consolidated financial statements and related notes. This discussion and analysis contains forward-looking statements. Please see "Forward-Looking Statements" and the risk factors set forth in our 2013 Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K"), for discussion of the uncertainties, risks and assumptions associated with these statements.

The Company is a publicly-owned financial holding company that provides a full range of banking and financial services through its subsidiaries, including commercial, consumer, auto and mortgage lending; checking and savings accounts; financial planning, insurance and securities brokerage services; and corporate and individual trust and retirement services. The Company operates through three major business segments: Banking, Wealth Management, and Treasury, and distinguishes itself based on quality service. The Company has 55 branches in Puerto Rico and a subsidiary in Boca Raton, Florida. The Company's long-term goal is to strengthen its banking and financial services franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and financial services, maintaining effective asset-liability management, growing non-interest revenue from banking and financial services, and improving operating efficiencies.

The Company's diversified mix of businesses and products generates both the interest income traditionally associated with a banking institution and non-interest income traditionally associated with a financial services institution (generated by such businesses as securities brokerage, fiduciary services, investment banking, insurance agency, and retirement plan administration). Although all of these businesses, to varying degrees, are affected by interest rate and financial market fluctuations and other external factors, the Company's commitment is to continue producing a balanced and growing revenue stream.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”) requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We provide a summary of our significant accounting policies in “Note 1—Summary of Significant Accounting Policies” of our annual report on the 2013 Form 10-K.

In the “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” section of our 2013 Form 10-K, we identified the following accounting policies as critical because they require significant judgments and assumptions about highly complex and inherently uncertain matters and the use of reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition:

- Business combination
- Allowance for loan and lease losses
- Financial instruments

We evaluate our critical accounting estimates and judgments on an ongoing basis and update them as necessary based on changing conditions. Management has reviewed and approved these critical accounting policies and has discussed its judgments and assumptions with the Audit and Compliance Committee of our Board of Directors. As part of the Company’s continuous enhancement to the allowance for loan and lease losses methodology, during the quarter ended March 31, 2014, an assessment of the look-back period and historical loss factor was performed for auto and leasing and consumer loan portfolios based on the trends observed and their relation with the economic cycle as of the period ended March 31, 2014. Same analysis was performed for the commercial portfolio during the quarter ended June 30, 2014. As a result, the period was changed to 24 months from the previously determined 12 months for auto and leasing and consumer. For the commercial portfolio, a look back period of 12 months was maintained. In addition, during the quarter ended June 30, 2014, an assessment of environmental factors was performed for commercial, auto, and consumer portfolios. As a result, more weight is been given to the environmental factors related to the economy, taking into consideration current evolution of the portfolio and expected impact, due to recent economic developments. These changes in the allowance for loan and lease losses’ look back period for the consumer and auto and leasing portfolios, and economic factors for the commercial, auto, and consumer portfolios are considered a change in accounting estimate as per ASC 250-10 provisions, where adjustments should be made prospectively. Apart from these changes, there have been no other material changes in the methods used to formulate these critical accounting estimates from those discussed in our 2013 Form 10-K.

**OVERVIEW OF FINANCIAL PERFORMANCE**

| <b>SELECTED FINANCIAL DATA</b>                                       |  |                  |  |                 |  |                  |  |                 |
|--|--|------------------|--|-----------------|--|------------------|--|-----------------|
|  | <b>Quarter Ended June 30,</b>                |                  |  |                 | <b>Six-Month Period Ended June 30,</b> |                  |  |                 |
|  |  |                  |  | <b>Variance</b> |  |                  |  | <b>Variance</b> |
|  | <b>2014</b>                                  | <b>2013</b>      |  | <b>%</b>        | <b>2014</b>                            | <b>2013</b>      |  | <b>%</b>        |
| <b>EARNINGS DATA:</b>  | <b>(In thousands, except per share data)</b> |                  |  |                 |  |                  |  |                 |
| Interest income  | \$ 125,900                                   | \$ 126,302       |  | -0.3%           | \$ 248,974                             | \$ 240,474       |  | 3.5%            |
| Interest expense   | 19,822                                       | 20,007           |  | -0.9%           | 39,498                                 | 40,565           |  | -2.6%           |
| <b>Net interest income</b>   | <b>106,078</b>                               | <b>106,295</b>   |  | <b>-0.2%</b>    | <b>209,476</b>                         | <b>199,909</b>   |  | <b>4.8%</b>     |
| Provision for non-covered loan and lease losses                      | 13,220                                       | 37,527           |  | -64.8%          | 23,282                                 | 45,443           |  | -48.8%          |
| Provision for covered loan and lease losses, net                     | 1,595  | 1,211            |  | 31.7%           | 3,224                                  | 1,883            |  | 71.2%           |
| <b>Total provision for loan and lease losses, net</b>                | <b>14,815</b>                                | <b>38,738</b>    |  | <b>-61.8%</b>   | <b>26,506</b>                          | <b>47,326</b>    |  | <b>-44.0%</b>   |
| <b>Net interest income after provision for loan and lease losses</b> | <b>91,263</b>                                | <b>67,557</b>    |  | <b>35.1%</b>    | <b>182,970</b>                         | <b>152,583</b>   |  | <b>19.9%</b>    |
| Non-interest income  | 507  | 6,735            |  | -92.5%          | 5,736                                  | 16,638           |  | -65.5%          |
| Non-interest expenses  | 59,848                                       | 68,687           |  | -12.9%          | 121,252                                | 135,298          |  | -10.4%          |
| <b>Income before taxes</b>   | <b>31,922</b>                                | <b>5,605</b>     |  | <b>469.5%</b>   | <b>67,454</b>                          | <b>33,923</b>    |  | <b>98.8%</b>    |
| Income tax expense (benefit)   | 10,613                                       | (31,934)         |  | 133.2%          | 22,398                                 | (24,808)         |  | 190.3%          |
| <b>Net income</b>  | <b>21,309</b>                                | <b>37,539</b>    |  | <b>-43.2%</b>   | <b>45,056</b>                          | <b>58,731</b>    |  | <b>-23.3%</b>   |
| Less: dividends on preferred stock                                   | (3,466)                                      | (3,466)          |  | 153.0%          | (6,931)                                | (6,931)          |  | 153.0%          |
| <b>Income available to common shareholders</b>                       | <b>\$ 17,843</b>                             | <b>\$ 34,073</b> |  | <b>-47.6%</b>   | <b>\$ 38,125</b>                       | <b>\$ 51,800</b> |  | <b>-26.4%</b>   |
| <b>PER SHARE DATA:</b>   |  |                  |  |                 |  |                  |  |                 |
| <b>Basic</b>   | <b>\$ 0.40</b>                               | <b>\$ 0.75</b>   |  | <b>-46.7%</b>   | <b>\$ 0.84</b>                         | <b>\$ 1.14</b>   |  | <b>-26.3%</b>   |
| <b>Diluted</b>   | <b>\$ 0.38</b>                               | <b>\$ 0.68</b>   |  | <b>-44.1%</b>   | <b>\$ 0.80</b>                         | <b>\$ 1.05</b>   |  | <b>-23.8%</b>   |
| <b>Average common shares outstanding</b>                             | <b>45,014</b>                                | <b>45,638</b>    |  | <b>-1.4%</b>    | <b>45,170</b>                          | <b>45,613</b>    |  | <b>-1.0%</b>    |
| <b>Average common shares outstanding and equivalents</b>             | <b>52,352</b>                                | <b>52,968</b>    |  | <b>-1.2%</b>    | <b>52,476</b>                          | <b>52,929</b>    |  | <b>-0.9%</b>    |
| <b>Cash dividends declared per common share</b>                      | <b>\$ 0.08</b>                               | <b>\$ 0.06</b>   |  | <b>33.3%</b>    | <b>\$ 0.16</b>                         | <b>\$ 0.12</b>   |  | <b>33.3%</b>    |



|   |    |               |    |               |               |    |               |    |               |               |
|---|----|---------------|----|---------------|---------------|----|---------------|----|---------------|---------------|
| <b>Cash dividends declared on common shares</b> | \$ | <b>3,560</b>  | \$ | <b>2,742</b>  | <b>29.8%</b>  | \$ | <b>7,217</b>  | \$ | <b>5,479</b>  | <b>31.7%</b>  |
| <b>PERFORMANCE RATIOS:</b>                      |    |               |    |               |               |    |               |    |               |               |
| <b>Return on average assets (ROA)</b>           |    | <b>1.10%</b>  |    | <b>1.76%</b>  | <b>-37.5%</b> |    | <b>1.14%</b>  |    | <b>1.35%</b>  | <b>-15.6%</b> |
| <b>Return on average tangible common equity</b> |    | <b>10.96%</b> |    | <b>22.75%</b> | <b>-51.8%</b> |    | <b>11.89%</b> |    | <b>17.35%</b> | <b>-31.5%</b> |
| <b>Return on average common equity (ROE)</b>    |    | <b>9.54%</b>  |    | <b>19.50%</b> | <b>-51.1%</b> |    | <b>10.32%</b> |    | <b>14.86%</b> | <b>-30.6%</b> |
| <b>Equity-to-assets ratio</b>                   |    | <b>12.00%</b> |    | <b>10.32%</b> | <b>16.2%</b>  |    | <b>12.00%</b> |    | <b>10.32%</b> | <b>16.2%</b>  |
| <b>Efficiency ratio</b>                         |    | <b>47.89%</b> |    | <b>52.49%</b> | <b>-8.8%</b>  |    | <b>48.99%</b> |    | <b>54.80%</b> | <b>-10.6%</b> |
| <b>Interest rate spread</b>                     |    | <b>6.05%</b>  |    | <b>5.65%</b>  | <b>7.1%</b>   |    | <b>5.91%</b>  |    | <b>5.26%</b>  | <b>12.4%</b>  |
| <b>Interest rate margin</b>                     |    | <b>6.10%</b>  |    | <b>5.66%</b>  | <b>7.8%</b>   |    | <b>5.96%</b>  |    | <b>5.26%</b>  | <b>13.3%</b>  |

| <b>SELECTED FINANCIAL DATA - (Continued)</b>                                 |  |                  |                     |                  |                 |              |
|--|--|------------------|---------------------|------------------|-----------------|--------------|
|  | <b>June 30,</b>                              |                  | <b>December 31,</b> |                  | <b>Variance</b> |              |
|  | <b>2014</b>                                  |                  | <b>2013</b>         |                  | <b>%</b>        |              |
| <b>PERIOD END BALANCES AND CAPITAL RATIOS:</b>                               | <b>(In thousands, except per share data)</b> |                  |                     |                  |                 |              |
| <b>Investments and loans</b>   |  |                  |                     |                  |                 |              |
| Investment securities  | \$   | 1,471,723        | \$                  | 1,614,809        |                 | -8.9%        |
| Loans and leases not covered under shared-loss agreements with the FDIC, net |  | 4,601,696        |                     | 4,662,458        |                 | -1.3%        |
| Loans and leases covered under shared-loss agreements with the FDIC, net     |  | 334,344          |                     | 356,961          |                 | -6.3%        |
| <b>Total investments and loans</b>   | <b>\$</b>                                    | <b>6,407,763</b> | <b>\$</b>           | <b>6,634,228</b> |                 | <b>-3.4%</b> |
| <b>Deposits and borrowings</b>   |  |                  |                     |                  |                 |              |
| Deposits   | \$   | 5,141,233        | \$                  | 5,383,265        |                 | -4.5%        |
| Securities sold under agreements to repurchase                               |  | 1,012,233        |                     | 1,267,618        |                 | -20.1%       |
| Other borrowings   |  | 464,874          |                     | 439,816          |                 | 5.7%         |
| <b>Total deposits and borrowings</b>   | <b>\$</b>                                    | <b>6,618,340</b> | <b>\$</b>           | <b>7,090,699</b> |                 | <b>-6.7%</b> |
| <b>Stockholders' equity</b>  |  |                  |                     |                  |                 |              |
| Preferred stock  | \$   | 176,000          | \$                  | 176,000          |                 | 0.0%         |
| Common stock   |  | 52,730           |                     | 52,707           |                 | 0.0%         |
| Additional paid-in capital   |  | 538,936          |                     | 538,071          |                 | 0.2%         |
| Legal surplus  |  | 66,438           |                     | 61,957           |                 | 7.2%         |
| Retained earnings  |  | 160,055          |                     | 133,629          |                 | 19.8%        |
| Treasury stock, at cost  |  | (90,712)         |                     | (80,642)         |                 | -12.5%       |
| Accumulated other comprehensive income                                       |  | 21,755           |                     | 3,191            |                 | 581.8%       |
| <b>Total stockholders' equity</b>  | <b>\$</b>                                    | <b>925,202</b>   | <b>\$</b>           | <b>884,913</b>   |                 | <b>4.6%</b>  |
| <b>Per share data</b>  |  |                  |                     |                  |                 |              |
| <b>Book value per common share</b>   | <b>\$</b>                                    | <b>16.87</b>     | <b>\$</b>           | <b>15.45</b>     |                 | <b>9.2%</b>  |
| <b>Tangible book value per common share</b>                                  | <b>\$</b>                                    | <b>14.71</b>     | <b>\$</b>           | <b>13.27</b>     |                 | <b>10.9%</b> |
| <b>Market price at end of period</b>   | <b>\$</b>                                    | <b>18.41</b>     | <b>\$</b>           | <b>17.34</b>     |                 | <b>6.2%</b>  |
| <b>Capital ratios</b>  |  |                  |                     |                  |                 |              |
| <b>Leverage capital</b>  |  | <b>10.26%</b>    |                     | <b>9.11%</b>     |                 | <b>12.6%</b> |
| <b>Tier 1 risk-based capital</b>   |  | <b>15.49%</b>    |                     | <b>14.35%</b>    |                 | <b>7.9%</b>  |
| <b>Total risk-based capital</b>  |  | <b>17.30%</b>    |                     | <b>16.14%</b>    |                 | <b>7.2%</b>  |
| <b>Tier 1 common equity to risk-weighted assets</b>                          |  | <b>11.47%</b>    |                     | <b>10.44%</b>    |                 | <b>9.9%</b>  |
| <b>Financial assets managed</b>  |  |                  |                     |                  |                 |              |
| Trust assets managed   | \$   | 2,866,576        | \$                  | 2,796,923        |                 | 2.5%         |
| Broker-dealer assets gathered  | \$   | 2,651,291        | \$                  | 2,493,324        |                 | 6.3%         |



## **FINANCIAL HIGHLIGHTS OF THE SECOND QUARTER OF 2014**

Income available to common shareholders for the quarter ended June 30, 2014 was \$17.8 million, or \$0.38 per diluted share. In the quarter ended June 30, 2013, the Company earned \$34.1 million or \$0.68 per diluted share, which included a net positive impact of \$16.3 million from non-recurring items. Such non-recurring items included a \$37.0 million deferred income tax benefit as result of the change in tax rate from 30% to 39%, \$13.6 million of additional provision for non-performing mortgage loans transferred to held for sale, \$8.5 million for the catch up of the first quarter of 2013 income tax expense as a result of the increase in effective income tax rate from 25% to 35%, and a \$1.4 million net gain on the sale of a claim on insolvency proceeding.

Net interest margin expanded to 6.10% from 5.66% primarily as a result of an increase in the yield of the Company's interest earning assets.

The Company's return on assets was 1.10%, and its return on equity was 9.54%, each of which were decreases from 1.76% and 19.50%, respectively, from the second quarter of 2013. The Company improved its efficiency ratio, which decreased to 47.89% from 52.49% when compared with the same quarter in 2013, primarily as a result of a decrease in the Company's non-interest expenses.

### **Interest Income**

Total interest income slightly decreased 0.3% to \$125.9 million. This was mainly related to the decrease in interest income from loans of \$2.2 million, or 1.9%, in the second quarter of 2014. The yield on non-covered loans decreased from 7.80% to 7.55% when compared to the same period in 2013 as a result of a decrease in the yield of acquired loans accounted for under ASC 310-20 from 6.29% to 6.20%, as this portfolio continues to decrease due to scheduled repayments and maturities. Nevertheless, the yield on covered loans increased from 25.70% to 29.06%. This increase in yield is the result of higher projected cash flows on certain pools of covered loans, as credit losses have been lower than initially estimated for these pools. The covered portfolio is having cost recoveries on pools with lower carrying amounts, and these have the effect of increasing net interest income and results mainly from favorable workout resolutions with borrowers.

Interest income from investments reflects a 15.7% increase. The increase is mainly due to the increase in the investments' yield to 2.66% as compared to 1.81%, driven by lower premium amortization.

### **Interest Expense**

Total interest expense slightly decreased 0.9% to \$19.8 million, as compared to the same period in 2013. Such decrease reflects the lower cost of deposits before purchase accounting adjustments (0.76% vs. 0.96%). Such lower cost reflects continuing progress in the repricing of the Company's core retail deposits and other reductions in its cost of funds.

**Net Interest Income**

Net interest income remained level at \$106.1 million for the second quarter of 2014. Net interest margin of 6.10% increased 45 basis points when compared to the second quarter of 2013.

### **Provision for Loan and Lease Losses**

Provision for non-covered loans losses decreased \$24.3 million when compared to \$37.5 million for the second quarter of 2013, which included the impact of a \$21.0 million additional provision due to the reclassification to held-for-sale of \$59 million non-performing residential mortgage loans. Excluding this effect, the provision would have been \$16.5 million, compared to \$13.2 for the second quarter of 2014. Provision for covered loans losses increased \$384 thousand when compared to the same period in 2013.

### **Non-Interest Income**

Core banking and financial services revenues decreased 23.2% to \$18.9 million as compared to the same period in 2013, primarily reflecting a decrease of \$2.7 million in banking services revenue to \$10.0 million, and a decrease of \$2.3 million in the mortgage banking activities to \$1.6 million. Decrease in banking services revenues is mostly due to the reclassification of loan late charges into interest income during the last quarter of 2013. For the quarter and six-month period ended June 30, 2013 these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013. Decrease in mortgage banking activities is mainly due to higher losses in repurchased loans and decrease in sales, when compared to same period in 2013.

The FDIC shared-loss expense of \$18.4 million, compared to \$20.0 million for the same period in 2013, resulted from the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced projected losses expected to be collected from the FDIC and the improved accretible yield on the covered loans.

Losses from derivative activities were \$247 thousand, compared to \$164 thousand for the same period in 2013.

### **Non-Interest Expense**

Non-interest expense, decreased to \$59.8 million, compared to \$68.7 million for the same period in 2013, mainly because during the second quarter of 2014, there were no merger and restructuring charges compared to \$5.3 million for the same period in 2013. As a result of such decrease, the Company's efficiency ratio improved to 47.89%, compared to 52.49% for the same period in 2013.

### **Income Tax Expense**

Income tax expense was \$10.6 million, compared to an income tax benefit of \$31.9 million for the same period in 2013. The income tax benefit for the quarter ended June 30, 2013 included a \$36.9 million benefit from the effect in deferred taxes due to the increase in tax rates from 30.0% to 39.0%.

### **Income Available to Common Shareholders**

The Company's income available to common shareholders amounted to \$17.8 million, compared to \$34.1 million for the same period in 2013. Income per basic common share and fully diluted common share was \$0.40 and \$0.38, respectively, compared to income per basic common share and fully diluted common share of \$0.75 and \$0.68, respectively, for the second quarter of 2013.

### **Interest Earning Assets**

The loan portfolio declined to \$4.936 billion at June 30, 2014, compared to \$5.003 billion at March 31, 2014, primarily due to the pay down of some commercial loans. The investment portfolio of \$1.472 billion at June 30, 2014 decreased slightly 0.7% compared to \$1.482 billion at March 31, 2014.

### **Interest Bearing Liabilities**

Total deposits amounted to \$5.141 billion at June 30, 2014, a decrease of 3.1% compared to \$5.301 billion at March 31, 2014. Securities sold under agreements to repurchase remained at \$1.012 billion.

## **Stockholders' Equity**

Stockholders' equity at June 30, 2014 was \$925.2 million compared to \$896.5 million at March 31, 2014, an increase of 3.2%. This increase reflects the net income for the quarter and an increase in other comprehensive income. Book value per share was \$16.87 at June 30, 2014 compared to \$16.23 at March 31, 2014.

The Company maintains capital ratios in excess of regulatory requirements. At June 30, 2014, Tier 1 Leverage Capital Ratio was 10.26% (March 31, 2014 – 9.51%), Tier 1 Risk-Based Capital Ratio was 15.49% (March 31, 2014 – 14.76%), and Total Risk-Based Capital Ratio was 17.30% (March 31, 2014 – 16.56%).

## **Return on Average Assets and Common Equity**

Return on average common equity ("ROE") was 9.54% compared to 19.50% for the quarter ended June 30, 2013. Return on average assets ("ROA") was 1.10% compared to 1.76% for the same period in 2013. The decreases in ROE and ROA are mostly due to a 43.2% decrease in net income from \$37.5 million to \$21.3 million in the second quarter of 2014.

## **Assets under Management**

At June 30, 2014, total assets managed by the Company's trust division and CPC increased 2.5% to \$2.867 billion compared to \$2.798 billion at March 31, 2014. At June 30, 2014, total assets gathered by the securities broker-dealer subsidiary from its customer investment accounts increased 2.9% to \$2.651 billion, compared to \$2.577 billion at March 31, 2014. Changes in trust and broker-dealer related assets primarily reflect a slight increase in portfolio and differences in market values.

## **Lending**

Total loan production of \$221.6 million decreased 32.3% from the second quarter of 2013. Total commercial loan production of \$45.4 million decreased 56.6% from \$104.5 million for the same period in 2013.



Mortgage loan production of \$52.0 million decreased 48.7% from the same period in 2013. The Company sells most of its conforming mortgage loans in the secondary market and retains the servicing rights.

In the aggregate, consumer loan and auto and leasing production totaled \$124.2 million, a slight increase of 2.3% from the same period in 2013.

Total loan portfolio declined by \$66.6 million from \$5.003 billion at March 31, 2014 to \$4.936 billion at June 30, 2014, mostly as the result of scheduled pay downs and maturities in both the non-covered and covered loan portfolios.

### **Credit Quality on Non-Covered Loans**

Net credit losses, excluding acquired loans, decreased \$26.3 million to \$6.3 million, representing 0.96% of average non-covered loans outstanding versus 8.89% in the same period in 2013. The credit losses for the quarter ended June 30, 2013, included a \$27 million charge-off from nonperforming mortgage loans reclassified as held-for-sale. The allowance for loan and lease losses on non-covered loans at June 30, 2014, increased to \$60.4 million compared to \$56.2 million at March 31, 2014. The allowances for loan and lease losses, excluding acquired loans, increased to \$50.6 million (1.92% of total non-covered loans, excluding acquired loans) at June 30, 2014, compared to \$49.5 million (1.95% of total non-covered loans, excluding acquired loans) at March 31, 2014. The allowance for loan and lease losses on acquired loans accounted for under ASC 310-20 decreased to \$3.4 million at June 30, 2014, compared to \$3.6 million at March 31, 2014.

Non-performing loans (“NPLs”), which exclude loans covered under shared-loss agreements with the FDIC and loans acquired in the BBVAPR Acquisition accounted under ASC 310-30, increased to \$94.1 million at June 30, 2014 compared to \$88.2 million at March 31, 2014. The increase is due mainly to increase in non-performing mortgage and auto loans.

## Non-GAAP Measures

The Company uses certain non-GAAP measures of financial performance to supplement the unaudited consolidated financial statements presented in accordance with GAAP. The Company presents non-GAAP measures that management believes are useful and meaningful to investors. Non-GAAP measures do not have any standardized meaning, are not required to be uniformly applied, and are not audited. Therefore, they are unlikely to be comparable to similar measures presented by other companies. The presentation of non-GAAP measures is not intended to be a substitute for, and should not be considered in isolation from, the financial measures reported in accordance with GAAP.

The Company's management has reported and discussed the results of operations herein both on a GAAP basis and on a pre-tax pre-provision operating income basis (defined as net interest income, plus banking and financial services revenue, less non-interest expenses, as calculated on the table below). The Company's management believes that, given the nature of the items excluded from the definition of pre-tax pre-provision operating income, it is useful to state what the results of operations would have been without them so that investors can see the financial trends from the Company's continuing business.

During the quarter ended June 30, 2014, the Company's pre-tax pre-provision operating income decreased 3.5% to \$65.1 million as compared to \$67.4 million for the same period in 2013. Pre-tax pre-provision operating income is calculated as follows:

|  | Quarter Ended June 30, |               |      |               | Six-Month Period Ended June 30, |               |      |               |
|--|------------------------|---------------|------|---------------|---------------------------------|---------------|------|---------------|
|  | 2014                   |               | 2013 |               | 2014                            |               | 2013 |               |
|  | (In thousands)         |               |      |               | (In thousands)                  |               |      |               |
| <b><u>PRE-TAX PRE-PROVISION OPERATING INCOME</u></b> |                        |               |      |               |                                 |               |      |               |
| Net interest income                                  | \$                     | 106,078       | \$   | 106,295       | \$                              | 209,476       | \$   | 199,909       |
| Core non-interest income:                            |                        |               |      |               |                                 |               |      |               |
| Banking service revenue                              |                        | 9,995         |      | 12,705        |                                 | 20,552        |      | 24,345        |
| Financial service revenue                            |                        | 7,336         |      | 8,030         |                                 | 14,203        |      | 15,690        |
| Mortgage banking activities                          |                        | 1,554         |      | 3,827         |                                 | 3,249         |      | 6,963         |
| <b>Total core non-interest income</b>                |                        | <b>18,885</b> |      | <b>24,562</b> |                                 | <b>38,004</b> |      | <b>46,998</b> |
| Non-interest expenses                                |                        | 59,848        |      | 68,687        |                                 | 121,252       |      | 135,298       |
|  |                        | -             |      | (5,273)       |                                 | -             |      | (10,808)      |

|   |           |               |           |               |           |                |           |                |         |
|---|-----------|---------------|-----------|---------------|-----------|----------------|-----------|----------------|---------|
| Less merger and restructuring charges               |           |               |           |               |           |                |           |                |         |
|   |           | 59,848        |           |               | 63,414    |                | 121,252   |                | 124,490 |
| <b>Total pre-tax pre-provision operating income</b> | <b>\$</b> | <b>65,115</b> | <b>\$</b> | <b>67,443</b> | <b>\$</b> | <b>126,228</b> | <b>\$</b> | <b>122,417</b> |         |

Tangible common equity consists of common equity less goodwill, core deposit intangibles and customer relationship intangible. Tier 1 common equity consists of common equity less goodwill, core deposit intangibles, net unrealized gains on available for sale securities, net unrealized losses on cash flow hedges, and disallowed deferred tax asset and servicing assets. Tangible book value per common share consists of tangible common equity divided by common stock outstanding at the end of the period. Ratios of tangible common equity to total assets, tangible common equity to risk-weighted assets, total equity to risk-weighted assets, and Tier 1 common equity to risk-weighted assets and tangible book value per common share are non-GAAP measures.

At June 30, 2014, tangible common equity to total assets and tangible common equity to risk-weighted assets increased to 8.59% and 13.26%, respectively, from 8.06% and 12.54%, respectively, at March 31, 2014. Total equity to risk-weighted assets and Tier 1 common equity to risk-weighted assets at June 30, 2014 increased to 18.52% and 11.47%, respectively, from 17.75% and 10.79%, respectively, at March 31, 2014.

Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Company's capital position. Furthermore, management and many stock analysts use tangible common equity in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations. Neither Tier 1 common equity nor tangible common equity or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP.

## ANALYSIS OF RESULTS OF OPERATIONS

The following tables show major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the quarters and six-month periods ended June 30, 2014 and 2013:

| <b>TABLE 1 - QUARTERLY ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE QUARTERS ENDED JUNE 30, 2014 AND 2013</b> |                 |                |  |                     |              |  |                        |  |                  |  |  |
|---|-----------------|----------------|--|---------------------|--------------|--|------------------------|--|------------------|--|--|
|   | <b>Interest</b> |                |  | <b>Average rate</b> |              |  | <b>Average balance</b> |  |                  |  |  |
|   | <b>June</b>     | <b>June</b>    |  | <b>June</b>         | <b>June</b>  |  | <b>June</b>            |  | <b>June</b>      |  |  |
|   | <b>2014</b>     | <b>2013</b>    |  | <b>2014</b>         | <b>2013</b>  |  | <b>2014</b>            |  | <b>2013</b>      |  |  |
| <b>(Dollars in thousands)</b>   |                 |                |  |                     |              |  |                        |  |                  |  |  |
| <b>A - TAX EQUIVALENT SPREAD</b>  |                 |                |  |                     |              |  |                        |  |                  |  |  |
| <b>Interest-earning assets</b>  | \$ 125,900      | \$ 126,302     |  | 7.24%               | 6.72%        |  | \$ 6,972,133           |  | \$ 7,542,763     |  |  |
| Tax equivalent adjustment   | 9,926           | 1,717          |  | 0.57%               | 0.09%        |  | -                      |  | -                |  |  |
| <b>Interest-earning assets - tax equivalent</b>   | <b>135,826</b>  | <b>128,019</b> |  | <b>7.82%</b>        | <b>6.81%</b> |  | <b>6,972,133</b>       |  | <b>7,542,763</b> |  |  |
| Interest-bearing liabilities  | 19,822          | 20,007         |  | 1.19%               | 1.07%        |  | 6,689,332              |  | 7,476,194        |  |  |
| <b>Tax equivalent net interest income / spread</b>  | <b>116,004</b>  | <b>108,012</b> |  | <b>6.64%</b>        | <b>5.74%</b> |  | <b>282,801</b>         |  | <b>66,569</b>    |  |  |
| <b>Tax equivalent interest rate margin</b>  |                 |                |  | <b>6.67%</b>        | <b>5.74%</b> |  |                        |  |                  |  |  |
| <b>B - NORMAL SPREAD</b>  |                 |                |  |                     |              |  |                        |  |                  |  |  |
| <b>Interest-earning assets:</b>   |                 |                |  |                     |              |  |                        |  |                  |  |  |
| <b>Investments:</b>   |                 |                |  |                     |              |  |                        |  |                  |  |  |
| Investment securities   | 12,569          | 10,925         |  | 3.62%               | 2.26%        |  | 1,391,655              |  | 1,936,467        |  |  |
| Trading securities  | 37              | 31             |  | 7.94%               | 7.84%        |  | 1,868                  |  | 1,585            |  |  |
| Interest bearing cash and money market investments  | 351             | 242            |  | 0.25%               | 0.18%        |  | 559,230                |  | 547,443          |  |  |
| <b>Total investments</b>  | <b>12,957</b>   | <b>11,198</b>  |  | <b>2.66%</b>        | <b>1.81%</b> |  | <b>1,952,753</b>       |  | <b>2,485,495</b> |  |  |

|   |                |  |                |              |              |  |                  |  |  |  |  |                  |  |
|---|----------------|--|----------------|--------------|--------------|--|------------------|--|--|--|--|------------------|--|
| <b>Loans not covered under shared-loss agreements</b>           |                |  |                |              |              |  |                  |  |  |  |  |                  |  |
| <b>with the FDIC:</b>   |                |  |                |              |              |  |                  |  |  |  |  |                  |  |
| <b>Originated</b>   |                |  |                |              |              |  |                  |  |  |  |  |                  |  |
| Mortgage  | 10,341         |  | 10,495         | 5.36%        | 5.24%        |  | 773,425          |  |  |  |  | 803,272          |  |
| Commercial  | 16,451         |  | 6,046          | 5.46%        | 6.18%        |  | 1,209,346        |  |  |  |  | 392,261          |  |
| Consumer  | 3,641          |  | 1,746          | 9.92%        | 8.98%        |  | 147,230          |  |  |  |  | 77,948           |  |
| Auto and leasing  | 12,650         |  | 5,075          | 10.47%       | 10.63%       |  | 484,536          |  |  |  |  | 191,438          |  |
| <b>Total originated non-covered loans</b>                       | <b>43,083</b>  |  | <b>23,362</b>  | <b>6.61%</b> | <b>6.40%</b> |  | <b>2,614,537</b> |  |  |  |  | <b>1,464,918</b> |  |
| <b>Acquired</b>   |                |  |                |              |              |  |                  |  |  |  |  |                  |  |
| Mortgage  | 9,363          |  | 11,138         | 5.37%        | 5.76%        |  | 698,720          |  |  |  |  | 775,711          |  |
| Commercial  | 18,959         |  | 35,645         | 11.35%       | 10.30%       |  | 669,983          |  |  |  |  | 1,387,963        |  |
| Consumer  | 3,992          |  | 5,431          | 13.84%       | 12.40%       |  | 115,676          |  |  |  |  | 175,678          |  |
| Auto  | 12,667         |  | 15,529         | 8.80%        | 7.09%        |  | 577,114          |  |  |  |  | 878,387          |  |
| <b>Total acquired non-covered loans</b>                         | <b>44,981</b>  |  | <b>67,743</b>  | <b>8.75%</b> | <b>8.44%</b> |  | <b>2,061,493</b> |  |  |  |  | <b>3,217,739</b> |  |
| <b>Total non-covered loans</b>                                  | <b>88,064</b>  |  | <b>91,105</b>  | <b>7.55%</b> | <b>7.80%</b> |  | <b>4,676,030</b> |  |  |  |  | <b>4,682,657</b> |  |
| <b>Loans covered under shared loss agreements with the FDIC</b> |                |  |                |              |              |  |                  |  |  |  |  |                  |  |
|   | 24,879         |  | 23,999         | 29.06%       | 25.70%       |  | 343,350          |  |  |  |  | 374,611          |  |
| <b>Total loans</b>  | <b>112,943</b> |  | <b>115,104</b> | <b>9.03%</b> | <b>9.13%</b> |  | <b>5,019,380</b> |  |  |  |  | <b>5,057,268</b> |  |
| <b>Total interest earning assets</b>                            | <b>125,900</b> |  | <b>126,302</b> | <b>7.24%</b> | <b>6.72%</b> |  | <b>6,972,133</b> |  |  |  |  | <b>7,542,763</b> |  |

|  | Interest               |                |      |                | Average rate |              | Average balance |                  |                |                  |               |
|--|------------------------|----------------|------|----------------|--------------|--------------|-----------------|------------------|----------------|------------------|---------------|
|  | June                   |                | June |                | June         |              | June            |                  | June           |                  |               |
|  | 2014                   |                | 2013 |                | 2014         |              | 2013            |                  | 2013           |                  |               |
|  | (Dollars in thousands) |                |      |                |              |              |                 |                  |                |                  |               |
| <b>Interest-bearing liabilities:</b>           |                        |                |      |                |              |              |                 |                  |                |                  |               |
| <b>Deposits:</b>                               |                        |                |      |                |              |              |                 |                  |                |                  |               |
| Non-interest bearing deposits                  |                        | -              |      | -              | 0.00%        | 0.00%        |                 | 704,107          |                | 769,830          |               |
| Now Accounts                                   |                        | 2,208          |      | 1,964          | 0.61%        | 0.57%        |                 | 1,443,824        |                | 1,390,030        |               |
| Savings and money market                       |                        | 2,192          |      | 3,015          | 0.75%        | 1.35%        |                 | 1,168,911        |                | 893,804          |               |
| Individual retirement accounts                 |                        | 940            |      | 1,169          | 1.14%        | 1.29%        |                 | 329,584          |                | 363,209          |               |
| Retail certificates of deposits                |                        | 1,742          |      | 2,851          | 1.31%        | 1.66%        |                 | 535,203          |                | 690,246          |               |
| <b>Total core deposits</b>                     |                        | <b>7,082</b>   |      | <b>8,999</b>   | <b>0.68%</b> | <b>0.88%</b> |                 | <b>4,181,629</b> |                | <b>4,107,119</b> |               |
| Institutional deposits                         |                        | 1,290          |      | 2,665          | 1.58%        | 1.65%        |                 | 327,660          |                | 647,493          |               |
| Brokered deposits                              |                        | 1,468          |      | 1,790          | 0.83%        | 0.84%        |                 | 709,374          |                | 858,199          |               |
| <b>Total wholesale deposits</b>                |                        | <b>2,758</b>   |      | <b>4,455</b>   | <b>1.07%</b> | <b>1.19%</b> |                 | <b>1,037,034</b> |                | <b>1,505,692</b> |               |
| Deposits fair value premium amortization       |                        | (1,010)        |      | (4,382)        | 0.00%        | 0.00%        |                 | -                |                | -                |               |
| Core deposit intangible amortization           |                        | 335            |      | 415            | 0.00%        | 0.00%        |                 | -                |                | -                |               |
| <b>Total deposits</b>                          |                        | <b>9,165</b>   |      | <b>9,487</b>   | <b>0.70%</b> | <b>0.68%</b> |                 | <b>5,218,663</b> |                | <b>5,612,811</b> |               |
| <b>Borrowings:</b>                             |                        |                |      |                |              |              |                 |                  |                |                  |               |
| Securities sold under agreements to repurchase |                        | 7,372          |      | 7,109          | 2.93%        | 2.10%        |                 | 1,010,000        |                | 1,356,716        |               |
| Advances from FHLB and other borrowings        |                        | 2,289          |      | 2,241          | 2.55%        | 2.20%        |                 | 360,130          |                | 408,019          |               |
| Subordinated capital notes                     |                        | 996            |      | 1,170          | 3.97%        | 4.76%        |                 | 100,539          |                | 98,648           |               |
| <b>Total borrowings</b>                        |                        | <b>10,657</b>  |      | <b>10,520</b>  | <b>2.91%</b> | <b>2.26%</b> |                 | <b>1,470,669</b> |                | <b>1,863,383</b> |               |
| <b>Total interest bearing liabilities</b>      |                        | <b>19,822</b>  |      | <b>20,007</b>  | <b>1.19%</b> | <b>1.07%</b> |                 | <b>6,689,332</b> |                | <b>7,476,194</b> |               |
| <b>Net interest income / spread</b>            | \$                     | <b>106,078</b> | \$   | <b>106,295</b> | <b>6.05%</b> | <b>5.65%</b> |                 |                  |                |                  |               |
| <b>Interest rate margin</b>                    |                        |                |      |                | <b>6.10%</b> | <b>5.65%</b> |                 |                  |                |                  |               |
|  |                        |                |      |                |              |              |                 | \$               | <b>282,801</b> | \$               | <b>66,569</b> |



| <b>TABLE 1/A - YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE</b> |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
|--|-----------------|---------------|-------------|---------------|---------------------|--------------|-------------|------------------|------------------------|------------------|-------------|--|
| <b>FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2013</b>                                  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
|  | <b>Interest</b> |               |             |               | <b>Average rate</b> |              |             |                  | <b>Average balance</b> |                  |             |  |
|  | <b>June</b>     |               | <b>June</b> |               | <b>June</b>         |              | <b>June</b> |                  | <b>June</b>            |                  | <b>June</b> |  |
|  | <b>2014</b>     |               | <b>2013</b> |               | <b>2014</b>         |              | <b>2013</b> |                  | <b>2014</b>            |                  | <b>2013</b> |  |
| <b>(Dollars in thousands)</b>  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| <b>A - TAX EQUIVALENT SPREAD</b>   |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| Interest-earning assets  | \$              | 248,974       | \$          | 240,474       | 7.08%               | 6.33%        | \$          | 7,093,560        | \$                     | 7,662,088        |             |  |
| Tax equivalent adjustment  |                 | 20,059        |             | 3,676         | 0.57%               | 0.10%        |             | -                |                        | -                |             |  |
| Interest-earning assets - tax equivalent   |                 | 269,033       |             | 244,150       | 7.65%               | 6.43%        |             | 7,093,560        |                        | 7,662,088        |             |  |
| Interest-bearing liabilities   |                 | 39,498        |             | 40,565        | 1.17%               | 1.07%        |             | 6,827,571        |                        | 7,633,386        |             |  |
| Tax equivalent net interest income / spread  |                 | 229,535       |             | 203,585       | 6.48%               | 5.36%        |             | 265,989          |                        | 28,702           |             |  |
| Tax equivalent interest rate margin  |                 |               |             |               | 6.53%               | 5.36%        |             |                  |                        |                  |             |  |
| <b>B - NORMAL SPREAD</b>   |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| <b>Interest-earning assets:</b>  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| <b>Investments:</b>  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| Investment securities  |                 | 26,690        |             | 23,734        | 3.58%               | 2.37%        |             | 1,503,772        |                        | 2,021,442        |             |  |
| Trading securities   |                 | 75            |             | 50            | 8.06%               | 8.47%        |             | 1,876            |                        | 1,190            |             |  |
| Interest bearing cash and money market investments   |                 | 635           |             | 550           | 0.22%               | 0.20%        |             | 574,509          |                        | 556,054          |             |  |
| <b>Total investments</b>   |                 | <b>27,400</b> |             | <b>24,334</b> | <b>2.66%</b>        | <b>1.90%</b> |             | <b>2,080,157</b> |                        | <b>2,578,686</b> |             |  |
| <b>Loans not covered under shared-loss agreements</b>  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| <b>with the FDIC:</b>  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| <b>Originated</b>  |                 |               |             |               |                     |              |             |                  |                        |                  |             |  |
| Mortgage   |                 | 20,799        |             | 21,938        | 5.49%               | 5.65%        |             | 763,400          |                        | 783,172          |             |  |
| Commercial   |                 | 30,797        |             | 10,937        | 5.33%               | 5.76%        |             | 1,165,891        |                        | 382,654          |             |  |
| Consumer   |                 | 6,780         |             | 2,943         | 9.92%               | 8.67%        |             | 137,787          |                        | 68,480           |             |  |



|  |                |                |              |              |                  |                  |
|--|----------------|----------------|--------------|--------------|------------------|------------------|
| Auto and leasing   | 23,639         | 7,920          | 10.56%       | 11.02%       | 451,488          | 144,995          |
| <b>Total originated non-covered loans</b>                | <b>82,015</b>  | <b>43,738</b>  | <b>6.57%</b> | <b>6.39%</b> | <b>2,518,566</b> | <b>1,379,302</b> |
| <b>Acquired</b>  |                |                |              |              |                  |                  |
| Mortgage   | 18,732         | 22,308         | 5.35%        | 5.73%        | 705,992          | 784,445          |
| Commercial   | 37,671         | 62,241         | 10.79%       | 8.77%        | 704,082          | 1,430,953        |
| Consumer   | 8,209          | 11,302         | 13.48%       | 12.47%       | 122,806          | 182,806          |
| Auto   | 26,680         | 32,323         | 8.78%        | 7.06%        | 612,551          | 923,135          |
| <b>Total acquired non-covered loans</b>                  | <b>91,292</b>  | <b>128,174</b> | <b>8.58%</b> | <b>7.78%</b> | <b>2,145,431</b> | <b>3,321,338</b> |
| <b>Total non-covered loans</b>                           | <b>173,307</b> | <b>171,912</b> | <b>7.49%</b> | <b>7.38%</b> | <b>4,663,997</b> | <b>4,700,641</b> |
| Loans covered under shared loss agreements with the FDIC | 48,267         | 44,228         | 27.86%       | 23.30%       | 349,406          | 382,761          |
| <b>Total loans</b>                                       | <b>221,574</b> | <b>216,140</b> | <b>8.91%</b> | <b>8.57%</b> | <b>5,013,403</b> | <b>5,083,402</b> |
| <b>Total interest earning assets</b>                     | <b>248,974</b> | <b>240,474</b> | <b>7.08%</b> | <b>6.33%</b> | <b>7,093,560</b> | <b>7,662,088</b> |

|  | Interest               |                |      |                | Average rate |              | Average balance |              |      |                  |      |                  |
|--|------------------------|----------------|------|----------------|--------------|--------------|-----------------|--------------|------|------------------|------|------------------|
|  | June                   |                | June |                | June         |              | June            |              | June |                  |      |                  |
|  | 2014                   |                | 2013 |                | 2014         |              | 2013            |              | 2014 |                  | 2013 |                  |
|  | (Dollars in thousands) |                |      |                |              |              |                 |              |      |                  |      |                  |
| <b>Interest-bearing liabilities:</b>           |                        |                |      |                |              |              |                 |              |      |                  |      |                  |
| <b>Deposits:</b>                               |                        |                |      |                |              |              |                 |              |      |                  |      |                  |
| Non-interest bearing deposits                  |                        | -              |      | -              |              | 0.00%        |                 | 0.00%        |      | 702,862          |      | 768,041          |
| Now Accounts                                   |                        | 4,531          |      | 5,707          |              | 0.63%        |                 | 0.81%        |      | 1,451,547        |      | 1,421,650        |
| Savings and money market                       |                        | 4,488          |      | 4,822          |              | 0.79%        |                 | 1.11%        |      | 1,148,918        |      | 876,624          |
| Individual retirement accounts                 |                        | 1,998          |      | 2,536          |              | 1.20%        |                 | 1.39%        |      | 336,634          |      | 368,042          |
| Retail certificates of deposits                |                        | 3,681          |      | 6,040          |              | 1.34%        |                 | 1.76%        |      | 553,527          |      | 691,565          |
| <b>Total core deposits</b>                     |                        | <b>14,698</b>  |      | <b>19,105</b>  |              | <b>0.71%</b> |                 | <b>0.93%</b> |      | <b>4,193,488</b> |      | <b>4,125,922</b> |
| Institutional deposits                         |                        | 2,699          |      | 5,359          |              | 1.54%        |                 | 1.74%        |      | 352,456          |      | 620,069          |
| Brokered deposits                              |                        | 2,984          |      | 3,779          |              | 0.82%        |                 | 0.89%        |      | 730,349          |      | 857,330          |
|  |                        | <b>5,683</b>   |      | <b>9,138</b>   |              | <b>1.06%</b> |                 | <b>1.25%</b> |      | <b>1,082,805</b> |      | <b>1,477,399</b> |
| Deposits fair value premium amortization       |                        | (2,908)        |      | (9,649)        |              | 0.00%        |                 | 0.00%        |      | -                |      | -                |
| Core deposit intangible amortization           |                        | 670            |      | 829            |              | 0.00%        |                 | 0.00%        |      | -                |      | -                |
| <b>Total deposits</b>                          |                        | <b>18,143</b>  |      | <b>19,423</b>  |              | <b>0.69%</b> |                 | <b>0.70%</b> |      | <b>5,276,293</b> |      | <b>5,603,321</b> |
| <b>Borrowings:</b>                             |                        |                |      |                |              |              |                 |              |      |                  |      |                  |
| Securities sold under agreements to repurchase |                        | 14,784         |      | 14,357         |              | 2.75%        |                 | 2.01%        |      | 1,082,968        |      | 1,440,679        |
| Advances from FHLB and other borrowings        |                        | 4,583          |      | 3,046          |              | 2.51%        |                 | 1.38%        |      | 367,953          |      | 446,482          |
| FDIC-guaranteed term notes                     |                        | -              |      | 909            |              | 0.00%        |                 | 8.38%        |      | -                |      | 21,875           |
| Subordinated capital notes                     |                        | 1,988          |      | 2,830          |              | 3.99%        |                 | 4.72%        |      | 100,357          |      | 121,029          |
| <b>Total borrowings</b>                        |                        | <b>21,355</b>  |      | <b>21,142</b>  |              | <b>2.78%</b> |                 | <b>2.10%</b> |      | <b>1,551,278</b> |      | <b>2,030,065</b> |
| <b>Total interest bearing liabilities</b>      |                        | <b>39,498</b>  |      | <b>40,565</b>  |              | <b>1.17%</b> |                 | <b>1.07%</b> |      | <b>6,827,571</b> |      | <b>7,633,386</b> |
| <b>Net interest income / spread</b>            | \$                     | <b>209,476</b> | \$   | <b>199,909</b> |              | <b>5.91%</b> |                 | <b>5.26%</b> |      |                  |      |                  |
| <b>Interest rate margin</b>                    |                        |                |      |                |              | <b>5.96%</b> |                 | <b>5.26%</b> |      |                  |      |                  |



## Net Interest Income

### *Comparison of quarters ended June 30, 2014 and 2013*

Net interest income of \$106.1 million remained level as compared to \$106.3 million in the second quarter of 2013, reflecting a decrease of 1.9% in interest income from loans partially offset by a 15.7% increase in interest income from investment securities and a 1.0% decrease in interest expense.

Interest rate spread increased 40 basis points to 6.05% from 5.65%. This increase is mainly due to the net effect of a 52 basis point increase in the average yield of interest-earning assets from 6.72% to 7.24%, and 12 basis point increases in the average cost of funds from 1.07% to 1.19%.

Interest income slightly decreased to \$125.9 million from \$126.3 million in the same quarter in 2013. Such decrease reflects a \$4.5 million decrease in the volume of interest-earning assets partially offset by an increase of \$4.1 million in interest rate. Interest income from loans decreased 1.9% to \$112.9 million, primarily reflecting a decrease in volume of \$2.1 million. Interest income from investments increased 15.7% to \$13.0 million, reflecting a lower premium amortization in the investment securities portfolio as conditional prepayment rates (“CPRs”) on mortgage-backed securities fell.

Interest expense decreased 1.0% to \$19.8 million, primarily because of a \$2.8 million decrease in the volume of interest-bearing liabilities, partially offset by a \$2.6 million increase in interest rate. The decrease in interest-bearing liabilities is mostly due to the decrease in deposits volume of \$666 thousand, partially offset by an increase in rate of \$344 thousand. The cost of deposits before purchase accounting adjustments decreased 20 basis points to 0.76% for the second quarter of 2014, compared to 0.96% for the second quarter of 2013. The decrease in the cost of deposits was partially offset by an increase in the cost of borrowings, which increased 65 basis points to 2.91% from 2.26%.

The average balance of total interest-earning assets was \$6.972 billion, a decrease of 7.6% from the same period in 2013. The decrease in average balance of interest-earning assets was mainly attributable to a decrease of 21.4% in average investments, resulting from redemptions and maturities during the current quarter. The average yield on interest-earning assets was 7.24% compared to 6.72% for the same quarter in 2013. This was mainly due to higher average yields in the investment portfolio, which increased to 2.66% from 1.81%, and in the covered loan portfolio, which increased to 29.06% from 25.70%.

### *Comparison of six-month periods ended June 30, 2014 and 2013*

Net interest income increased 4.8% to \$209.5 million as compared to \$199.9 million for the same period in 2013. The change reflects a decrease of 2.6% in interest expense and increases of 2.5% in interest income from loans and 12.6% in interest income from investment securities.

Interest rate spread increased 65 basis points to 5.91% from 5.26% in the same period for 2013. This increase is mainly due to the net effect of a 75 basis point increase in the average yield of interest-earning assets from 6.33% to 7.08% and a 10 basis point increase in the average cost of funds from 1.07% to 1.17%.

Interest income increased 3.5% to \$249.0 million when compared to \$240.5 million for the same period in 2013. Results reflect an increase of \$18.4 million in interest-earning asset interest rate partially offset by a \$9.9 million decrease in volume. Interest income from loans increased 2.5% to \$221.6 million, reflecting an increase in interest rate of \$10.6 million, partially offset by a \$5.2 million decrease in volume. Interest income from investments increased 12.6% to \$27.4 million, reflecting a lower premium amortization in the investment securities portfolio as CPRs on mortgage-backed securities fell.

Interest expense decreased 2.6% to \$39.5 million, primarily the result of a \$6.1 million decrease in the volume of interest-bearing liabilities, partially offset by a \$5.0 million increase in interest rate. The decrease in interest-bearing liabilities is mostly due to the decrease in the repurchase agreement volume of \$3.6 million, as the company repaid \$510 million of repurchase agreements at maturity. The increase in interest rate is due to an increase in the cost of borrowings, which increased 68 basis points to 2.78%, compared to 2.10%. The cost of deposits before purchase accounting adjustments decreased 24 basis points to 0.78%, compared to 1.01% for the same period in 2013.

Average balance of total interest-earning assets was \$7.094 billion, a decrease of 7.5% from the same period in 2013. The decrease in average balance of interest-earning assets was mainly attributable to a decrease of 19.3% in average investments, resulting from redemptions and maturities, to the sale of available for sale securities during the current quarter amounting to \$110.8 million, and to a reduction of 1.4% in the average loan portfolio primarily due to the early pay down of some commercial loans. The average yield on interest-earning assets was 7.08% compared to 6.33% for the same period in 2013. This was mainly due to higher average yields in the investment portfolio, which increased to 2.66% from 1.90%, and in the loan portfolio, which increased to 8.91% from 8.57%.

| <b>TABLE 2 - NON-INTEREST INCOME SUMMARY</b>       |                               |                 |                 |  |               |                 |  |  |
|--|-------------------------------|-----------------|-----------------|--|---------------|-----------------|--|--|
|  | <b>Quarter Ended June 30,</b> |                 |                 | <b>Six-Month Period Ended June 30,</b> |               |                 |  |  |
|  | <b>2014</b>                   | <b>2013</b>     | <b>Variance</b> | <b>2014</b>                            | <b>2013</b>   | <b>Variance</b> |  |  |
| <b>(Dollars in thousands)</b>                      |                               |                 |                 |  |               |                 |  |  |
| Banking service revenue                            | \$ 9,995                      | \$ 12,705       | -21.3%          | \$ 20,552                              | \$ 24,345     | -15.6%          |  |  |
| Wealth management revenue                          | 7,336                         | 8,030           | -8.6%           | 14,203                                 | 15,690        | -9.5%           |  |  |
| Mortgage banking activities                        | 1,554                         | 3,827           | -59.4%          | 3,249                                  | 6,963         | -53.3%          |  |  |
| <b>Total banking and financial service revenue</b> | <b>18,885</b>                 | <b>24,562</b>   | <b>-23.1%</b>   | <b>38,004</b>                          | <b>46,998</b> | <b>-19.1%</b>   |  |  |
| FDIC shared-loss expense, net                      | (18,355)                      | (19,965)        | 8.1%            | (36,842)                               | (32,836)      | -12.2%          |  |  |
| Sale of securities available for sale              | -                             | -               | 0.0%            | 4,366                                  | -             | 100.0%          |  |  |
| Derivatives  | (247)                         | (164)           | -50.6%          | (470)                                  | (934)         | 49.7%           |  |  |
| Early extinguishment of debt                       | -                             | -               | 0.0%            | -                                      | 1,061         | -100.0%         |  |  |
| Other non-interest income                          | 224                           | 2,302           | -90.3%          | 678                                    | 2,349         | -71.1%          |  |  |
|  | (18,378)                      | (17,827)        | -3.1%           | (32,268)                               | (30,360)      | -6.3%           |  |  |
| <b>Total non-interest income, net</b>              | <b>\$ 507</b>                 | <b>\$ 6,735</b> | <b>-92.5%</b>   | <b>5,736</b>                           | <b>16,638</b> | <b>-65.5%</b>   |  |  |

### Non-Interest Income

Non-interest income is affected by the level of trust assets under management, transactions generated by clients' financial assets serviced by the securities broker-dealer and insurance agency subsidiaries, the level of mortgage banking activities, and the fees generated from loans and deposit accounts. It is also affected by the FDIC shared-loss expense, which varies depending on the results of the on-going evaluation of expected cash flows of the loan portfolio acquired in the FDIC-assisted acquisition. In addition, it is affected by the amount of securities, derivatives and trading transactions.

*Comparison of quarters ended June 30, 2014 and 2013*

As shown in Table 2 above, the Company recorded non-interest income in the amount of \$507 thousand, compared to \$6.7 million for the same period in 2013, a decrease of \$6.2 million.

The FDIC shared-loss expense decreased to \$18.4 million as compared to \$20.0 million for the same period in 2013, which resulted from the ongoing evaluation of expected cash flows of the covered loan portfolio. The majority of the FDIC indemnification asset is recorded for projected claimable losses on non-single family residential loans whose loss share period ends by the second quarter of 2015, although the recovery share period extends for an additional three-year period.

Banking service revenue, which consists primarily of fees generated by deposit accounts, electronic banking services, and customer services, decreased 21.3% to \$10.0 million, from \$12.7 million for the same period in 2013. The decrease in banking services revenues is mostly due to the reclassification of auto loan late charges into interest income during the last quarter of 2013 amounting to \$1.8 million. For the quarter ended June 30, 2013, these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013.

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased 8.6% to \$7.3 million, compared to \$8.0 million for the same period in 2013. This decrease is mainly due to local market conditions.

Income generated from mortgage banking activities decreased 59.4% to \$1.6 million, compared to \$3.8 million for the same period in 2013. The decrease in mortgage banking activities is mainly due to higher losses in repurchased loans and a decrease in sales when compared to same period in 2013.

Losses from derivative activities were \$247 thousand, as compared to \$164 thousand for the same period in 2013.

*Comparison of six-month periods ended June 30, 2014 and 2013*

Non-interest income decreased \$10.9 million to \$5.7 million from \$16.6 million in the six-month period ended June 30, 2013.

The FDIC shared-loss expense increased to \$36.8 million, as compared to \$32.8 million for the same period in 2013, as a result of the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced projected losses expected to be collected from the FDIC and improved the accretable yield on the covered loans. The reduction in claimable losses amortizes the FDIC indemnification asset through the life of the shared loss agreements. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value. During the six-month period ended June 30, 2014, the net amortization included \$5.1 million of additional amortization of the FDIC indemnification asset from stepped up cost recoveries on certain construction and leasing loan pools. Additional amortization of the FDIC indemnification asset may be recorded, should the Company continue to experience reduced expected losses.

Banking service revenue decreased 15.6% to \$20.6 million from \$24.3 million for the same period in 2013. The decrease in banking services revenues is mostly due to the reclassification of auto loan late charges into interest income during the last quarter of 2013 amounting to \$1.8 million. For the six-month period ended June 30, 2013, these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013. In addition, a non-recurring prepayment penalty was received during the first quarter of 2013 of approximately \$1 million.

Wealth management revenue decreased 9.5% to \$14.2 million, compared to \$15.7 million for the same period in 2013. This decrease is mainly due to local market conditions.



Income generated from mortgage banking activities decreased 53.4% to \$3.2 million, compared to \$7.0 million for the same period in 2013. The decrease in mortgage banking activities is mainly due to higher losses in repurchased loans and a decrease in sales when compared to same period in 2013.

Gains from the sale of securities increased to \$4.4 million from the same period in 2013, in which no gain or loss from the sale of securities was recorded. Losses from derivative activities were \$470 thousand, as compared to \$934 thousand for the same period in 2013. During the six-month period ended June 30, 2014, the Company did not have a gain or loss on extinguishment of debt, as compared to the same period in 2013 in which the Company had a gain of \$1.1 million.

| <b>TABLE 3 -<br/>NON-INTEREST<br/>EXPENSES SUMMARY</b>     |                               |  |                  |                       |  |  |  |                   |                       |  |
|--|-------------------------------|--|------------------|-----------------------|--|--|--|-------------------|-----------------------|--|
|  | <b>Quarter Ended June 30,</b> |  |                  |                       |  | <b>Six-Month Period Ended June 30,</b> |  |                   |                       |  |
|  | <b>2014</b>                   |  | <b>2013</b>      | <b>Variance<br/>%</b> |  | <b>2014</b>                            |  | <b>2013</b>       | <b>Variance<br/>%</b> |  |
| <b>(Dollars in thousands)</b>                              |                               |  |                  |                       |  |  |  |                   |                       |  |
| Compensation and employee benefits                         | \$ 20,707                     |  | \$ 24,089        | -14.0%                |  | \$ 42,494                              |  | \$ 47,338         | -10.2%                |  |
| Professional and service fees                              | 3,512                         |  | 5,375            | -34.7%                |  | 7,719                                  |  | 11,853            | -34.9%                |  |
| Occupancy and equipment                                    | 8,605                         |  | 8,066            | 6.7%                  |  | 16,914                                 |  | 17,282            | -2.1%                 |  |
| Merger and restructuring charges                           | -                             |  | 5,273            | -100.0%               |  | -                                      |  | 10,808            | -100.0%               |  |
| Taxes, other than payroll and income taxes                 | 3,776                         |  | 5,132            | -26.4%                |  | 7,511                                  |  | 7,754             | -3.1%                 |  |
| Electronic banking charges                                 | 4,796                         |  | 4,065            | 18.0%                 |  | 9,449                                  |  | 7,763             | 21.7%                 |  |
| Information technology expenses                            | 1,485                         |  | 2,335            | -36.4%                |  | 3,300                                  |  | 4,979             | -33.7%                |  |
| Insurance  | 2,333                         |  | 2,723            | -14.3%                |  | 4,407                                  |  | 5,401             | -18.4%                |  |
| Foreclosure, repossession and other real estate expenses   | 6,554                         |  | 3,717            | 76.3%                 |  | 12,941                                 |  | 6,900             | 87.6%                 |  |
| Loan servicing and clearing expenses                       | 1,669                         |  | 1,884            | -11.4%                |  | 3,728                                  |  | 3,360             | 11.0%                 |  |
| Advertising, business promotion, and strategic initiatives | 1,669                         |  | 1,670            | -0.1%                 |  | 3,450                                  |  | 3,079             | 12.0%                 |  |
| Printing, postage, stationery and supplies                 | 645                           |  | 851              | -24.2%                |  | 1,200                                  |  | 2,017             | -40.5%                |  |
| Communication  | 813                           |  | 835              | -2.6%                 |  | 1,770                                  |  | 1,699             | 4.2%                  |  |
| Director and investor relations                            | 293                           |  | 377              | -22.3%                |  | 544                                    |  | 613               | -11.3%                |  |
| Other operating expenses                                   | 2,991                         |  | 2,295            | 30.3%                 |  | 5,825                                  |  | 4,452             | 30.8%                 |  |
| <b>Total non-interest expenses</b>                         | <b>\$ 59,848</b>              |  | <b>\$ 68,687</b> | <b>-12.9%</b>         |  | <b>\$ 121,252</b>                      |  | <b>\$ 135,298</b> | <b>-10.4%</b>         |  |
| <b>Relevant ratios and data:</b>                           |                               |  |                  |                       |  |  |  |                   |                       |  |
| Efficiency ratio   | <b>47.89%</b>                 |  | <b>52.49%</b>    |                       |  | <b>48.99%</b>                          |  | <b>54.80%</b>     |                       |  |
| Compensation and benefits to                               |                               |  |                  |                       |  |  |  |                   |                       |  |
| non-interest expense                                       | <b>34.60%</b>                 |  | <b>35.07%</b>    |                       |  | <b>35.05%</b>                          |  | <b>34.99%</b>     |                       |  |
|  | <b>0.54%</b>                  |  | <b>0.57%</b>     |                       |  | <b>0.54%</b>                           |  | <b>0.55%</b>      |                       |  |

|  |    |       |    |       |  |  |    |       |    |  |  |       |  |
|--|----|-------|----|-------|--|--|----|-------|----|--|--|-------|--|
| Compensation to average total assets owned |    |       |    |       |  |  |    |       |    |  |  |       |  |
| Average number of employees                |    | 1,566 |    | 1,559 |  |  |    | 1,559 |    |  |  | 1,573 |  |
| Average compensation per employee          | \$ | 13.2  | \$ | 15.5  |  |  | \$ | 27.3  | \$ |  |  | 30.1  |  |
| Average loans per average employee         | \$ | 3,205 | \$ | 3,244 |  |  | \$ | 3,216 | \$ |  |  | 3,232 |  |

## Non-Interest Expenses

### *Comparison of quarters ended June 30, 2014 and 2013*

Non-interest expense reached \$59.8 million, representing a decrease of 12.9% compared to \$68.7 million. The decrease is due mainly to the non-recurring merger and restructuring charges of \$5.3 million incurred during the quarter ended June 30, 2013 for the BBVAPR Acquisition and to the decrease of \$3.4 million in compensation and employee benefits.

Compensation and employee benefits decreased 14.0% to \$20.7 million from \$24.1 million for the same periods in 2013. The decrease is due mainly to the impact in the second quarter of 2013 of the assessment of employee bonuses required pursuant to the BBVAPR Acquisition of \$1.9 million and a decrease in commissions paid by the securities broker-dealer of \$541 thousand.

Professional and service fees decreased 34.7% to \$3.5 million, as compared to \$5.4 million for the same period in 2013. Professional and service fees primarily comprise expenses and consulting and outsourcing expenses. For the quarter ended June 30, 2014, legal expenses amounted to \$1.1 million compared to \$1.3 million for the same period in 2013. Consulting and outsourcing expenses amounted to \$714 thousand, compared to \$1.3 million. The decrease in professional and service fees is mainly related to loan servicing fees amounting to \$1.1 million for a third party loan servicer whose contract was terminated during the quarter ended June 30, 2013.

Taxes, other than payroll and income taxes decreased to \$3.8 million, as compared to \$5.1 million for the same period in 2013. The decrease primarily reflects the cumulative impact in the second quarter of 2013 from the application of the 1.0% tax on gross revenues enacted on June 30, 2013.

Information technology expenses decreased 36.4% to \$1.5 million, as compared to \$2.3 million, mostly due to a decrease in data processing expenses.

The decreases in the foregoing non-interest expenses were partially offset by increases in electronic banking charges and foreclosure, repossession and other real estate expenses.

Electronic banking charges increased 18.0% to \$4.8 million, mostly due to the increase in expenses related to merchant business and card interchange transactions resulting from the continued growth of our banking business.

Foreclosure, repossession and other real estate expenses increased 76.3% to \$6.6 million, as compared to \$3.7 million, principally due to an increase in foreclosures and a decrease in the fair value of real estate as a result of current local economic conditions.

The decrease in non-interest expenses resulted in an improved efficiency ratio of 47.89%, from 52.49% for the same period in 2013. The efficiency ratio measures how much of the Company's revenue is used to pay operating expenses. The Company computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on the sale of investment securities, derivatives gains or losses, credit-related other-than-temporary impairment losses, FDIC shared-loss expense, losses on the early extinguishment of debt, other gains and losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits consistent comparability. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to losses of \$18.4 million, compared to \$17.8 million for the same period in 2013. Revenue for purposes of the efficiency ratio amounted to \$125.0 million, compared to \$130.9 million for the same period in 2013.

#### ***Comparison of six-month periods ended June 30, 2014 and 2013***

Non-interest expense decreased 10.4% to \$121.3 million, compared to \$135.3. The decrease is due mainly to the non-recurring merger and restructuring charges of \$10.8 million incurred during the six-month period ended June 30, 2013 for the BBVAPR Acquisition and the implementation of expense reduction measures.

Compensation and employee benefits decreased 10.2% to \$42.5 million from \$47.3 million for the same period in 2013. The decrease is due mainly to a decrease in average total employees during the six-month period ended June 30, 2014, compared to the same period in 2013, and a decrease in commissions paid by the securities broker-dealer of \$1.1 million.

Professional and service fees decreased 34.9% to \$7.7 million, as compared to \$11.9 million for the same period in 2013. Legal expenses amounted to \$2.2 million, compared to \$2.5 million for the same period in 2013. Consulting and outsourcing expenses amounted to \$1.9 million, compared to \$2.8 million for the same period in 2013. Decrease in professional and service fees is mainly related to loan servicing fees amounting to \$2.8 million for a third party loan servicer whose contract was terminated during the quarter ended June 30, 2013.

Information technology expenses decreased 33.7% to \$3.3 million, as compared to \$5.0 million, mostly due to decrease in data processing expenses.

The decreases in the foregoing non-interest expenses were partially offset by increases in electronic banking charges and foreclosure, repossession and other real estate expenses.

Electronic banking charges increased 21.7% to \$9.4 million, as compared to \$7.8 million, mostly due to the increase in expenses related to merchant business and card interchange transactions resulting from the continued growth of our banking business.

Foreclosure, repossession and other real estate expenses increased 87.6% to \$12.9 million, as compared to \$6.9 million for the same period in 2013, principally due to an increase in foreclosures and a decrease in the fair value of real estate as a result of current local economic conditions.

The decrease in non-interest expenses resulted in an improved efficiency ratio of 48.99% from 54.80%. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to losses of \$32.3 million, compared to \$30.4 million for the same period in 2013. Revenue for purposes of the efficiency ratio amounted to \$247.5 million, compared to \$246.9 million for the same period in 2013.

## **Provision for Loan and Lease Losses**

### ***Comparison of quarters ended June 30, 2014 and 2013***

Provision for non-covered loan and lease losses decreased \$24.3 million to \$13.2 million when compared to \$37.5 million, which included the impact of a \$21.0 million additional provision due to the reclassification to held-for-sale of non-performing residential mortgage loans during the second quarter of 2013. Provision for covered loan and lease losses increased \$384 thousand to \$1.6 million when compared to the same period in 2013. Based on an analysis of the credit quality and the composition of the Company's loan portfolio, management determined that the provision for the quarter ended June 30, 2014 was adequate in order to maintain the allowance for loan and lease losses at an adequate level to provide for probable losses based upon an evaluation of known and inherent risks.

Total charge-offs on non-covered loans, excluding acquired loans, decreased 73.1% to \$8.9 million, as compared to \$33.0 million for the same period in 2013, and total recoveries increased from \$486 thousand to \$2.6 million. As a result, the recoveries to charge-offs ratio increased from 1.47% to 29.08%. Net credit losses, excluding acquired loans, decreased \$26.3 million to \$6.3 million, representing 0.96% of average non-covered loans outstanding versus 8.89% in the same period in 2013, annualized. The credit losses for the quarter ended June 30, 2013, included a \$27 million charge-off from nonperforming mortgage loans transferred into the loan held-for-sale category. Isolating this credit charge-off, the net credit losses for the quarter ended June 30, 2013 would have been \$5.6 million, representing 1.52% of average non-covered loans outstanding, annualized.

The non-covered acquired loans accounted for under ASC 310-20 required a provision for loan and lease losses of \$2.6 million, as compared to \$1.6 million for the same period in 2013. Non-covered acquired loans accounted for under ASC 310-30 required a provision for loan and lease losses of \$3.2 million. This portfolio did not require a provision for loan and leases losses for the same period in 2013. The provision for the quarter ended June 30, 2014, reflects the Company's revision of the expected cash flows in the non-covered acquired loan portfolio considering actual experiences and changes in the Company's expectations for the remaining term of the loan pools. Provision for covered loan and lease losses was \$1.6 million, compared to \$1.2 million for the same period in 2013, reflecting the Company's revision of the expected cash flows in the covered loan portfolio considering actual experiences and changes in the Company's expectations for the remaining terms of the loan pools.

### ***Comparison of six-month periods ended June 30, 2014 and 2013***

Provision for non-covered loan and lease losses decreased \$22.2 million to \$23.3 million when compared to \$45.4 million, which included the impact of a \$21.0 million additional provision due to the reclassification to held-for-sale of non-performing residential mortgage loans. Provision for covered loan and lease losses increased \$1.3 million, when compared to the same period in 2013. Based on an analysis of the credit quality and the composition of the Company's loan portfolio, management determined that the provision for the six-month period ended June 30, 2014, was adequate in order to maintain the allowance for loan and lease losses at an adequate level to provide for probable losses based upon an evaluation of known and inherent risks.

Total charge-offs on non-covered loans, excluding acquired loans, decreased 56.2% to \$16.0 million, as compared to \$36.5 million for the same period in 2013, and total recoveries increased from \$586 thousand to \$4.5 million. As a result, the recoveries to charge-offs ratio increased from 1.60% to 28.13%. Net credit losses, excluding acquired loans, decreased \$24.4 million to \$11.5 million, representing 0.91% of average non-covered loans outstanding versus 5.22% in the same period in 2013, annualized. The credit losses for the six-month period ended June 30, 2013 included a \$27 million charge-off from nonperforming mortgage loans transferred into the loan held-for-sale category. Isolating this credit charge-off, the net credit losses for the quarter ended June 30, 2013 would have been \$8.9 million, representing 1.30% of average non-covered loans outstanding, annualized.

The non-covered acquired loans accounted for under ASC 310-20 required a provision for loan and lease losses of \$6.8 million, as compared to \$3.7 million for the same period in 2013. Non-covered acquired loans accounted for under ASC 310-30 required a provision for loan and lease losses of \$3.4 million for the six-month period ended June 30, 2014. This portfolio did not require provision for loan and leases losses for the same period in 2013. The provision for the six-month period ended June 30, 2014 reflects the Company's revision of the expected cash flows in the non-covered acquired loan portfolio considering actual experiences and changes in the Company's expectations for the remaining term of the loan pools. Provision for covered loan and lease losses was \$3.2 million, compared to \$1.9 million, reflecting the Company's revision of the expected cash flows in the covered loan portfolio considering actual experiences and changes in the Company's expectations for the remaining terms of the loan pools.

Please refer to the “Allowance for Loan and Lease Losses and Non-Performing Assets” section in this MD&A and Table 8 through Table 13 below for more detailed information concerning the allowances for the loan and lease losses, net credit losses and credit quality statistics.

## **Income Taxes**

### ***Comparison of quarters ended June 30, 2014 and 2013***

Income tax expense increased to \$10.6 million, compared to an income tax benefit of \$31.9 million for the same period in 2013. The income tax benefit for the quarter ended June 30, 2013 included a \$36.9 million benefit from the effect in deferred taxes due to the increase in tax rates from 30.0% to 39.0%, partially offset by an increase in the effective income tax rate the for first quarter of 2013 from 25% to 35%.

### ***Comparison of six-month periods ended June 30, 2014 and 2013***

Income tax expense increased to \$22.4 million, compared to an income tax benefit of \$24.8 million for the same period in 2013. The income tax benefit for the six-month period ended June 30, 2013 included a \$36.9 million benefit from the effect in deferred taxes due to the increase in tax rates from 30.0% to 39.0%.



## **ANALYSIS OF FINANCIAL CONDITION**

### **Assets Owned**

At June 30, 2014, the Company's total assets amounted to \$7.710 billion, a decrease of 5.5% when compared to \$8.158 billion at December 31, 2013, and interest-earning assets decreased 4.3% from \$6.694 billion at December 31, 2013 to \$6.408 billion at June 30, 2014.

At June 30, 2014, loans represented 77% of total interest-earning assets while investments represented 23%, compared to 75% and 25%, respectively, at December 31, 2013.

The Company's loan portfolio is comprised of residential mortgage loans, commercial loans collateralized by mortgages on real estate located in Puerto Rico, other commercial and industrial loans, consumer loans, leases, and auto loans. At June 30, 2014, the Company's loan portfolio decreased by 1.7% to \$4.936 billion compared to \$5.019 billion at December 31, 2013. At June 30, 2014, the covered loan portfolio decreased \$22.6 million, or 6.3%, from December 31, 2013 as the loans continue to pay down. At June 30, 2014, the non-covered loan portfolio decreased \$60.8 million, or 1.3%, primarily due to the early pay down of some commercial loans.

The FDIC indemnification asset amounted to \$143.7 million at June 30, 2014 and \$189.2 million as of December 31, 2013, representing a 24.1% reduction. The decrease in the FDIC indemnification asset is mainly related to reimbursements of \$18.7 million received from the FDIC, and the amortization of the FDIC indemnification asset by \$35.1 million during the six-month period ended June 30, 2014.

Investments principally consist of U.S. government and agency bonds, mortgage-backed securities, U.S. treasury securities, and Puerto Rico government and agency bonds. At June 30, 2014, the investment portfolio decreased 8.9% to \$1.472 billion from \$1.615 billion at December 31, 2013. This decrease is mostly due to net effect of a reduction of \$78.5 million in FNMA and FHLMC certificates and \$97.4 million in Puerto Rico government obligations due to redemptions and maturities. In addition, during the six-month period ended June 30, 2014, the Company sold \$110.8 million of mortgage-backed available for sale securities taking advantage of market opportunities to realize gains and reduce some interest rate sensitivity. During the six-month period ended June 30, 2014, the Company also experienced a normal prepayment of mortgage-backed securities of approximately \$106 million. The decrease in investments was partially offset by the increase of \$63.9 million in obligations of U.S. government-sponsored agencies.

### **Financial Assets Managed**

The Company's financial assets managed include those managed by the Company's trust division, retirement plan administration subsidiary, and assets gathered by its broker-dealer subsidiary. The Company's trust division offers various types of IRAs and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while the retirement plan administration subsidiary, CPC, manages private retirement plans. At June 30, 2014, total assets managed by the Company's trust division and CPC amounted to \$2.867 billion, compared to \$2.797 billion at December 31, 2013. Oriental Financial Services offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At June 30, 2014, total assets gathered by Oriental Financial Services from its customer investment accounts increased to \$2.651 billion, compared to \$2.493 billion at December 31, 2013. Changes in trust and broker-dealer related assets primarily reflect an increase in portfolio and differences in market values.

| <b>TABLE 4 - ASSETS SUMMARY AND COMPOSITION</b>          |                               |                  |                     |                  |  |                 |
|--|-------------------------------|------------------|---------------------|------------------|--|-----------------|
|  |                               |                  |                     |                  |  |                 |
|  | <b>June 30,</b>               |                  | <b>December 31,</b> |                  |  |                 |
|  | <b>2014</b>                   |                  | <b>2013</b>         |                  |  | <b>Variance</b> |
|  | <b>(Dollars in thousands)</b> |                  |                     |                  |  |                 |
| <b>Investments:</b>                                      |                               |                  |                     |                  |  |                 |
| FNMA and FHLMC certificates                              | \$                            | 1,138,824        | \$                  | 1,217,330        |  | -6.4%           |
| Obligations of US government-sponsored agencies          |                               | 74,574           |                     | 10,649           |  | 600.3%          |
| US Treasury securities                                   |                               | 9,000            |                     | -                |  | 100.0%          |
| CMOs issued by US government-sponsored agencies          |                               | 196,631          |                     | 214,394          |  | -8.3%           |
| GNMA certificates  |                               | 5,928            |                     | 7,816            |  | -24.2%          |
| Puerto Rico government and political subdivisions        |                               | 16,800           |                     | 114,190          |  | -85.3%          |
| FHLB stock   |                               | 24,381           |                     | 24,450           |  | -0.3%           |
| Other debt securities                                    |                               | 3,907            |                     | 24,047           |  | -83.8%          |
| Other investments  |                               | 1,678            |                     | 1,933            |  | -13.2%          |
| <b>Total investments</b>                                 |                               | <b>1,471,723</b> |                     | <b>1,614,809</b> |  | <b>-8.9%</b>    |
| <b>Loans:</b>  |                               |                  |                     |                  |  |                 |
| Non-covered loans  |                               | 4,647,264        |                     | 4,670,227        |  | -0.5%           |
| Allowance for loan and lease losses on non-covered loans |                               | (60,360)         |                     | (54,298)         |  | -11.2%          |
| <b>Non-covered loans receivable, net</b>                 |                               | <b>4,586,904</b> |                     | <b>4,615,929</b> |  | <b>-0.6%</b>    |
| Mortgage loans held for sale                             |                               | 14,792           |                     | 46,529           |  | -68.2%          |
| <b>Total non-covered loans, net</b>                      |                               | <b>4,601,696</b> |                     | <b>4,662,458</b> |  | <b>-1.3%</b>    |
| Covered loans  |                               | 393,859          |                     | 409,690          |  | -3.9%           |
| Allowance for loan and lease losses on covered loans     |                               | (59,515)         |                     | (52,729)         |  | -12.9%          |
| <b>Total covered loans, net</b>                          |                               | <b>334,344</b>   |                     | <b>356,961</b>   |  | <b>-6.3%</b>    |
| <b>Total loans, net</b>                                  |                               | <b>4,936,040</b> |                     | <b>5,019,419</b> |  | <b>-1.7%</b>    |
| Securities purchased under agreements to resell          |                               | -                |                     | 60,000           |  | -100.0%         |
| <b>Total securities and loans</b>                        |                               | <b>6,407,763</b> |                     | <b>6,694,228</b> |  | <b>-4.3%</b>    |
| <b>Other assets:</b>                                     |                               |                  |                     |                  |  |                 |
| Cash and due from banks                                  |                               | 603,427          |                     | 696,501          |  | -13.4%          |
| Money market investments                                 |                               | 8,228            |                     | 6,967            |  | 18.1%           |
| FDIC indemnification asset                               |                               | 143,660          |                     | 189,240          |  | -24.1%          |
| Foreclosed real estate                                   |                               | 102,235          |                     | 90,024           |  | 13.6%           |
| Accrued interest receivable                              |                               | 22,508           |                     | 18,734           |  | 20.1%           |

## Edgar Filing: OFG BANCORP - Form 10-Q

|   |           |                  |  |           |                  |  |               |  |
|---|-----------|------------------|--|-----------|------------------|--|---------------|--|
| Deferred tax asset, net                           |           | 123,298          |  |           | 137,564          |  | -10.4%        |  |
| Premises and equipment, net                       |           | 82,167           |  |           | 82,903           |  | -0.9%         |  |
| Servicing assets                                  |           | 13,655           |  |           | 13,801           |  | -1.1%         |  |
| Derivative assets                                 |           | 9,558            |  |           | 20,502           |  | -53.4%        |  |
| Goodwill  |           | 86,069           |  |           | 86,069           |  | 0.0%          |  |
| Other assets                                      |           | 107,577          |  |           | 121,482          |  | -11.4%        |  |
| <b>Total other assets</b>                         |           | <b>1,302,382</b> |  |           | <b>1,463,787</b> |  | <b>-11.0%</b> |  |
| <b>Total assets</b>                               | <b>\$</b> | <b>7,710,145</b> |  | <b>\$</b> | <b>8,158,015</b> |  | <b>-5.5%</b>  |  |
| <b>Investments portfolio composition:</b>         |           |                  |  |           |                  |  |               |  |
| FNMA and FHLMC certificates                       |           | 77.4%            |  |           | 75.4%            |  |               |  |
| Obligations of US government-sponsored agencies   |           | 5.1%             |  |           | 0.7%             |  |               |  |
| US Treasury securities                            |           | 0.6%             |  |           | 0.0%             |  |               |  |
| CMOs issued by US government-sponsored agencies   |           | 13.4%            |  |           | 13.3%            |  |               |  |
| GNMA certificates                                 |           | 0.4%             |  |           | 0.5%             |  |               |  |
| Puerto Rico government and political subdivisions |           | 1.1%             |  |           | 7.1%             |  |               |  |
| FHLB stock  |           | 1.7%             |  |           | 1.5%             |  |               |  |
| Other debt securities and other investments       |           | 0.3%             |  |           | 1.5%             |  |               |  |
|   |           | <b>100.0%</b>    |  |           | <b>100.0%</b>    |  |               |  |

| <b>TABLE 5 — LOANS RECEIVABLE COMPOSITION</b>                             |                 |                  |                     |                  |                 |               |
|---|-----------------|------------------|---------------------|------------------|-----------------|---------------|
|   | <b>June 30,</b> |                  | <b>December 31,</b> |                  | <b>Variance</b> |               |
|   | <b>2014</b>     |                  | <b>2013</b>         |                  | <b>%</b>        |               |
| <b>(Dollars in thousands)</b>   |                 |                  |                     |                  |                 |               |
| <b>Non-covered loans:</b>   |                 |                  |                     |                  |                 |               |
| <b>Originated and other loans and leases held for investment:</b>         |                 |                  |                     |                  |                 |               |
| Mortgage  | \$              | 788,001          | \$                  | 766,265          |                 | 2.8%          |
| Commercial  |                 | 1,183,172        |                     | 1,127,657        |                 | 4.9%          |
| Consumer  |                 | 161,538          |                     | 127,744          |                 | 26.5%         |
| Auto and leasing  |                 | 508,034          |                     | 379,874          |                 | 33.7%         |
| <b>Total originated and other loans and leases held for investment</b>    |                 | <b>2,640,745</b> |                     | <b>2,401,540</b> |                 | <b>10.0%</b>  |
| <b>Acquired loans:</b>  |                 |                  |                     |                  |                 |               |
| <b>Accounted for under ASC 310-20</b>                                     |                 |                  |                     |                  |                 |               |
| Commercial  |                 | 38,602           |                     | 77,681           |                 | -50.3%        |
| Consumer  |                 | 49,604           |                     | 56,174           |                 | -11.7%        |
| Auto  |                 | 238,399          |                     | 301,584          |                 | -21.0%        |
|   |                 | <b>326,605</b>   |                     | <b>435,439</b>   |                 | <b>-25.0%</b> |
| <b>Accounted for under ASC 310-30</b>                                     |                 |                  |                     |                  |                 |               |
| Mortgage  |                 | 692,069          |                     | 717,904          |                 | -3.6%         |
| Commercial  |                 | 632,273          |                     | 671,544          |                 | -5.8%         |
| Consumer  |                 | 43,824           |                     | 63,620           |                 | -31.1%        |
| Auto  |                 | 308,512          |                     | 379,145          |                 | -18.6%        |
|   |                 | <b>1,676,678</b> |                     | <b>1,832,213</b> |                 | <b>-8.5%</b>  |
|   |                 | <b>2,003,283</b> |                     | <b>2,267,652</b> |                 | <b>-11.7%</b> |
|   |                 | <b>4,644,028</b> |                     | <b>4,669,192</b> |                 | <b>-0.5%</b>  |
| Deferred loans fees, net  |                 | 3,236            |                     | 1,035            |                 | 212.7%        |
| <b>Loans receivable</b>   |                 | <b>4,647,264</b> |                     | <b>4,670,227</b> |                 | <b>-0.5%</b>  |
| Allowance for loan and lease losses on non-covered loans                  |                 | (60,360)         |                     | (54,298)         |                 | -11.2%        |
| <b>Loans receivable, net</b>  |                 | <b>4,586,904</b> |                     | <b>4,615,929</b> |                 | <b>-0.6%</b>  |
| Mortgage loans held-for-sale  |                 | 14,792           |                     | 46,529           |                 | -68.2%        |
| <b>Total non-covered loans, net</b>                                       |                 | <b>4,601,696</b> |                     | <b>4,662,458</b> |                 | <b>-1.3%</b>  |
| <b>Covered loans:</b>   |                 |                  |                     |                  |                 |               |
| Loans secured by 1-4 family residential properties                        |                 | 121,416          |                     | 121,748          |                 | -0.3%         |
| Construction and development secured by 1-4 family residential properties |                 | 18,566           |                     | 17,304           |                 | 7.3%          |
| Commercial and other construction   |                 | 248,700          |                     | 264,249          |                 | -5.9%         |

## Edgar Filing: OFG BANCORP - Form 10-Q

|   |           |                  |  |           |                  |  |              |
|---|-----------|------------------|--|-----------|------------------|--|--------------|
| Consumer  |           | 5,177            |  |           | 6,119            |  | -15.4%       |
| Leasing   |           | -                |  |           | 270              |  | -100.0%      |
| <b>Total covered loans</b>                              |           | <b>393,859</b>   |  |           | <b>409,690</b>   |  | <b>-3.9%</b> |
| Allowance for loan and lease losses<br>on covered loans |           | (59,515)         |  |           | (52,729)         |  | -12.9%       |
| <b>Total covered loans, net</b>                         |           | <b>334,344</b>   |  |           | <b>356,961</b>   |  | <b>-6.3%</b> |
| <b>Total loans receivable, net</b>                      | <b>\$</b> | <b>4,936,040</b> |  | <b>\$</b> | <b>5,019,419</b> |  | <b>-1.7%</b> |

97

As shown in Table 5 above, total loans, net, amounted to \$4.936 billion at June 30, 2014 and \$5.019 billion at December 31, 2013.

The Company's originated and other loans held-for-investment portfolio composition and trends were as follows:

- Mortgage loan portfolio amounted to \$788.0 million (29.9% of the gross originated loan portfolio) compared to \$766.3 million (31.9% of the gross originated loan portfolio) at December 31, 2013. Mortgage loan production totaled \$52.0 million and \$102.8 million for the quarter and six-month period ended June 30, 2014, respectively, which represents a decrease of 48.7% and 42.4 % from \$101.3 million and \$178.4 million for the same periods in 2013. Mortgage loans included delinquent loans in the GNMA buy-back option program amounting to \$38.3 million and \$34.9 million for the periods ended June 30, 2014, and December 31, 2013, respectively. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.
- Commercial loan portfolio amounted to \$1.183 billion (44.8% of the gross originated loan portfolio) compared to \$1.128 billion (47.0% of the gross originated loan portfolio) at December 31, 2013. Commercial loan production decreased 56.5% to \$45.4 million for the second quarter of 2014, and 52.3% to \$85.2 million for the six-month period ended June 30, 2014, from \$104.3 million and \$178.5 million for the same periods in 2013, respectively.
- Consumer loan portfolio amounted to \$161.5 million (6.1% of the gross originated loan portfolio) compared to \$127.7 million (5.3% of the gross originated loan portfolio) at December 31, 2013. Consumer loan production increased 33.4% to \$34.5 million for the quarter ended June 30, 2014, and 26.6 % to \$62.3 million for the six-month period ended June 30, 2014 from \$26.6 million and \$49.2 million for the same periods in 2013, respectively.
- Auto loans and leasing portfolio amounted to \$508.0 million (19.2% of the gross originated loan portfolio) compared to \$379.9 million (15.8% of the gross originated loan portfolio) at December 31, 2013. Auto production was \$89.6 million for the quarter ended June 30, 2014 and \$183.4 million for the six-month period ended June 30, 2014, compared to \$94.7 million and \$195.7 million for the same periods in 2013, respectively.

At June 30, 2014 and December 31, 2013, the Company's non-covered acquired loan portfolio composition was as follows:

| Portfolio Type         | June 30, 2014    |  |  | December 31, 2013 |  |  |
|------------------------|------------------|--|--|-------------------|--|--|
|                        | Carrying Amounts | % of Gross Non-Covered Acquired Loan Portfolio |  | Carrying Amounts  | % of Gross Non-Covered Acquired Loan Portfolio |  |
| (Dollars in thousands) |                  |  |  |                   |  |  |

Edgar Filing: OFG BANCORP - Form 10-Q

|            |    |                  |  |                |  |    |                  |  |                |
|------------|----|------------------|--|----------------|--|----|------------------|--|----------------|
| Mortgage   | \$ | 692,068          |  | 34.5%          |  | \$ | 717,904          |  | 31.7%          |
| Commercial |    | 670,874          |  | 33.5%          |  |    | 749,225          |  | 33.0%          |
| Consumer   |    | 93,428           |  | 4.7%           |  |    | 119,794          |  | 5.3%           |
| Auto       |    | 546,910          |  | 27.3%          |  |    | 680,729          |  | 30.0%          |
|            | \$ | <b>2,003,280</b> |  | <b>100.00%</b> |  | \$ | <b>2,267,652</b> |  | <b>100.00%</b> |

98



| <b>TABLE 6 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS</b>                           |                  |                 |                            |                  |                 |              |                         |                 |   |  |
|---|------------------|-----------------|----------------------------|------------------|-----------------|--------------|-------------------------|-----------------|---|--|
| <b>June 30, 2014</b>  |                  |                 |                            |                  |                 |              |                         |                 |   |  |
| <b>Higher-Risk Residential Mortgage Loans*</b>                                    |                  |                 |                            |                  |                 |              |                         |                 |   |  |
|   |                  |                 |                            |                  |                 |              |                         |                 | <b>High Loan-to-Value Ratio<br/>Mortgages</b> |  |
| <b>Junior Lien Mortgages</b>  |                  |                 | <b>Interest Only Loans</b> |                  |                 |              | <b>LTV 90% and over</b> |                 |   |  |
| <b>Carrying</b>   |                  |                 | <b>Carrying</b>            |                  |                 |              | <b>Carrying</b>         |                 |   |  |
| <b>Value</b>  | <b>Allowance</b> | <b>Coverage</b> | <b>Value</b>               | <b>Allowance</b> | <b>Coverage</b> | <b>Value</b> | <b>Allowance</b>        | <b>Coverage</b> |   |  |
| <b>(In thousands)</b>   |                  |                 |                            |                  |                 |              |                         |                 |   |  |
| <b>Delinquency:</b>   |                  |                 |                            |                  |                 |              |                         |                 |   |  |
| 0 - 89 days   | \$ 13,218        | \$ 239          | 1.81%                      | \$ 22,726        | \$ 925          | 4.07%        | \$ 90,317               | \$ 2,014        | 2.23%   |  |
| 90 - 119 days   | 245              | 8               | 3.27%                      | 115              | 5               | 0.00%        | 511                     | 22              | 4.31%   |  |
| 120 - 179 days  | 91               | 3               | 0.00%                      | -                | -               | 0.00%        | 1,438                   | 61              | 4.24%   |  |
| 180 - 364 days  | 163              | 9               | 5.52%                      | 658              | 84              | 12.77%       | 763                     | 45              | 5.90%   |  |
| 365+ days   | 400              | 43              | 10.75%                     | 423              | 192             | 45.39%       | 1,822                   | 285             | 15.64%  |  |
| <b>Total</b>  | <b>\$ 14,117</b> | <b>\$ 302</b>   | <b>2.14%</b>               | <b>\$ 23,922</b> | <b>\$ 1,206</b> | <b>5.04%</b> | <b>\$ 94,851</b>        | <b>\$ 2,427</b> | <b>2.56%</b>                                  |  |
| Percentage of total loans excluding acquired loans accounted for under ASC 310-30 | 0.47%            |                 |                            | 0.80%            |                 |              | 3.18%                   |                 |   |  |
| <b>Refinanced or Modified Loans:</b>  |                  |                 |                            |                  |                 |              |                         |                 |   |  |
| Amount  | \$ 2,270         | \$ 175          | 7.71%                      | \$ -             | \$ -            | 0.00%        | \$ 14,825               | \$ 1,185        | 7.99%   |  |
| Percentage of Higher-Risk Loan Category   | 16.08%           |                 |                            | 0.00%            |                 |              | 15.63%                  |                 |   |  |
| <b>Loan-to-Value Ratio:</b>   |                  |                 |                            |                  |                 |              |                         |                 |   |  |
| Under 70%   | \$ 9,307         | \$ 205          | 2.20%                      | \$ 2,459         | \$ 212          | 8.62%        | \$ -                    | \$ -            | -   |  |
| 70% - 79%   | 2,874            | 54              | 1.88%                      | 3,238            | 145             | 4.48%        | -                       | -               | -   |  |
| 80% - 89%   | 826              | 21              | 2.54%                      | 7,118            | 334             | 4.69%        | -                       | -               | -   |  |
| 90% and over  | 1,110            | 22              | 1.98%                      | 11,107           | 515             | 4.64%        | 94,851                  | 2,427           | 2.56%   |  |
|   | \$ 14,117        | \$ 302          | 2.14%                      | \$ 23,922        | \$ 1,206        | 5.04%        | \$ 94,851               | \$ 2,427        | 2.56%   |  |



| The following table includes the Company's lending and investment exposure to the Puerto Rico government, including its agencies, instrumentalities, municipalities and public corporations: |                       |                         |                     |                          |  |  |  |  |  |  |  |  |
|--|-----------------------|-------------------------|---------------------|--------------------------|--|--|--|--|--|--|--|--|
| <b>TABLE 7 - PUERTO RICO GOVERNMENT RELATED LOANS AND SECURITIES</b>   |                       |                         |                     |                          |  |  |  |  |  |  |  |  |
| <b>June 30, 2014</b>   |                       |                         |                     |                          |  |  |  |  |  |  |  |  |
| <b>Maturity</b>  |                       |                         |                     |                          |  |  |  |  |  |  |  |  |
| <b>Loans and Securities:</b>   | <b>Carrying Value</b> | <b>Less than 1 Year</b> | <b>1 to 3 Years</b> | <b>More than 3 Years</b> | <b>Comments</b>  |  |  |  |  |  |  |  |
| <b>(In thousands)</b>  |                       |                         |                     |                          |  |  |  |  |  |  |  |  |
| Central government   | \$ 49,660             | \$ 20,750               | \$ -                | \$ 28,910                | Repayment sources include all available revenues of the Commonwealth                   |  |  |  |  |  |  |  |
| Public corporations  | 382,888               | 299,991                 | 1,422               | 81,475                   | \$81.5 million which mature in more than 3 years, with pledged securities (rating > A) |  |  |  |  |  |  |  |
| Municipalities   | 222,881               | -                       | 507                 | 222,374                  | Repayment from property taxes  |  |  |  |  |  |  |  |
| Investment securities  | 22,391                | -                       | -                   | 22,391                   |  |  |  |  |  |  |  |  |
| <b>Total</b>   | <b>\$ 677,820</b>     | <b>\$ 320,741</b>       | <b>\$ 1,929</b>     | <b>\$ 355,150</b>        |  |  |  |  |  |  |  |  |

Some highlights follow on the data included above:

- Loans to Puerto Rico central government and public corporations are collateralized or have specific repayment sources.
- Loans to municipalities are backed by their unlimited taxing power or real and personal property taxes.
- 49% of loans and securities balances mature in 12-months or less.

- Deposits from municipalities, central government and other government entities totaled \$362.8 million at June 30, 2014. However, this amount may decline as a result of recently enacted legislation to improve the liquidity of the Government Development Bank for Puerto Rico (“GDB”) by requiring the Commonwealth’s agencies, instrumentalities and public corporations to maintain certain deposits at GDB.
- The Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”) enacted in the second quarter of 2014 establishes procedures for the adjustment of debts of certain public corporations. Significantly all of the Company’s public corporation debtors are authorized to seek relief under the Recovery Act.
- Oriental Bank is part of a four bank syndicate providing a \$550 million dollar revolving line of credit to finance the purchase of fuel for the day to day power generation activities of the Puerto Rico Electric Power Authority (“PREPA”), a public corporation authorized to seek relief under the Recovery Act. The Bank’s participation in the line of credit has an unpaid principal balance of \$200.0 million as of June 30, 2014, which matures on August 14, 2014 and is currently accruing. The bank syndicate and PREPA have executed a short term forbearance agreement that expires at the maturity of the line of credit pursuant to which the bank syndicate agreed to not exercise remedies in connection with certain defaults under the loan agreement to facilitate a dialogue with PREPA, which is actively ongoing, regarding the future of the line of credit. As of June 30, 2014, this credit facility has a rating of special mention.

## Credit Risk Management

### Allowance for Loan and Lease Losses

The Company maintains an allowance for loan and lease losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Company's allowance for loan and lease losses policy provides for a detailed quarterly analysis of probable losses. Tables 8 through 12 set forth an analysis of activity in the allowance for loan and lease losses and present selected loan loss statistics. In addition, Table 5 sets forth the composition of the loan portfolio. As part of the Company's continuous enhancement to the allowance for loan and lease losses methodology, during the quarter ended March 31, 2014, an assessment of the look-back period and historical loss factor was performed for auto and leasing and consumer loan portfolios based on the trends observed and their relation with the economic cycle as of the period ended March 31, 2014. As a result, the period was changed to 24 months from the previously determined 12 months. In addition, during the quarter ended June 30, 2014, an assessment of environmental factors was performed for commercial, auto, and consumer portfolios. As a result, more weight is given to the environmental factors related to the economy, taking into consideration current evolution of the portfolio and expected impact, due to recent economic developments. These changes in the allowance for loan and lease losses' look back period for the consumer and auto and leasing portfolios, and economic factors for the commercial, auto, and consumer portfolios are considered a change in accounting estimate as per ASC 250-10 provisions, where adjustments should be made prospectively.

At June 30, 2014, the Company's allowance for non-covered loan and lease losses amounted to \$60.4 million, an increase from \$54.3 million at December 31, 2013. At June 30, 2014, \$50.6 million of the allowance corresponded to originated and other loans held for investment, or 1.92% of total non-covered originated and other loans held for investment, compared to \$49.1 million or 2.04% of total non-covered originated and other loans held for investment at December 31, 2013. The allowance increase as a result of a \$13.1 million provision for loan and lease losses and \$4.5 million of recoveries, which were partially offset by charge-offs of \$16.0 million during the six-month period ended June 30, 2014. The allowance for residential mortgage loans and commercial loans decreased by 4.4% (or \$875 thousand), and 16.6% (or \$2.5 million), respectively, when compared with the balances recorded at December 31, 2013. The allowance for consumer loans and auto and leases increased by 31.4% (or \$1.9 million) and 41.5% (or \$3.3 million), respectively, when compared with the balances recorded at December 31, 2013. The unallocated allowance at June 30, 2014 decreased by 63.0%, or \$236 thousand, when compared with the balance recorded at December 31, 2013.

Allowance for loan and lease losses recorded for acquired non-covered loans accounted for under the provisions of ASC 310-20 at June 30, 2014 was \$3.4 million compared to \$2.4 million at December 31, 2013, a 46.3% increase. The allowance increased as a result of a \$6.8 million provision for loan and lease losses and \$1.2 million of recoveries, which were partially offset by \$7.0 million in charge-offs during the six-month period ended June 30, 2014. The allowance for commercial loans decreased by 49.9% (or \$462 thousand), when compared with the balance recorded at December 31, 2013. The allowance for consumer and auto loans increased by 100% (or \$338 thousand) and 85.1% (or \$1.2 million), respectively, when compared with the balances recorded at December 31, 2013.

Allowance for loan and lease losses recorded for acquired non-covered loans accounted for under ASC-310-30 at June 30, 2014 was \$6.3 million as compared to \$2.9 million at December 31, 2013. The allowance increased as a result of a \$3.4 million provision for loan and lease losses during the six-month period ended June 30, 2014. The allowance for commercial loans increased by 262.9% (or \$4.5 million), when compared with the balance recorded at December 31, 2013. The allowance for consumer and auto loans decreased by 85.2% (or \$356 thousand) and 100% (or \$732 thousand), respectively, when compared with the balances recorded at December 31, 2013.

Allowance for loan and lease losses recorded for covered loans at June 30, 2014 was \$59.5 million as compared to \$52.7 million at December 31, 2013. The allowance increased as a result of a \$3.2 million provision for loan and lease losses and \$3.6 million of FDIC shared-loss portion of provision for covered loan and lease losses during the six-month period ended June 30, 2014. The allowance for loan and lease losses on covered loans is accounted under the provisions of ASC 310-30. Under this accounting guidance, the allowance for loan and lease losses on covered loans is evaluated at each financial reporting period, based on forecasted cash flows. Credit related decreases in expected cash flows, compared to those previously forecasted, are recognized by recording a provision for credit losses on covered loans when it is probable that all cash flows expected at acquisition will not be collected. The portion of the loss on covered loans reimbursable from the FDIC is recorded as an offset to the provision for credit losses and increases the FDIC indemnification asset.

Please refer to the “Provision for Loan and Lease Losses” section in this MD&A for a more detailed analysis of provisions for loan and lease losses.

**Non-performing Assets**

The Company's non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At June 30, 2014 and December 31, 2013, the Company had \$94.1 million and \$86.2 million, respectively, of non-accrual loans, including acquired loans accounted under ASC 310-20 (loans with revolving feature and/or acquired at a premium). At June 30, 2014 and December 31 2013, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-performing assets amounted to \$75.4 million and \$66.5 million, respectively.

Covered loans and loans acquired in the BBVAPR Acquisition with credit deterioration are considered to be performing due to the application of the accretion method under ASC 310-30, in which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analyses. Credit related decreases in expected cash flows, compared to those previously forecasted are recognized by recording a provision for credit losses on non-covered loans when it is probable that all cash flows expected at acquisition will not be collected.

At June 30, 2014, the Company's non-performing assets increased by 7.1% to \$166.3 million (2.90% of total assets, excluding covered assets and acquired loans with deteriorated credit quality) from \$155.3 million (2.61% of total assets, excluding covered assets and acquired loans with deteriorated credit quality) at December 31, 2013. The Company does not expect non-performing loans to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios. At June 30, 2014, the allowance for non-covered originated loan and lease losses to non-performing loans coverage ratio was 56.53% (61.52% at December 31, 2013).

The Company follows a conservative residential mortgage lending policy, with more than 90% of its residential mortgage portfolio consisting of fixed-rate, fully amortizing, fully documented loans that do not have the level of risk associated with subprime loans offered by certain major U.S. mortgage loan originators. Furthermore, the Company has never been active in negative amortization loans or adjustable rate mortgage loans, including those with teaser rates.

The following items comprise non-performing assets:

- Originated and other loans held for investment:

Mortgage loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan, except for FHA and VA insured mortgage loans which are placed in non-accrual when they become 18 months or more past due. At June 30, 2014, the Company's originated non-performing mortgage loans totaled \$57.3 million (60.9% of the Company's non-performing loans), a 12.3% increase from \$51.1 million (59.4% of the Company's non-performing loans) at December 31, 2013. Non-performing loans in this category are primarily residential mortgage loans.

Commercial loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At June 30, 2014, the Company's originated non-performing commercial loans amounted to \$23.5 million (25.0% of the Company's non-performing loans), a 3.0% increase from \$22.8 million at December 31, 2013 (26.5% of the Company's non-performing loans). Most of this portfolio is collateralized by commercial real estate properties.

Consumer loans — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At June 30, 2014, the Company's originated non-performing consumer loans amounted to \$1.5 million (1.5% of the Company's total non-performing loans), an 80.6% increase from \$805 thousand at December 31, 2013 (0.9% of the Company's total non-performing loans).

Auto loans and leases — are placed on non-accrual status when they become 90 days past due, partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At June 30, 2014, the Company's originated non-performing auto loans and leases amounted to \$7.3 million (7.8% of the Company's total non-performing loans), an increase of 43.4% from \$5.1 million at December 31, 2013 (5.9% of the Company's total non-performing loans).



- Acquired loans accounted for under ASC 310-20 (loans with revolving features and/or acquired at premium):

Commercial revolving lines of credit and credit cards — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At June 30, 2014, the Company's acquired non-performing commercial lines of credit accounted for under ASC 310-20 amounted to \$1.4 million (1.5% of the Company's non-performing loans), a 43.1% decrease from \$2.5 million at December 31, 2013 (3.0% of the Company's non-performing loans).

Consumer revolving lines of credit and credit cards — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 180 days. At June 30, 2014, the Company's acquired non-performing consumer lines of credit and credit cards accounted for under ASC 310-20 totaled \$1.4 million (1.4% of the Company's non-performing loans), a 39.1% decrease from \$2.2 million at December 31, 2013 (2.6% of the Company's non-performing loans).

Auto loans acquired at premium - are placed on non-accrual status when they become 90 days past due, partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At June 30, 2014, the Company's acquired non-performing auto loans accounted for under ASC 310-20 totaled \$1.7 million (1.8% of the Company's non-performing loans), a 4.5% increase from \$1.6 million at December 31, 2013 (1.9% of the Company's non-performing loans).

- Foreclosed real estate is initially recorded at the lower of the related loan balance or fair value less the estimated cost to sell as of the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan and lease losses. Subsequently, any excess of the carrying value over the estimated fair value less disposition cost is charged to operations. Net losses on foreclosed real estate and other repossessed assets for the quarter and six month period ended June 30, 2014, amounted to \$4.9 million and \$8.4 million, respectively, compared to \$1.7 million and \$3.6 million for the same periods in 2013.

The Company has two mortgage loan modification programs. These are the Loss Mitigation Program and the Non-traditional Mortgage Loan Program. Both programs are intended to help responsible homeowners to remain in their homes and avoid foreclosure, while also reducing the Company's losses on non-performing mortgage loans.

The Loss Mitigation Program helps mortgage borrowers who are or will become financially unable to meet the current or scheduled mortgage payments. Loans that qualify under this program are those guaranteed by FHA, VA, RHS, "Banco de la Vivienda de Puerto Rico," conventional loans guaranteed by Mortgage Guaranty Insurance Corporation

(MGIC), conventional loans sold to FNMA and FHLMC, and conventional loans retained by the Company. The program offers diversified alternatives such as regular or reduced payment plans, payment moratorium, mortgage loan modification, partial claims (only FHA), short sale, and payment in lieu of foreclosure.

The Non-traditional Mortgage Loan Program is for non-traditional mortgages, including balloon payment, interest only / interest first, variable interest rate, adjustable interest rate and other qualified loans. Non-traditional mortgage loan portfolios are segregated into the following categories: performing loans that meet secondary market requirement and are refinanced under the credit underwriting guidelines of FHA/VA/FNMA/ FHLMC, and performing loans not meeting secondary market guidelines processed by the Company's current credit and underwriting guidelines. The Company achieved an affordable and sustainable monthly payment by taking specific, sequential, and necessary steps such as reducing the interest rate, extending the loan term, capitalizing arrearages, deferring the payment of principal or, if the borrower qualifies, refinancing the loan.

There may not be a foreclosure sale scheduled within 60 days prior to a loan modification under any such programs. This requirement does not apply to loans where the foreclosure process has been stopped by the Company. In order to apply for any of the loan modification programs, the borrower may not be in active bankruptcy or have been discharged from Chapter 7 bankruptcy since the loan was originated. Loans in these programs are to be evaluated by management for troubled-debt restructuring classification if the Company grants a concession for legal or economic reasons due to the debtor's financial difficulties.

| <b>TABLE 8 —<br/>ALLOWANCE<br/>FOR LOAN AND<br/>LEASE LOSSES<br/>SUMMARY</b> |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |
|--|-------------------------------|---------|-------------|----------|-----------------|--|----------|-------------|----------|-----------------|--|--|--|
|  |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |
|  |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |
|  | <b>Quarter Ended June 30,</b> |         |             |          | <b>Variance</b> | <b>Six-Month Period Ended June 30,</b> |          |             |          | <b>Variance</b> |  |  |  |
|  | <b>2014</b>                   |         | <b>2013</b> |          | <b>%</b>        | <b>2014</b>                            |          | <b>2013</b> |          | <b>%</b>        |  |  |  |
|  | <b>(Dollars in thousands)</b> |         |             |          |                 |  |          |             |          |                 |  |  |  |
| <b>Non-covered loans</b>   |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |
| <b>Originated and other loans:</b>   |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |
| <b>Balance at beginning of period</b>  | \$                            | 49,507  | \$          | 42,334   | 16.9%           | \$                                     | 49,081   | \$          | 39,921   | 22.9%           |  |  |  |
| Provision for non-covered loan and lease losses                              |                               | 7,431   |             | 35,919   | -79.3%          |  | 13,056   |             | 41,715   | -68.7%          |  |  |  |
| Charge-offs  |                               | (8,883) |             | (33,038) | -73.1%          |  | (15,999) |             | (36,521) | -56.2%          |  |  |  |
| Recoveries   |                               | 2,583   |             | 486      | 431.5%          |  | 4,500    |             | 586      | 667.9%          |  |  |  |
|  |                               | 50,638  |             | 45,701   | 10.8%           |  | 50,638   |             | 45,701   | 10.8%           |  |  |  |
| <b>Acquired loans accounted for under ASC 310-20:</b>                        |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |
| <b>Balance at beginning of period</b>  | \$                            | 3,618   | \$          | 386      | 100.0%          | \$                                     | 2,354    | \$          | -        | 100.0%          |  |  |  |
| Provision for non-covered loan and lease losses                              |                               | 2,569   |             | 1,608    | 59.8%           |  | 6,811    |             | 3,728    | 82.7%           |  |  |  |
| Charge-offs  |                               | (3,432) |             | (2,593)  | 32.4%           |  | (6,960)  |             | (5,764)  | 20.7%           |  |  |  |
| Recoveries   |                               | 689     |             | 1,523    | -54.8%          |  | 1,239    |             | 2,960    | -58.1%          |  |  |  |
|  |                               | 3,444   |             | 924      | 272.7%          |  | 3,444    |             | 924      | 272.7%          |  |  |  |
| <b>Acquired loans accounted for</b>  |                               |         |             |          |                 |  |          |             |          |                 |  |  |  |

|  |    |               |    |               |              |    |               |    |               |              |  |  |  |  |
|--|----|---------------|----|---------------|--------------|----|---------------|----|---------------|--------------|--|--|--|--|
| <b>under ASC 310-30:</b>   |    |               |    |               |              |    |               |    |               |              |  |  |  |  |
| <b>Balance at beginning of period</b>  | \$ | 3,058         | \$ | -             | 100.0%       | \$ | 2,863         | \$ | -             | 100.0%       |  |  |  |  |
| Provision for non-covered loan and lease losses  |    | 3,220         |    | -             | 100.0%       |    | 3,415         |    | -             | 100.0%       |  |  |  |  |
|  |    | 6,278         |    | -             | 100.0%       |    | 6,278         |    | -             | 100.0%       |  |  |  |  |
| <b>Total non-covered loans balance at end of period</b>  | \$ | <b>60,360</b> | \$ | <b>46,625</b> | <b>29.5%</b> | \$ | <b>60,360</b> | \$ | <b>46,625</b> | <b>29.5%</b> |  |  |  |  |
| <b>Allowance for loans and lease losses on originated and other loans to:</b>                    |    |               |    |               |              |    |               |    |               |              |  |  |  |  |
| Total originated loans   |    | 1.92%         |    | 2.91%         | -34.1%       |    | 1.92%         |    | 2.91%         | -34.1%       |  |  |  |  |
| Non-performing originated loans  |    | 56.53%        |    | 32.45%        | 74.2%        |    | 56.53%        |    | 32.45%        | 74.2%        |  |  |  |  |
| <b>Allowance for loans and lease losses on acquired loans accounted for under ASC 310-20 to:</b> |    |               |    |               |              |    |               |    |               |              |  |  |  |  |
| Total acquired loans accounted for under ASC 310-20  |    | 1.05%         |    | 0.05          | 100.0%       |    | 1.05%         |    | 0.05          | 100.0%       |  |  |  |  |
| Non-performing acquired loans accounted for under ASC 310-20                                     |    | 76.88%        |    | 21.94         | -96.5%       |    | 76.88%        |    | 21.94         | -96.5%       |  |  |  |  |

Edgar Filing: OFG BANCORP - Form 10-Q

| <b>Covered loans</b>   |    |               |    |               |              |    |               |    |               |              |  |  |  |  |
|--|----|---------------|----|---------------|--------------|----|---------------|----|---------------|--------------|--|--|--|--|
| <b>Balance at beginning of period</b>  | \$ | 54,398        | \$ | 54,124        | 0.5%         | \$ | 52,729        | \$ | 54,124        | -2.6%        |  |  |  |  |
| Provision for covered loan and lease losses, net                               |    | 1,595         |    | 672           | 137.4%       |    | 3,223         |    | 672           | 379.6%       |  |  |  |  |
| FDIC shared-loss portion on (provision for) recapture of loan and lease losses |    | 3,522         |    | (1,822)       | -293.3%      |    | 3,562         |    | (1,822)       | -295.5%      |  |  |  |  |
| <b>Balance at end of period</b>  | \$ | <b>59,515</b> | \$ | <b>52,974</b> | <b>12.3%</b> | \$ | <b>59,514</b> | \$ | <b>52,974</b> | <b>12.3%</b> |  |  |  |  |

| <b>TABLE 9 — ALLOWANCE FOR NON-COVERED LOAN AND LEASE LOSSES BREAKDOWN</b> |                        |                          |  |                          |                |                       |
|--|------------------------|--------------------------|--|--------------------------|----------------|-----------------------|
|  |                        | <b>June 30,<br/>2014</b> |  | <b>December 31, 2013</b> |                | <b>Variance<br/>%</b> |
|  | (Dollars in thousands) |                          |  |                          |                |                       |
| <b>Originated and other loans held for investment</b>                      |                        |                          |  |                          |                |                       |
| <b>Allowance balance:</b>  |                        |                          |  |                          |                |                       |
| Mortgage   | \$                     | 19,062                   |  | \$                       | 19,937         | -4.4%                 |
| Commercial   |                        | 12,423                   |  |                          | 14,897         | -16.6%                |
| Consumer   |                        | 7,887                    |  |                          | 6,006          | 31.3%                 |
| Auto and leasing   |                        | 11,127                   |  |                          | 7,866          | 41.5%                 |
| Unallocated allowance  |                        | 139                      |  |                          | 375            | -62.9%                |
| <b>Total allowance balance</b>   | <b>\$</b>              | <b>50,638</b>            |  | <b>\$</b>                | <b>49,081</b>  | <b>3.2%</b>           |
| <b>Allowance composition:</b>  |                        |                          |  |                          |                |                       |
| Mortgage   |                        | 37.64%                   |  |                          | 40.62%         | -7.3%                 |
| Commercial   |                        | 24.53%                   |  |                          | 30.35%         | -19.2%                |
| Consumer   |                        | 15.58%                   |  |                          | 12.24%         | 27.3%                 |
| Auto and leasing   |                        | 21.97%                   |  |                          | 16.03%         | 37.1%                 |
| Unallocated allowance  |                        | 0.27%                    |  |                          | 0.76%          | -64.5%                |
|  |                        | <b>100.00%</b>           |  |                          | <b>100.00%</b> |                       |
| <b>Allowance coverage ratio at end of period applicable to:</b>            |                        |                          |  |                          |                |                       |
| Mortgage   |                        | 2.42%                    |  |                          | 2.60%          | -7.0%                 |
| Commercial   |                        | 1.05%                    |  |                          | 1.32%          | -20.5%                |
| Consumer   |                        | 4.88%                    |  |                          | 4.70%          | 3.8%                  |
| Auto and leasing   |                        | 2.19%                    |  |                          | 2.07%          | 5.8%                  |
| Unallocated allowance to total originated loans                            |                        | 0.01%                    |  |                          | 0.02%          | -66.3%                |
| <b>Total allowance to total originated loans</b>                           |                        | <b>1.92%</b>             |  |                          | <b>2.04%</b>   | <b>-6.2%</b>          |
| <b>Allowance coverage ratio to non-performing loans:</b>                   |                        |                          |  |                          |                |                       |
| Mortgage   |                        | 33.26%                   |  |                          | 39.05%         | -14.8%                |
| Commercial   |                        | 52.85%                   |  |                          | 65.25%         | -19.0%                |
| Consumer   |                        | 542.43%                  |  |                          | 746.09%        | -27.3%                |
| Auto and leasing   |                        | 152.42%                  |  |                          | 154.57%        | -1.4%                 |
| <b>Total</b>   |                        | <b>56.53%</b>            |  |                          | <b>61.52%</b>  | <b>-8.1%</b>          |
| <b>Acquired loans accounted for under ASC 310-20</b>                       |                        |                          |  |                          |                |                       |
| <b>Allowance balance:</b>  |                        |                          |  |                          |                |                       |
| Commercial   | \$                     | 464                      |  | \$                       | 926            | -49.9%                |
| Consumer   |                        | 338                      |  |                          | -              | 100.0%                |

## Edgar Filing: OFG BANCORP - Form 10-Q

|   |           |                |  |           |                |  |               |
|---|-----------|----------------|--|-----------|----------------|--|---------------|
| Auto  |           | 2,642          |  |           | 1,428          |  | 85.0%         |
| <b>Total allowance balance</b>                                  | <b>\$</b> | <b>3,444</b>   |  | <b>\$</b> | <b>2,354</b>   |  | <b>46.3%</b>  |
| <b>Allowance composition:</b>                                   |           |                |  |           |                |  |               |
| Commercial  |           | 13.48%         |  |           | 39.34%         |  | -65.7%        |
| Consumer  |           | 9.81%          |  |           | 0.00%          |  | 100.0%        |
| Auto  |           | 76.71%         |  |           | 60.66%         |  | 26.5%         |
|   |           | <b>100.00%</b> |  |           | <b>100.00%</b> |  |               |
| <b>Allowance coverage ratio at end of period applicable to:</b> |           |                |  |           |                |  |               |
| Commercial  |           | 1.20%          |  |           | 1.19%          |  | 0.8%          |
| Consumer  |           | 0.68%          |  |           | 0.00%          |  | 100.0%        |
| Auto  |           | 1.11%          |  |           | 0.47%          |  | 134.0%        |
| <b>Total allowance to total acquired loans</b>                  |           | <b>1.05%</b>   |  |           | <b>0.54%</b>   |  | <b>95.1%</b>  |
| <b>Allowance coverage ratio to non-performing loans:</b>        |           |                |  |           |                |  |               |
| Commercial  |           | 32.04%         |  |           | 36.41%         |  | -12.0%        |
| Consumer  |           | 25.00%         |  |           | 0.00%          |  | 100.0%        |
| Auto  |           | 157.26%        |  |           | 88.81%         |  | 77.1%         |
| <b>Total</b>  |           | <b>76.88%</b>  |  |           | <b>36.95%</b>  |  | <b>108.0%</b> |

| <b>TABLE 9 — ALLOWANCE FOR NON-COVERED LOAN AND LEASE LOSSES BREAKDOWN<br/>(CONTINUED)</b> |                        |                          |  |                          |                |                       |  |
|--|------------------------|--------------------------|--|--------------------------|----------------|-----------------------|--|
|  |                        | <b>June 30,<br/>2014</b> |  | <b>December 31, 2013</b> |                | <b>Variance<br/>%</b> |  |
|  | (Dollars in thousands) |                          |  |                          |                |                       |  |
| <b>Acquired loans accounted for under<br/>ASC 310-30</b>                                   |                        |                          |  |                          |                |                       |  |
| <b>Allowance balance:</b>  |                        |                          |  |                          |                |                       |  |
| Commercial   | \$                     | 6,216                    |  | \$                       | 1,713          | 262.9%                |  |
| Consumer   |                        | 62                       |  |                          | 418            | 100.0%                |  |
| Auto   |                        | -                        |  |                          | 732            | -100.0%               |  |
| <b>Total allowance balance</b>   | <b>\$</b>              | <b>6,278</b>             |  | <b>\$</b>                | <b>2,863</b>   | <b>119.3%</b>         |  |
| <b>Allowance composition:</b>  |                        |                          |  |                          |                |                       |  |
| Commercial   |                        | 99.01%                   |  |                          | 59.83%         | 65.5%                 |  |
| Consumer   |                        | 0.99%                    |  |                          | 14.60%         | 100.0%                |  |
| Auto   |                        | 0.00%                    |  |                          | 25.57%         | -100.0%               |  |
|  |                        | <b>100.00%</b>           |  |                          | <b>100.00%</b> |                       |  |



| <b>TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30</b> |                               |                    |  |                 |  |                    |          |                 |  |
|---|-------------------------------|--------------------|--|-----------------|--|--------------------|----------|-----------------|--|
|   | <b>Quarter Ended June 30,</b> |                    |  | <b>Variance</b> | <b>Six-Month Period Ended June 30,</b> |                    |          | <b>Variance</b> |  |
|   | <b>2014</b>                   | <b>2013</b>        |  | <b>%</b>        | <b>2014</b>                            | <b>2013</b>        | <b>%</b> |                 |  |
| <b>(Dollar in thousands)</b>  |                               |                    |  |                 |  |                    |          |                 |  |
| <b>Originated and other loans and leases:</b>   |                               |                    |  |                 |  |                    |          |                 |  |
| <b>Mortgage</b>   |                               |                    |  |                 |  |                    |          |                 |  |
| Charge-offs   | \$ (987)                      | \$ (29,119)        |  | -96.6%          | \$ (2,201)                             | \$ (31,708)        |          | -93.1%          |  |
| Recoveries  | 88                            | -                  |  | 100.0%          | 236                                    | -                  |          | 100.0%          |  |
| <b>Total</b>  | <b>(899)</b>                  | <b>(29,119)</b>    |  | <b>-96.9%</b>   | <b>(1,965)</b>                         | <b>(31,708)</b>    |          | <b>-93.8%</b>   |  |
| <b>Commercial</b>   |                               |                    |  |                 |  |                    |          |                 |  |
| Charge-offs   | (543)                         | (2,887)            |  | -81.2%          | (962)                                  | (3,444)            |          | -72.1%          |  |
| Recoveries  | 115                           | 234                |  | -50.9%          | 213                                    | 262                |          | -18.7%          |  |
| <b>Total</b>  | <b>(428)</b>                  | <b>(2,653)</b>     |  | <b>-83.9%</b>   | <b>(749)</b>                           | <b>(3,182)</b>     |          | <b>-76.5%</b>   |  |
| <b>Consumer</b>   |                               |                    |  |                 |  |                    |          |                 |  |
| Charge-offs   | (1,397)                       | (323)              |  | 332.5%          | (2,235)                                | (569)              |          | 292.8%          |  |
| Recoveries  | 244                           | 43                 |  | 467.4%          | 391                                    | 108                |          | 262.0%          |  |
| <b>Total</b>  | <b>(1,153)</b>                | <b>(280)</b>       |  | <b>311.8%</b>   | <b>(1,844)</b>                         | <b>(461)</b>       |          | <b>300.0%</b>   |  |
| <b>Auto</b>   |                               |                    |  |                 |  |                    |          |                 |  |
| Charge-offs   | (5,956)                       | (709)              |  | 740.1%          | (10,601)                               | (800)              |          | 1225.1%         |  |
| Recoveries  | 2,136                         | 209                |  | 922.0%          | 3,660                                  | 216                |          | 1594.4%         |  |
| <b>Total</b>  | <b>(3,820)</b>                | <b>(500)</b>       |  | <b>664%</b>     | <b>(6,941)</b>                         | <b>(584)</b>       |          | <b>1088.5%</b>  |  |
| <b>Net credit losses</b>  |                               |                    |  |                 |  |                    |          |                 |  |
| Total charge-offs   | (8,883)                       | (33,038)           |  | -73.1%          | (15,999)                               | (36,521)           |          | -56.2%          |  |
| Total recoveries  | 2,583                         | 486                |  | 431.5%          | 4,500                                  | 586                |          | 667.9%          |  |
| <b>Total</b>  | <b>\$ (6,300)</b>             | <b>\$ (32,552)</b> |  | <b>-80.6%</b>   | <b>\$ (11,499)</b>                     | <b>\$ (35,935)</b> |          | <b>-68.0%</b>   |  |
| <b>Net credit losses to average loans outstanding:</b>  |                               |                    |  |                 |  |                    |          |                 |  |
| Mortgage  | 0.46%                         | 14.50%             |  | -96.8%          | 0.51%                                  | 8.10%              |          | -93.7%          |  |
| Commercial  | 0.14%                         | 2.71%              |  | -94.8%          | 0.13%                                  | 1.66%              |          | -92.2%          |  |
| Consumer  | 3.13%                         | 1.44%              |  | 117.4%          | 2.68%                                  | 1.35%              |          | 98.5%           |  |
| Auto  | 3.15%                         | 1.04%              |  | 202.9%          | 3.07%                                  | 0.81%              |          | 279.0%          |  |
| <b>Total</b>  | <b>0.96%</b>                  | <b>8.89%</b>       |  | <b>-89.2%</b>   | <b>0.91%</b>                           | <b>5.21%</b>       |          | <b>-82.5%</b>   |  |
| <b>Recoveries to charge-offs</b>  | <b>29.08%</b>                 | <b>1.47%</b>       |  | <b>1876.7%</b>  | <b>28.13%</b>                          | <b>1.60%</b>       |          | <b>1652.9%</b>  |  |

Edgar Filing: OFG BANCORP - Form 10-Q

|                                  |           |                  |           |                  |              |           |                  |           |                  |              |
|----------------------------------|-----------|------------------|-----------|------------------|--------------|-----------|------------------|-----------|------------------|--------------|
| <b>Average originated loans:</b> |           |                  |           |                  |              |           |                  |           |                  |              |
| Mortgage                         | \$        | 773,425          | \$        | 803,272          | -3.7%        | \$        | 763,400          | \$        | 783,172          | -2.5%        |
| Commercial                       |           | 1,209,346        |           | 392,261          | 208.3%       |           | 1,165,891        |           | 382,654          | 204.7%       |
| Consumer                         |           | 147,230          |           | 77,948           | 88.9%        |           | 137,787          |           | 68,480           | 101.2%       |
| Auto                             |           | 484,536          |           | 191,438          | 153.1%       |           | 451,488          |           | 144,995          | 211.4%       |
| <b>Total</b>                     | <b>\$</b> | <b>2,614,537</b> | <b>\$</b> | <b>1,464,919</b> | <b>78.5%</b> | <b>\$</b> | <b>2,518,566</b> | <b>\$</b> | <b>1,379,302</b> | <b>82.6%</b> |

107

| <b>TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30 (CONTINUED)</b> |                               |  |                   |  |                 |  |             |                   |             |                 |
|---|-------------------------------|--|-------------------|--|-----------------|--|-------------|-------------------|-------------|-----------------|
|   | <b>Quarter Ended June 30,</b> |  |                   |  | <b>Variance</b> | <b>Six-Month Period Ended June 30,</b> |             |                   |             | <b>Variance</b> |
|   | <b>2014</b>                   |  | <b>2013</b>       |  |                 | <b>%</b>                               | <b>2013</b> |                   | <b>2014</b> |                 |
| <b>(Dollars in thousands)</b>   |                               |  |                   |  |                 |  |             |                   |             |                 |
| <b>Acquired loans accounted for under ASC 310-20:</b>   |                               |  |                   |  |                 |  |             |                   |             |                 |
| <b>Commercial</b>   |                               |  |                   |  |                 |  |             |                   |             |                 |
| Charge-offs   | \$ (110)                      |  | \$ (25)           |  | 340.0%          | \$ (284)                               |             | \$ (25)           |             | 1036.0%         |
| Recoveries  | 30                            |  | -                 |  | 100.0%          | 30                                     |             | -                 |             | 100.0%          |
| <b>Total</b>  | <b>(80)</b>                   |  | <b>(25)</b>       |  | <b>220.0%</b>   | <b>(254)</b>                           |             | <b>(25)</b>       |             | <b>916.0%</b>   |
| <b>Consumer</b>   |                               |  |                   |  |                 |  |             |                   |             |                 |
| Charge-offs   | (1,952)                       |  | (1,158)           |  | 68.6%           | (4,010)                                |             | (2,614)           |             | 53.4%           |
| Recoveries  | 124                           |  | 637               |  | -80.5%          | 224                                    |             | 844               |             | -73.5%          |
| <b>Total</b>  | <b>(1,828)</b>                |  | <b>(521)</b>      |  | <b>250.9%</b>   | <b>(3,786)</b>                         |             | <b>(1,770)</b>    |             | <b>113.9%</b>   |
| <b>Auto</b>   |                               |  |                   |  |                 |  |             |                   |             |                 |
| Charge-offs   | (1,370)                       |  | (1,410)           |  | -2.8%           | (2,666)                                |             | (3,125)           |             | -14.7%          |
| Recoveries  | 535                           |  | 886               |  | -39.6%          | 985                                    |             | 2,116             |             | -53.4%          |
| <b>Total</b>  | <b>(835)</b>                  |  | <b>(524)</b>      |  | <b>59.4%</b>    | <b>(1,681)</b>                         |             | <b>(1,009)</b>    |             | <b>66.6%</b>    |
| <b>Net credit losses</b>  |                               |  |                   |  |                 |  |             |                   |             |                 |
| Total charge-offs   | (3,432)                       |  | (2,593)           |  | 32.4%           | (6,960)                                |             | (5,764)           |             | 20.7%           |
| Total recoveries  | 689                           |  | 1,523             |  | -54.8%          | 1,239                                  |             | 2,960             |             | -58.1%          |
| <b>Total</b>  | <b>\$ (2,743)</b>             |  | <b>\$ (1,070)</b> |  | <b>156.4%</b>   | <b>\$ (5,721)</b>                      |             | <b>\$ (2,804)</b> |             | <b>104.0%</b>   |
| <b>Net credit losses to average loans outstanding:</b>  |                               |  |                   |  |                 |  |             |                   |             |                 |
| Commercial  | 1.29%                         |  | 0.03%             |  | 4914.2%         | 1.04%                                  |             | 0.01%             |             | 7778.2%         |
| Consumer  | 10.96%                        |  | 2.92%             |  | 275.3%          | 11.09%                                 |             | 4.97%             |             | 123.3%          |
| Auto  | 1.34%                         |  | 0.54%             |  | 148.2%          | 1.27%                                  |             | 0.49%             |             | 157.2%          |
| <b>Total</b>  | <b>3.22%</b>                  |  | <b>0.50%</b>      |  | <b>538.6%</b>   | <b>2.99%</b>                           |             | <b>0.65%</b>      |             | <b>358.6%</b>   |
| <b>Recoveries to charge-offs</b>  | <b>20.08%</b>                 |  | <b>58.74%</b>     |  | <b>-65.8%</b>   | <b>17.80%</b>                          |             | <b>51.35%</b>     |             | <b>-65.3%</b>   |
| <b>Average loans accounted for under ASC 310-20:</b>  |                               |  |                   |  |                 |  |             |                   |             |                 |
| Commercial  | \$ 24,855                     |  | \$ 389,461        |  | -93.6%          | \$ 48,868                              |             | \$ 378,929        |             | -87.1%          |
| Consumer  | 66,690                        |  | 71,334            |  | -6.5%           | 68,294                                 |             | 71,290            |             | -4.2%           |

Edgar Filing: OFG BANCORP - Form 10-Q

|              |           |                |           |                |  |               |           |                |           |                |  |               |
|--------------|-----------|----------------|-----------|----------------|--|---------------|-----------|----------------|-----------|----------------|--|---------------|
| Auto         |           | 249,395        |           | 388,486        |  | -35.8%        |           | 265,459        |           | 409,798        |  | -35.2%        |
| <b>Total</b> | <b>\$</b> | <b>340,940</b> | <b>\$</b> | <b>849,281</b> |  | <b>-59.9%</b> | <b>\$</b> | <b>382,621</b> | <b>\$</b> | <b>860,016</b> |  | <b>-55.5%</b> |

108

| <b>TABLE 11 — NON-PERFORMING ASSETS</b>   |                 |                |                     |                |                 |  |
|---|-----------------|----------------|---------------------|----------------|-----------------|--|
|   | <b>June 30,</b> |                | <b>December 31,</b> |                | <b>Variance</b> |  |
|   | <b>2014</b>     |                | <b>2013</b>         |                | <b>(%)</b>      |  |
| <b>(Dollars in thousands)</b>   |                 |                |                     |                |                 |  |
| <b>Non-performing assets:</b>   |                 |                |                     |                |                 |  |
| Non-accruing loans  |                 |                |                     |                |                 |  |
| Troubled-Debt Restructuring loans   | \$              | 26,435         | \$                  | 26,847         | -1.5%           |  |
| Other loans   |                 | 62,746         |                     | 56,430         | 11.2%           |  |
| Accruing loans  |                 |                |                     |                |                 |  |
| Troubled-Debt Restructuring loans   |                 | 3,731          |                     | 1,898          | 100.0%          |  |
| Other loans   |                 | 1,142          |                     | 977            | 100.0%          |  |
| Total non-performing loans  | \$              | 94,054         | \$                  | 86,152         | 9.2%            |  |
| Foreclosed real estate not covered under the shared-loss agreements with the FDIC   |                 | 55,523         |                     | 56,815         | -2.3%           |  |
| Other repossessed assets  |                 | 16,765         |                     | 12,314         | 36.1%           |  |
| Mortgage loans held for sale  |                 | -              |                     | -              | 100.0%          |  |
|   | \$              | <b>166,342</b> | \$                  | <b>155,281</b> | <b>7.1%</b>     |  |
| <b>Non-performing assets to total assets, excluding covered assets and acquired loans with deteriorated credit quality (including those by analogy)</b> |                 | <b>2.90%</b>   |                     | <b>2.61%</b>   | <b>11.1%</b>    |  |
| <b>Non-performing assets to total capital</b>   |                 | <b>17.98%</b>  |                     | <b>17.55%</b>  | <b>2.5%</b>     |  |

|  | <b>Quarter Ended June 30,</b> |     |             |     | <b>Six-Month Period Ended June 30,</b> |       |             |     |
|--|-------------------------------|-----|-------------|-----|--|-------|-------------|-----|
|  | <b>2014</b>                   |     | <b>2013</b> |     | <b>2014</b>                            |       | <b>2013</b> |     |
| <b>(In thousands)</b>  |                               |     |             |     |  |       |             |     |
| <b>Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans</b> | \$                            | 723 | \$          | 530 | \$                                     | 1,213 | \$          | 991 |

| <b>TABLE 12 — NON-PERFORMING LOANS</b>   |                 |               |                     |               |                 |             |  |
|--|-----------------|---------------|---------------------|---------------|-----------------|-------------|--|
|  | <b>June 30,</b> |               | <b>December 31,</b> |               | <b>Variance</b> |             |  |
|  | <b>2014</b>     |               | <b>2013</b>         |               | <b>%</b>        |             |  |
| <b>(Dollars in thousands)</b>  |                 |               |                     |               |                 |             |  |
| <b>Non-performing loans:</b>   |                 |               |                     |               |                 |             |  |
| <b>Originated and other loans held for investment</b>  |                 |               |                     |               |                 |             |  |
| Mortgage   | \$              | 57,314        | \$                  | 51,058        |                 | 12.3%       |  |
| Commercial   |                 | 23,506        |                     | 22,830        |                 | 3.0%        |  |
| Consumer   |                 | 1,454         |                     | 805           |                 | 80.6%       |  |
| Auto and leasing   |                 | 7,300         |                     | 5,089         |                 | 43.4%       |  |
|  |                 | 89,574        |                     | 79,782        |                 | 12.3%       |  |
| <b>Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b> |                 |               |                     |               |                 |             |  |
| Commercial   |                 | 1,448         |                     | 2,543         |                 | -43.1%      |  |
| Consumer   |                 | 1,352         |                     | 2,219         |                 | -39.1%      |  |
| Auto   |                 | 1,680         |                     | 1,608         |                 | 4.5%        |  |
|  |                 | 4,480         |                     | 6,370         |                 | -29.7%      |  |
| <b>Total</b>   | <b>\$</b>       | <b>94,054</b> | <b>\$</b>           | <b>86,152</b> |                 | <b>9.2%</b> |  |
| <b>Non-performing loans composition percentages:</b>   |                 |               |                     |               |                 |             |  |
| <b>Originated loans</b>  |                 |               |                     |               |                 |             |  |
| Mortgage   |                 | 60.9%         |                     | 59.4%         |                 |             |  |
| Commercial   |                 | 25.0%         |                     | 26.5%         |                 |             |  |
| Consumer   |                 | 1.5%          |                     | 0.9%          |                 |             |  |
| Auto and leasing   |                 | 7.8%          |                     | 5.9%          |                 |             |  |
| <b>Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b> |                 |               |                     |               |                 |             |  |
| Commercial   |                 | 1.5%          |                     | 3.0%          |                 |             |  |
| Consumer   |                 | 1.4%          |                     | 2.6%          |                 |             |  |
| Auto   |                 | 1.8%          |                     | 1.9%          |                 |             |  |
| <b>Total</b>   |                 | <b>100.0%</b> |                     | <b>100.0%</b> |                 |             |  |
| <b>Non-performing loans to:</b>  |                 |               |                     |               |                 |             |  |
| Total loans, excluding covered loans and loans accounted for   |                 | <b>3.17%</b>  |                     | <b>3.04%</b>  |                 | <b>4.2%</b> |  |

Edgar Filing: OFG BANCORP - Form 10-Q

|   |  |               |  |  |               |  |              |  |
|---|--|---------------|--|--|---------------|--|--------------|--|
| under ASC 310-30 (including those by analogy)                   |  |               |  |  |               |  |              |  |
| Total assets, excluding covered assets and loans accounted for  |  |               |  |  |               |  |              |  |
| under ASC 310-30 (including those by analogy)                   |  | <b>1.64%</b>  |  |  | <b>1.45%</b>  |  | <b>13.0%</b> |  |
| Total capital   |  | <b>10.17%</b> |  |  | <b>9.74%</b>  |  | <b>4.4%</b>  |  |
| <b>Non-performing loans with partial charge-offs to:</b>        |  |               |  |  |               |  |              |  |
| Total loans, excluding covered loans and loans accounted for    |  |               |  |  |               |  |              |  |
| under ASC 310-30 (including those by analogy)                   |  | <b>0.89%</b>  |  |  | <b>0.83%</b>  |  | <b>7.2%</b>  |  |
| Non-performing loans  |  | <b>27.92%</b> |  |  | <b>27.35%</b> |  | <b>2.1%</b>  |  |
| <b>Other non-performing loans ratios:</b>                       |  |               |  |  |               |  |              |  |
| Charge-off rate on non-performing loans to non-performing loans |  |               |  |  |               |  |              |  |
| on which charge-offs have been taken                            |  | <b>53.99%</b> |  |  | <b>56.05%</b> |  | <b>-3.7%</b> |  |
| Allowance for loan and lease losses to non-performing           |  |               |  |  |               |  |              |  |
| loans on which no charge-offs have been taken                   |  | <b>79.78%</b> |  |  | <b>82.18%</b> |  | <b>-2.9%</b> |  |

| <b>TABLE 13 - LIABILITIES SUMMARY AND COMPOSITION</b> |    |                  |  |                     |    |                   |
|---|----|------------------|--|---------------------|----|-------------------|
|   |    | <b>June 30,</b>  |  | <b>December 31,</b> |    |                   |
|   |    | <b>2014</b>      |  | <b>2013</b>         |    | <b>Variance %</b> |
| <b>(Dollars in thousands)</b>                         |    |                  |  |                     |    |                   |
| <b>Deposits:</b>                                      |    |                  |  |                     |    |                   |
| Non-interest bearing deposits                         | \$ | 731,295          |  | \$ 744,328          |    | -1.8%             |
| NOW accounts  |    | 1,404,042        |  | 1,393,645           |    | 0.7%              |
| Savings and money market accounts                     |    | 1,226,747        |  | 1,194,566           |    | 2.7%              |
| Certificates of deposit                               |    | 1,776,971        |  | 2,048,040           |    | -13.2%            |
| <b>Total deposits</b>                                 |    | <b>5,139,055</b> |  | <b>5,380,579</b>    |    | <b>-4.5%</b>      |
| Accrued interest payable                              |    | 2,178            |  | 2,686               |    | -18.9%            |
| <b>Total deposits and accrued interest payable</b>    |    | <b>5,141,233</b> |  | <b>5,383,265</b>    |    | <b>-4.5%</b>      |
| <b>Borrowings:</b>                                    |    |                  |  |                     |    |                   |
| Securities sold under agreements to repurchase        |    | 1,012,233        |  | 1,267,618           |    | -20.1%            |
| Advances from FHLB                                    |    | 360,240          |  | 336,143             |    | 7.2%              |
| Other term notes                                      |    | 3,837            |  | 3,663               |    | 4.8%              |
| Subordinated capital notes                            |    | 100,797          |  | 100,010             |    | 0.8%              |
| <b>Total borrowings</b>                               |    | <b>1,477,107</b> |  | <b>1,707,434</b>    |    | <b>-13.5%</b>     |
| <b>Total deposits and borrowings</b>                  |    | <b>6,618,340</b> |  | <b>7,090,699</b>    |    | <b>-6.7%</b>      |
| Derivative liabilities                                |    | 13,617           |  | 14,937              |    | -8.8%             |
| Acceptances outstanding                               |    | 17,581           |  | 23,042              |    | -23.7%            |
| Other liabilities                                     |    | 135,405          |  | 144,424             |    | -6.2%             |
| <b>Total liabilities</b>                              | \$ | <b>6,784,943</b> |  | <b>7,273,102</b>    | \$ | <b>-6.7%</b>      |
| <b>Deposits portfolio composition percentages:</b>    |    |                  |  |                     |    |                   |
| Non-interest bearing deposits                         |    | 14.2%            |  | 13.8%               |    |                   |
| NOW accounts  |    | 27.3%            |  | 25.9%               |    |                   |
| Savings and money market accounts                     |    | 23.9%            |  | 22.2%               |    |                   |
| Certificates of deposit                               |    | 34.6%            |  | 38.1%               |    |                   |
|   |    | <b>100.0%</b>    |  | <b>100.0%</b>       |    |                   |
| <b>Borrowings portfolio composition percentages:</b>  |    |                  |  |                     |    |                   |
| Securities sold under agreements to repurchase        |    | 68.5%            |  | 74.2%               |    |                   |
| Advances from FHLB                                    |    | 24.4%            |  | 19.7%               |    |                   |
| Other term notes                                      |    | 0.3%             |  | 0.2%                |    |                   |
| Subordinated capital notes                            |    | 6.8%             |  | 5.9%                |    |                   |



Edgar Filing: OFG BANCORP - Form 10-Q

|  |    |               |  |    |               |  |  |
|--|----|---------------|--|----|---------------|--|--|
|  |    | <b>100.0%</b> |  |    | <b>100.0%</b> |  |  |
| <b>Securities sold under agreements to repurchase (excluding accrued interest)</b> |    |               |  |    |               |  |  |
| Amount outstanding at period-end   | \$ | 1,010,000     |  | \$ | 1,265,000     |  |  |
| Daily average outstanding balance  | \$ | 1,082,968     |  | \$ | 1,353,011     |  |  |
| Maximum outstanding balance at any month-end                                       | \$ | 1,149,167     |  | \$ | 1,552,269     |  |  |

111

## Liabilities and Funding Sources

As shown in Table 13 above, at June 30, 2014, the Company's total liabilities were \$6.785 billion, 6.7% less than the \$7.273 billion reported at December 31, 2013. Deposits and borrowings, the Company's funding sources, amounted to \$6.618 billion at June 30, 2014 versus \$7.091 billion at December 31, 2013, a 6.7% decrease.

At June 30, 2014, deposits represented 78% and borrowings represented 22% of interest-bearing liabilities, compared to 76% and 24%, respectively, at December 31, 2013. At June 30, 2014, deposits, the largest category of the Company's interest-bearing liabilities, were \$5.141 billion, down 4.5% from \$5.383 billion at December 31, 2013. Non-maturing deposit balances increased 0.89%, to \$3.362 billion, while higher-priced time deposits declined 13.2% as part of efforts to reduce the cost of deposits, which averaged 0.69% as of June 30, 2014 compared to 0.72% at December 31, 2013.

Borrowings consist mainly of repurchase agreements, FHLB-NY advances, subordinated capital notes, and short-term borrowings. At June 30, 2014, borrowings amounted to \$1.477 billion, 13.5% lower than the \$1.707 billion reported at December 31, 2013. Repurchase agreements as of June 30, 2014 decreased \$255.4 million to \$1.012 billion from \$1.268 billion at December 31, 2013, as the Company used available cash to pay off repurchase agreements at maturity.

As a member of the FHLB-NY, the Bank can obtain advances from the FHLB-NY secured by the FHLB-NY stock owned by the Bank as well as by certain of the Bank's mortgage loans and investment securities. Advances from the FHLB-NY amounted to \$360.2 million as of June 30, 2014 and \$336.1 million as of December 31, 2013. These advances mature from July 2014 through July 2020.

## Stockholders' Equity

At June 30, 2014, the Company's total stockholders' equity was \$925.2 million, a 4.6% increase when compared to \$884.9 million at December 31, 2013. Increase in stockholders' equity was mainly driven by the income for the six-month period ended June 30, 2014, partially offset by an increase in treasury stock, as a result of the 707,400 repurchased shares of outstanding common stock during the first quarter of 2014.

From December 31, 2013 to June 30, 2014, tangible common equity to total assets increased to 8.59% from 7.61%, Tier 1 Leverage Capital Ratio increased to 10.26% from 9.11%, Tier 1 Risk-Based Capital Ratio increased to 15.49% from 14.35%, and Total Risk-Based Capital Ratio increased to 17.30% from 16.14%.

Taking into consideration the strong capital position, in the fourth quarter of 2013, the Company increased the cash dividend per common share to \$0.08 from the dividend of \$0.06 paid in previous quarters in 2013.

The following are the consolidated capital ratios of the Company at June 30, 2014 and December 31, 2013:

| <b>TABLE 14 — CAPITAL, DIVIDENDS AND STOCK DATA</b>   |    |                 |  |                     |               |                 |
|---|----|-----------------|--|---------------------|---------------|-----------------|
|   |    | <b>June 30,</b> |  | <b>December 31,</b> |               | <b>Variance</b> |
|   |    | <b>2014</b>     |  | <b>2013</b>         |               | <b>%</b>        |
| <b>(Dollars in thousands, except per share data)</b>  |    |                 |  |                     |               |                 |
| <b>Capital data:</b>                                  |    |                 |  |                     |               |                 |
| Stockholders' equity                                  | \$ | 925,202         |  | \$                  | 884,913       | 4.6%            |
| <b>Regulatory Capital Ratios data:</b>                |    |                 |  |                     |               |                 |
| <b>Leverage capital ratio</b>                         |    | <b>10.26%</b>   |  |                     | <b>9.11%</b>  | 12.6%           |
| Minimum leverage capital ratio required               |    | 4.00%           |  |                     | 4.00%         |                 |
| Actual tier 1 capital                                 | \$ | 773,824         |  | \$                  | 736,930       | 5.0%            |
| Minimum tier 1 capital required                       | \$ | 301,829         |  | \$                  | 323,476       | -6.7%           |
| Excess over regulatory requirement                    | \$ | 471,995         |  | \$                  | 413,455       | 14.2%           |
| <b>Tier 1 risk-based capital ratio</b>                |    | <b>15.49%</b>   |  |                     | <b>14.35%</b> | 7.9%            |
| Minimum tier 1 risk-based capital ratio required      |    | 4.00%           |  |                     | 4.00%         |                 |
| Actual tier 1 risk-based capital                      | \$ | 773,824         |  | \$                  | 736,930       | 5.0%            |
| Minimum tier 1 risk-based capital required            | \$ | 199,775         |  | \$                  | 205,382       | -2.7%           |
| Excess over regulatory requirement                    | \$ | 574,049         |  | \$                  | 531,548       | 8.0%            |
| Risk-weighted assets                                  | \$ | 4,994,378       |  | \$                  | 5,134,538     | -2.7%           |
| <b>Total risk-based capital ratio</b>                 |    | <b>17.30%</b>   |  |                     | <b>16.14%</b> | 7.2%            |
| Minimum total risk-based capital ratio required       |    | 8.00%           |  |                     | 8.00%         |                 |
| Actual total risk-based capital                       | \$ | 863,790         |  | \$                  | 828,476       | 4.3%            |
| Minimum total risk-based capital required             | \$ | 399,550         |  | \$                  | 410,763       | -2.7%           |
| Excess over regulatory requirement                    | \$ | 464,240         |  | \$                  | 417,713       | 11.1%           |
| Risk-weighted assets                                  | \$ | 4,994,378       |  | \$                  | 5,134,538     | -2.7%           |
| <b>Tangible common equity to total assets</b>         |    | <b>8.59%</b>    |  |                     | <b>7.61%</b>  | 12.9%           |
| <b>Tangible common equity to risk-weighted assets</b> |    | <b>13.26%</b>   |  |                     | <b>12.10%</b> | 9.6%            |
| <b>Total equity to total assets</b>                   |    | <b>12.00%</b>   |  |                     | <b>10.85%</b> | 10.6%           |
| <b>Total equity to risk-weighted assets</b>           |    | <b>18.52%</b>   |  |                     | <b>17.23%</b> | 7.5%            |
| <b>Tier 1 common equity to risk-weighted assets</b>   |    | <b>11.47%</b>   |  |                     | <b>10.44%</b> | 9.9%            |
| Tier 1 common equity capital                          | \$ | 572,954         |  | \$                  | 536,062       | 6.9%            |
| <b>Stock data:</b>                                    |    |                 |  |                     |               |                 |

Edgar Filing: OFG BANCORP - Form 10-Q

|  |    |            |  |    |            |  |       |
|--|----|------------|--|----|------------|--|-------|
| Outstanding common shares              |    | 45,022,823 |  |    | 45,676,922 |  | -1.4% |
| Book value per common share            | \$ | 16.87      |  | \$ | 15.74      |  | 7.2%  |
| Tangible book value per common share   | \$ | 14.71      |  | \$ | 13.60      |  | 8.2%  |
| Market price at end of period          | \$ | 18.41      |  | \$ | 17.34      |  | 6.2%  |
| Market capitalization at end of period | \$ | 828,870    |  | \$ | 792,038    |  | 4.7%  |

|                                   | Six-Month Period Ended June 30, |        |      |        | Variance |
|-----------------------------------|---------------------------------|--------|------|--------|----------|
|                                   | 2014                            |        | 2013 |        | %        |
| <b>Common dividend data:</b>      |                                 |        |      |        |          |
| Cash dividends declared           | \$                              | 7,218  | \$   | 5,749  | 25.6%    |
| Cash dividends declared per share | \$                              | 0.16   | \$   | 0.12   | 33.3%    |
| Payout ratio                      |                                 | 19.05% |      | 11.54% | 65.1%    |
| Dividend yield                    |                                 | 1.74%  |      | 1.33%  | 30.7%    |

The following table presents a reconciliation of the Company's total stockholders' equity to tangible common equity and total assets to tangible assets at June 30, 2014 and December 31, 2013:

|  | <b>June 30,</b>  |                  | <b>December 31,</b> |                  |
|--|--|------------------|---------------------|------------------|
|  | <b>2014</b>  |                  | <b>2013</b>         |                  |
|  | <b>(In thousands, except share or per share information)</b> |                  |                     |                  |
| Total stockholders' equity                       | \$   | 925,202          | \$                  | 884,913          |
| Preferred stock                                  |  | (176,000)        |                     | (176,000)        |
| Preferred stock issuance costs                   |  | 10,130           |                     | 10,130           |
| Goodwill   |  | (86,069)         |                     | (86,069)         |
| Core deposit intangible                          |  | (7,133)          |                     | (7,804)          |
| Customer relationship intangible                 |  | (3,694)          |                     | (4,108)          |
| <b>Total tangible common equity</b>              | <b>\$</b>  | <b>662,436</b>   | <b>\$</b>           | <b>621,062</b>   |
| Total assets                                     |  | 7,710,145        |                     | 8,158,015        |
| Goodwill   |  | (86,069)         |                     | (86,069)         |
| Core deposit intangible                          |  | (7,133)          |                     | (7,804)          |
| Customer relationship intangible                 |  | (3,694)          |                     | (4,108)          |
| <b>Total tangible assets</b>                     | <b>\$</b>  | <b>7,613,249</b> | <b>\$</b>           | <b>8,060,034</b> |
| <b>Tangible common equity to tangible assets</b> |  | <b>8.70%</b>     |                     | <b>7.71%</b>     |
| Common shares outstanding at end of period       |  | 45,022,823       |                     | 45,676,922       |
| <b>Tangible book value per common share</b>      | <b>\$</b>  | <b>14.71</b>     | <b>\$</b>           | <b>13.60</b>     |

The tangible common equity ratio and tangible book value per common share are non-GAAP measures. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations. Neither tangible common equity nor tangible assets or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Company calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names.

The Tier 1 common equity to risk-weighted assets ratio is another non-GAAP measure. Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Company's capital position. In connection with the 2009 Supervisory Capital Assessment Program, the Federal Reserve Board supplemented its assessment of the capital adequacy of certain large bank holding companies based on a variation of Tier 1 capital, known as Tier 1 common equity.

Because Tier 1 common equity is not formally defined by GAAP or, unlike Tier 1 capital, codified in the federal banking regulations, this measure is considered to be a non-GAAP financial measure. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. To mitigate these limitations, the Company has procedures in place to calculate these measures using the appropriate GAAP or regulatory components. Although these non-GAAP financial measures are frequently used by stakeholders in the evaluation of a company, they have limitations as analytical tools and should not be considered in isolation or as a substitute for analyses of results as reported under GAAP.

The table below presents a reconciliation of the Company's total common equity (GAAP) at June 30, 2014 and December 31, 2013 to Tier 1 common equity (non-GAAP):

|  | June 30,               |                | December 31, |                |
|--|------------------------|----------------|--------------|----------------|
|  | 2014                   |                | 2013         |                |
|  | (Dollars in thousands) |                |              |                |
| Common stockholders' equity  | \$                     | 759,332        | \$           | 719,043        |
| Unrealized gains on available-for-sale securities, net of income tax |                        | (29,759)       |              | (11,434)       |
| Unrealized losses on cash flow hedges, net of income tax             |                        | 8,004          |              | 8,243          |
| Disallowed deferred tax assets                                       |                        | (66,362)       |              | (80,430)       |
| Disallowed servicing assets  |                        | (1,365)        |              | (1,380)        |
| Intangible assets:   |                        |                |              |                |
| Goodwill   |                        | (86,069)       |              | (86,069)       |
| Other intangible assets  |                        | (10,827)       |              | (11,912)       |
| <b>Total Tier 1 common equity</b>                                    | <b>\$</b>              | <b>572,954</b> | <b>\$</b>    | <b>536,062</b> |
| <b>Tier 1 common equity to risk-weighted assets</b>                  |                        | <b>11.47%</b>  |              | <b>10.44%</b>  |

The following table presents the Company's capital adequacy information at June 30, 2014 and December 31, 2013:

|  | June 30,               |                  | December 31, |                  |
|--|------------------------|------------------|--------------|------------------|
|  | 2014                   |                  | 2013         |                  |
|  | (Dollars in thousands) |                  |              |                  |
| Risk-based capital:                    |                        |                  |              |                  |
| Tier 1 capital                         | \$                     | 773,824          | \$           | 736,930          |
| Supplementary (Tier 2) capital         |                        | 89,966           |              | 91,546           |
| <b>Total risk-based capital</b>        | <b>\$</b>              | <b>863,790</b>   | <b>\$</b>    | <b>828,476</b>   |
| Risk-weighted assets:                  |                        |                  |              |                  |
| Balance sheet items                    | \$                     | 4,829,755        | \$           | 4,969,531        |
| Off-balance sheet items                |                        | 164,623          |              | 165,007          |
| <b>Total risk-weighted assets</b>      | <b>\$</b>              | <b>4,994,378</b> | <b>\$</b>    | <b>5,134,538</b> |
| Ratios:                                |                        |                  |              |                  |
| Tier 1 capital (minimum required - 4%) |                        | <b>15.49%</b>    |              | <b>14.35%</b>    |
| Total capital (minimum required - 8%)  |                        | <b>17.30%</b>    |              | <b>16.14%</b>    |
| Leverage ratio                         |                        | <b>10.26%</b>    |              | <b>9.11%</b>     |
| Equity to assets                       |                        | <b>12.00%</b>    |              | <b>10.85%</b>    |
| Tangible common equity to assets       |                        | <b>8.59%</b>     |              | <b>7.61%</b>     |



The Federal Reserve Board has risk-based capital guidelines for bank holding companies. Under the guidelines, the minimum ratio of qualifying total capital to risk-weighted assets is 8%. At least half of the total capital is to be comprised of qualifying common stockholders' equity, qualifying noncumulative perpetual preferred stock (including related surplus), minority interests related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, and restricted core capital elements (collectively, "Tier 1 Capital"). Banking organizations are expected to maintain at least 50% of their Tier 1 Capital as common equity. Except for certain debt or equity instruments issued on or after May 19, 2010, which are excluded from Tier 1 Capital, not more than 25% of qualifying Tier 1 Capital may consist of qualifying cumulative perpetual preferred stock, trust preferred securities or other so-called restricted core capital elements. "Tier 2 Capital" may consist, subject to certain limitations, of allowance for loan and lease losses; perpetual preferred stock and related surplus; hybrid capital instruments, perpetual debt, and mandatory convertible debt securities; term subordinated debt and intermediate-term preferred stock, including related surplus; and unrealized holding gains on equity securities. "Tier 3 Capital" consists of qualifying unsecured subordinated debt. The sum of Tier 2 and Tier 3 Capital may not exceed the amount of Tier 1 Capital.

Pursuant to the Dodd-Frank Act, federal banking agencies have adopted new capital rules that became effective January 1, 2014 for advanced approaches banking organizations (i.e., those with consolidated assets greater than \$250 billion or consolidated on-balance sheet foreign exposures of at least \$10 billion) and will become effective on January 1, 2015 for all other covered organizations (subject to certain phase-in periods through January 1, 2019) and that will replace their general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules.

The new capital rules provide certain changes to the prompt corrective action regulations adopted by the agencies under Section 38 of the FDIA, as amended by FDICIA. These regulations are designed to place restrictions on U.S. insured depository institutions if their capital levels begin to show signs of weakness. The five capital categories established by the agencies under their prompt corrective action framework are: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” As of June 30, 2014 and December 31, 2013, the Company is “well capitalized” for regulatory purposes.

The new capital rules expand such categories by introducing a common equity tier 1 capital requirement for all depository institutions, revising the minimum risk-based capital ratios and, beginning in 2018, the proposed supplementary leverage requirement for advanced approaches banking organizations. The common equity tier 1 capital ratio is a new minimum requirement designed to ensure that banking organizations hold sufficient high-quality regulatory capital that is available to absorb losses on a going-concern basis. The Company believes that it will continue to meet the “well capitalized” category after the implementation of new capital rules on January 1, 2015.

The Bank is considered “well capitalized” under the regulatory framework for prompt corrective action. The table below shows the Bank’s regulatory capital ratios at June 30, 2014, and December 31, 2013:

|   | June 30 , |               | December 31, |               | Variance     |
|---|-----------|---------------|--------------|---------------|--------------|
|   | 2014      |               | 2013         |               | %            |
| (Dollars in thousands)                          |           |               |              |               |              |
| <b>Oriental Bank Regulatory Capital Ratios:</b> |           |               |              |               |              |
| <b>Total Tier 1 Capital to Total Assets</b>     |           | <b>9.65%</b>  |              | <b>8.57%</b>  | <b>12.6%</b> |
| Actual tier 1 capital                           | \$        | 722,603       | \$           | 689,174       | 4.9%         |
| Minimum capital requirement (4%)                | \$        | 299,657       | \$           | 321,551       | -6.8%        |
| Minimum to be well capitalized (5%)             | \$        | 374,571       | \$           | 401,939       | -6.8%        |
| <b>Tier 1 Capital to Risk-Weighted Assets</b>   |           | <b>14.54%</b> |              | <b>13.47%</b> | <b>7.9%</b>  |
| Actual tier 1 risk-based capital                | \$        | 722,603       | \$           | 689,174       | 4.9%         |
| Minimum capital requirement (4%)                | \$        | 198,796       | \$           | 204,627       | -2.8%        |
| Minimum to be well capitalized (6%)             | \$        | 298,195       | \$           | 306,940       | -2.8%        |

Edgar Filing: OFG BANCORP - Form 10-Q

|  |    |               |  |    |               |  |             |
|--|----|---------------|--|----|---------------|--|-------------|
| <b>Total Capital to Risk-Weighted Assets</b> |    | <b>16.34%</b> |  |    | <b>15.26%</b> |  | <b>7.1%</b> |
| Actual total risk-based capital              | \$ | 812,267       |  | \$ | 780,487       |  | 4.1%        |
| Minimum capital requirement (8%)             | \$ | 397,593       |  | \$ | 409,253       |  | -2.8%       |
| Minimum to be well capitalized (10%)         | \$ | 496,991       |  | \$ | 511,567       |  | -2.8%       |

116

The Company's common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "OFG." At June 30, 2014 and December 31, 2013, the Company's market capitalization for its outstanding common stock was \$828.9 million (\$18.41 per share) and \$792.0 million (\$17.34 per share), respectively.

The following table provides the high and low prices and dividends per share of the Company's common stock for each quarter of the last two calendar years:

|                    |       |       |     |       |           |  | Cash |
|--------------------|-------|-------|-----|-------|-----------|--|------|
|                    | Price |       |     |       | Dividend  |  |      |
|                    | High  |       | Low |       | Per share |  |      |
| <b>2014</b>        |       |       |     |       |           |  |      |
| June 30, 2014      | \$    | 18.88 | \$  | 16.38 | \$        |  | 0.08 |
| March 31, 2014     | \$    | 17.54 | \$  | 14.30 | \$        |  | 0.08 |
| <b>2013</b>        |       |       |     |       |           |  |      |
| December 31, 2013  | \$    | 17.34 | \$  | 14.74 | \$        |  | 0.08 |
| September 30, 2013 | \$    | 18.97 | \$  | 16.13 | \$        |  | 0.06 |
| June 30, 2013      | \$    | 18.11 | \$  | 14.26 | \$        |  | 0.06 |
| March 31, 2013     | \$    | 15.83 | \$  | 13.85 | \$        |  | 0.06 |
| <b>2012</b>        |       |       |     |       |           |  |      |
| December 31, 2012  | \$    | 13.35 | \$  | 9.98  | \$        |  | 0.06 |
| September 30, 2012 | \$    | 11.49 | \$  | 10.02 | \$        |  | 0.06 |
| June 30, 2012      | \$    | 12.37 | \$  | 9.87  | \$        |  | 0.06 |
| March 31, 2012     | \$    | 12.69 | \$  | 11.25 | \$        |  | 0.06 |

Under the Company's current stock repurchase program it is authorized to purchase in the open market up to \$70 million of its outstanding shares of common stock. The shares of common stock repurchased are to be held by the Company as treasury shares. During the six-month period ended June 30, 2014, the Company purchased 707,400 shares under this program for a total of \$10.4 million, at an average price of \$14.66 per share. There were no repurchases during 2013. The number of shares that may yet be purchased under the \$70 million program is estimated at 1,252,136 and was calculated by dividing the remaining balance of \$23.1 million the closing price of the Company's common stock at June 30, 2014 (\$18.41).



### **ITEM 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

#### **Background**

The Company's risk management policies are established by its Board of Directors (the "Board") with the assistance of the Board Risk and Compliance Committee formed during the second quarter of 2014. Such policies are implemented by management through the adoption of a risk management program, which is overseen and monitored by the Chief Risk Officer and the Executive Risk and Compliance Committee and the Board Risk and Compliance Committee. The Company has continued to refine and enhance its risk management program by strengthening policies, processes and procedures necessary to maintain effective risk management.

All aspects of the Company's business activities are susceptible to risk. Consequently, risk identification and monitoring are essential to risk management. As more fully discussed below, the Company's primary risk exposures include, market, interest rate, credit, liquidity, operational and concentration risks.

#### **Market Risk**

Market risk is the risk to earnings or capital arising from adverse movements in market rates or prices, such as interest rates or prices. The Company evaluates market risk together with interest rate risk. The Company's financial results and capital levels are constantly exposed to market risk. The Board and management are primarily responsible for ensuring that the market risk assumed by the Company complies with the guidelines established by policies approved by the Board. The Board has delegated the management of this risk to the Asset/Liability Management Committee ("ALCO") which is composed of certain executive officers from the business, treasury and finance areas. One of ALCO's primary goals is to ensure that the market risk assumed by the Company is within the parameters established in such policies.

#### **Interest Rate Risk**

Interest rate risk is the exposure of the Company's earnings or capital to adverse movements in interest rates. It is a predominant market risk in terms of its potential impact on earnings. The Company manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income. ALCO oversees interest rate risk, liquidity management and other related matters.

In discharging its responsibilities, ALCO examines current and expected conditions in global financial markets, competition and prevailing rates in the local deposit market, liquidity, unrealized gains and losses in securities, recent

or proposed changes to the investment portfolio, alternative funding sources and their costs, hedging and the possible purchase of derivatives such as swaps, and any tax or regulatory issues which may be pertinent to these areas.

On a monthly basis, the Company performs a net interest income simulation analysis on a consolidated basis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-year time horizon, assuming certain gradual upward and downward interest rate movements, achieved during a twelve-month period. Simulations are carried out in two ways:

- (i) using a static balance sheet as the Company had on the simulation date, and
  
- (ii) using a dynamic balance sheet based on recent growth patterns and business strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposits decay and other factors which may be important in projecting the future growth of net interest income.

The Company uses a software application to project future movements in the Company's balance sheet and income statement. The starting point of the projections generally corresponds to the actual values of the balance sheet on the date of the simulations.

These simulations are complex, and use many assumptions that are intended to reflect the general behavior of the Company over the period in question. There can be no assurance that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates. The following table presents the results of the simulations at June 30, 2014 for the most likely scenario, assuming a one-year time horizon:

|                                | Net Interest Income Risk (one year projection) |         |         |        |                    |         |         |        |
|--------------------------------|--|---------|---------|--------|--------------------|---------|---------|--------|
|                                | Static Balance Sheet                           |         |         |        | Growing Simulation |         |         |        |
|                                | Amount   |         | Percent |        | Amount             |         | Percent |        |
|                                | Change   |         | Change  |        | Change             |         | Change  |        |
| <b>Change in interest rate</b> | <b>(Dollars in thousands)</b>                  |         |         |        |                    |         |         |        |
| + 200 Basis points             | \$   | 6,491   |         | 1.79%  | \$                 | 6,720   |         | 1.85%  |
| + 100 Basis points             | \$   | 3,202   |         | 0.88%  | \$                 | 3,317   |         | 0.91%  |
| - 50 Basis points              | \$   | (1,100) |         | -0.30% | \$                 | (1,098) |         | -0.30% |

The impact of -100 and -200 basis point reductions in interest rates is not presented in view of current level of the federal funds rate and other short-term interest rates.

Future net interest income could be affected by the Company's investments in callable securities, prepayment risk related to mortgage loans and mortgage-backed securities, and any structured repurchase agreements and advances from the FHLB-NY in which it may enter into from time to time. As part of the strategy to limit the interest rate risk and reduce the re-pricing gaps of the Company's assets and liabilities, the Company has executed certain transactions which include extending the maturity and the re-pricing frequency of the liabilities to longer terms reducing the amounts of its structured repurchase agreements and entering into hedge-designated swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings that only consist of advances from the FHLB-NY as of June 30, 2014.

The Company maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Company's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. Also, for some fixed-rate assets or liabilities, the effect of this variability in earnings is expected to be substantially offset by the Company's gains and losses on the derivative instruments that are linked to the forecasted cash flows of these hedged assets and liabilities. The Company considers its strategic use of derivatives to be a prudent method of managing interest-rate sensitivity as it reduces the exposure of earnings and the market value of its equity to undue risk posed by changes in interest rates. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the Company's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the contractual interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or



decrease.

Derivative instruments that are used as part of the Company's interest risk management strategy include interest rate swaps, forward-settlement swaps, futures contracts, and option contracts that have indices related to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties based on a common notional principal amount and maturity date. Interest rate futures generally involve exchanged-traded contracts to buy or sell U.S. Treasury bonds and notes in the future at specified prices. Interest rate options represent contracts that allow the holder of the option to (i) receive cash or (ii) purchase, sell, or enter into a financial instrument at a specified price within a specified period. Some purchased option contracts give the Company the right to enter into interest rate swaps and cap and floor agreements with the writer of the option. In addition, the Company enters into certain transactions that contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value. Please refer to Note 7 to the accompanying unaudited consolidated financial statements for further information concerning the Company's derivative activities.

Following is a summary of certain strategies, including derivative activities, currently used by the Company to manage interest rate risk:

Interest rate swaps — The Company entered into hedge-designated swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings attributable to changes in the one-month LIBOR rate. Once the forecasted wholesale borrowings transactions occurred, the interest rate swap effectively fixes the Company's interest payments on an amount of forecasted interest expense attributable to the one-month LIBOR rate corresponding to the swap notional stated rate. A derivative liability of \$10.5 million (notional amount of \$264.5 million) was recognized at June 30, 2014 related to the valuation of these swaps.

In addition, the Company has certain derivative contracts, including interest rate swaps not designated as hedging instruments, which are utilized to convert certain variable rate loans to fixed-rate loans, and the mirror-images of these interest rate swaps in which the Company enters into to minimize its interest rate risk exposure that results from offering the derivatives to clients. These interest rate swaps are marked to market through earnings. At June 30, 2014, interest rate swaps offered to clients not designated as hedging instruments represented a derivative asset of \$2.7 million (notional amounts of \$16.5 million), and the mirror-image interest rate swaps in which BBVAPR entered into represented a derivative liability of \$2.7 million (notional amounts of \$16.5 million).

S&P options — The Company has offered its customers certificates of deposit with an option tied to the performance of the S&P 500 Index. At the end of five years, the depositor receives a minimum return or a specified percentage of the average increase of the month-end value of the S&P 500 Index. The Company uses option agreements with major money center banks and major broker-dealer companies to manage its exposure to changes in that index. Under the terms of the option agreements, the Company receives the average increase in the month-end value of the S&P 500 Index in exchange for a fixed premium. The changes in fair value of the options purchased and the options embedded in the certificates of deposit are recorded in earnings.

At June 30, 2014, the fair value of the purchased options used to manage the exposure to the S&P 500 Index on stock-indexed certificates of deposit represented an asset of \$6.6 million (notional amounts of \$14.0 million) and the options sold to customers embedded in the certificates of deposit represented a liability of \$6.4 million (notional amount of \$13.4 million).

Wholesale borrowings — The Company uses interest rate swaps to hedge the variability of interest cash flows of certain advances from the FHLB-NY that are tied to a variable rate index. The interest rate swaps effectively fix the Company's interest payments on these borrowings. As of June 30, 2014, the Company had \$265 million in interest rate swaps at an average rate of 2.6% designated as cash flow hedges for \$265 million in advances from the FHLB-NY that reprice or are being rolled over on a monthly basis.

## Credit Risk

Credit risk is the possibility of loss arising from a borrower or counterparty in a credit-related contract failing to perform in accordance with its terms. The principal source of credit risk for the Company is its lending activities. In Puerto Rico, the Company's principal market, economic conditions are challenging, as they have been for the last eight years, due to a shrinking population, a protracted economic recession, a housing sector that remains under pressure, the Puerto Rico government's large indebtedness and structural budget deficit, and the recent rating downgrades of Puerto Rico general obligations and other government bonds to levels that are below investment grade.

The Company manages its credit risk through a comprehensive credit policy which establishes sound underwriting standards by monitoring and evaluating loan portfolio quality, and by the constant assessment of reserves and loan concentrations. The Company also employs proactive collection and loss mitigation practices.

The Company may also encounter risk of default in relation to its securities portfolio. The securities held by the Company are principally agency mortgage-backed securities. Thus, a substantial portion of these instruments are guaranteed by mortgages, a U.S. government-sponsored entity, or the full faith and credit of the U.S. government.

The Company's Executive Credit Committee, composed of its Chief Executive Officer, Chief Credit Risk Officer and other senior executives, has primary responsibility for setting strategies to achieve the Company's credit risk goals and objectives. Those goals and objectives are set forth in the Company's Credit Policy as approved by the Board.

## **Liquidity Risk**

Liquidity risk is the risk of the Company not being able to generate sufficient cash from either assets or liabilities to meet obligations as they become due without incurring substantial losses. The Board has established a policy to manage this risk. The Company's cash requirements principally consist of deposit withdrawals, contractual loan funding, repayment of borrowings as these mature, and funding of new and existing investments as required.

The Company's business requires continuous access to various funding sources. While the Company is able to fund its operations through deposits as well as through advances from the FHLB-NY and other alternative sources, the Company's business is dependent upon other wholesale funding sources. Although the Company has selectively reduced its use of wholesale funding sources, such as repurchase agreements and brokered deposits, it is still dependent on wholesale funding sources. As of June 30, 2014, the Company had \$1.010 billion in repurchase agreements and \$718.5 million in brokered deposits.

Brokered deposits are typically offered through an intermediary to small retail investors. The Company's ability to continue to attract brokered deposits is subject to variability based upon a number of factors, including volume and volatility in the global securities markets, the Company's credit rating, and the relative interest rates that it is prepared to pay for these liabilities. Brokered deposits are generally considered a less stable source of funding than core deposits obtained through retail bank branches. Investors in brokered deposits are generally more sensitive to interest rates and will generally move funds from one depository institution to another based on small differences in interest rates offered on deposits.

The Company participates in the Federal Reserve Bank's Borrower-In Custody Program which allows it to pledge certain type of loans while keeping physical control of the collateral.

Although the Company expects to have continued access to credit from the foregoing sources of funds, there can be no assurance that such financing sources will continue to be available or will be available on favorable terms. In a period of financial disruption or if negative developments occur with respect to the Company, the availability and cost of the Company's funding sources could be adversely affected. In that event, the Company's cost of funds may increase, thereby reducing its net interest income, or the Company may need to dispose of a portion of its investment portfolio, which depending upon market conditions, could result in realizing a loss or experiencing other adverse accounting consequences upon any such dispositions. The Company's efforts to monitor and manage liquidity risk may not be successful to deal with dramatic or unanticipated changes in the global securities markets or other reductions in liquidity driven by the Company or market-related events. In the event that such sources of funds are reduced or eliminated and the Company is not able to replace these on a cost-effective basis, the Company may be forced to curtail or cease its loan origination business and treasury activities, which would have a material adverse effect on its

operations and financial condition.

As of June 30, 2014, the Company had approximately \$611.7 million in unrestricted cash and cash equivalents, \$222.7 million in investment securities that are not pledged as collateral, \$629.1 million in borrowing capacity at the FHLB-NY and \$881.4 million in borrowing capacity at the Federal Reserve's discount window available to cover liquidity needs.

### **Operational Risk**

Operational risk is the risk of loss from inadequate or failed internal processes, personnel and systems or from external events. All functions, products and services of the Company are susceptible to operational risk.

The Company faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products and services. Coupled with external influences such as market conditions, security risks, and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Company has developed, and continues to enhance, specific internal controls, policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these policies and procedures is to provide reasonable assurance that the Company's business operations are functioning within established limits.

The Company classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, legal and compliance, the Company has specialized groups, such as Information Security, Enterprise Risk Management, Corporate Compliance, Information

Technology, Legal and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups. All these matters are reviewed and discussed in the Information Technology Steering Committee, and the Executive Risk and Compliance Committee.

The Company is subject to extensive United States federal and Puerto Rico regulations, and this regulatory scrutiny has been significantly increasing over the last several years. The Company has established and continues to enhance procedures based on legal and regulatory requirements that are reasonably designed to ensure compliance with all applicable statutory and regulatory requirements. The Company has a corporate compliance function headed by a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of a company-wide compliance program.

### **Concentration Risk**

Substantially all of the Company's business activities and a significant portion of its credit exposure are concentrated in Puerto Rico. As a consequence, the Company's profitability and financial condition may be adversely affected by an extended economic slowdown, adverse political or economic developments in Puerto Rico or the effects of a natural disaster, all of which could result in a reduction in loan originations, an increase in non-performing assets, an increase in foreclosure losses on mortgage loans, and a reduction in the value of its loans and loan servicing portfolio.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

As of the end of the period covered by this quarterly report on Form 10-Q, an evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon such evaluation, the CEO and the CFO have concluded that, as of the end of such period, the Company's disclosure controls and procedures provided reasonable assurance of effectiveness in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

**Internal Control over Financial Reporting**

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2014, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART - II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The Company and its subsidiaries are defendants in a number of legal proceedings incidental to their business. The Company is vigorously contesting such claims. Based upon a review by legal counsel and the development of these matters to date, management is of the opinion that the ultimate aggregate liability, if any, resulting from these claims will not have a material adverse effect on the Company's financial condition or results of operations.

### **ITEM 1A. RISK FACTORS**

Except as set forth below, there have been no material changes to the risk factors previously disclosed in the Company's annual report on Form 10-K for the year ended December 31, 2013. In addition to other information set forth in this report, you should carefully consider the risk factors included in the Company's annual report on Form 10-K, as updated by this report or other filings the Company makes with the SEC under the Exchange Act. Additional risks and uncertainties not presently known to the Company at this time or that the Company currently deems immaterial may also adversely affect the Company's business, financial condition or results of operations.

***We rely on the services of third parties for our banking, information technology, telecommunications, and mortgage loan servicing infrastructure, and any failure, interruption or termination of such services or systems could have a material adverse affect on our financial condition and results of operations.***

Our business relies on the secure, successful and uninterrupted functioning of our banking, information technology, telecommunications, and mortgage loan servicing infrastructure. We outsource some of our major systems, such as customer data and deposit processing, mortgage loan servicing, Internet and mobile banking, and electronic fund transfer systems. The failure or interruption of such systems, or the termination of a third-party software license or mortgage servicing, or any service agreement on which any of these systems or services is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such systems fail or experience interruptions.

We periodically sell or securitize our mortgage loans while retaining the obligation to perform the servicing of such loans. Although we are the master servicer of our mortgage loan portfolios, we outsource our servicing functions pursuant to a subservicing arrangement with a third party in Puerto Rico. The termination or interruption of such



subservicing arrangement, without a feasible substitute or successor, could adversely affect our financial condition and results of operations. In addition, because the FDIC has the right to refuse or delay payment for loan and lease losses if the shared-loss agreements are not performed by us in accordance with their terms, any such termination or interruption of the subservicing of the covered loans that we acquired in the FDIC-assisted acquisition could adversely affect our ability to comply with such terms.

If sustained or repeated, a failure, denial or termination of such systems or services could result in a deterioration of our ability to process new loans, service existing loans, gather deposits and/or provide customer service. It could also compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability. Any of the foregoing could have a material adverse effect on our financial condition and results of operations.

***A credit default or ratings downgrade on the Puerto Rico government's debt obligations could adversely affect the value of our loans to the government of Puerto Rico and our investment portfolio of Puerto Rico government bonds.***

Even though the economy of Puerto Rico is closely related to the economy of the rest of the United States, prevailing economic conditions, the fiscal situation of the Puerto Rico government and legislation it has recently enacted have led Standard & Poor's, Moody's and Fitch to further downgrade all obligations of the Puerto Rico government to levels below investment grade.

In the second quarter of 2014, the government enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act"), which establishes procedures for the adjustment of certain public corporations' debts. The Recovery Act states in its preamble that it further promotes the central government's public policy objectives of no longer providing financial support to public corporations and promoting their economic independence. The Recovery Act, which is without precedent and is being challenged in federal court on constitutional grounds, has increased the level of uncertainty as to the rights of the affected public corporation's creditors.

Despite the Commonwealth's progress in addressing its persistent budget deficits and underfunded government retirement plans, Puerto Rico continues to face significant economic and fiscal challenges, including a protracted economic recession, sizable debt-service obligations, high unemployment and a shrinking population. The recent Commonwealth credit downgrades by three leading rating agencies reflect only the views of such agencies, an explanation of which may be obtained from each such rating agency. Generally, below-investment-grade securities present greater risks and can be less liquid than investment-grade securities.

The reduction in the credit ratings of Puerto Rico government debt obligations could severely weaken the demand for such securities and the Commonwealth's access to capital markets, which may affect its ability to obtain the financing that it needs. This may in turn increase the Commonwealth's risk of default.

It is uncertain how capital markets may react to any future ratings downgrade in Puerto Rico government debt obligations. However, a further deterioration of economic or fiscal conditions in Puerto Rico, with possible negative ratings implications, could adversely affect the value of our loans to the government of Puerto Rico and the value of our investment portfolio of Puerto Rico government bonds.

At June 30, 2014, we had approximately \$666.6 million of credit facilities granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities, of which \$655.3 million was outstanding as of such date. A substantial portion of our credit exposure to the government of Puerto Rico consists of collateralized loans or obligations that have a specific source of income or revenues identified for its repayment. Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services or products, such as the Puerto Rico Electric Power Authority (“PREPA”) and the Puerto Rico Aqueducts and Sewer Authority. Public corporations have varying degrees of independence from the central government and many have received appropriations or are due other payments from it. At June 30, 2014, we had approximately \$382.9 million of credit facilities granted to public corporations, and significantly all such debtors are authorized to seek relief under the Recovery Act. The Company’s banking subsidiary is part of a four bank syndicate providing a \$550 million dollar revolving line of credit to finance the purchase of fuel for the day to day power generation activities of the PREPA. The Bank’s participation in the line of credit has an unpaid principal balance of \$200.0 million as of June 30, 2014, which matures on August 14, 2014 and is currently accruing. The bank syndicate and PREPA have executed a short term forbearance agreement that expires at the maturity of the line of credit pursuant to which the bank syndicate agreed to not exercise remedies in connection with certain defaults under the loan agreement to facilitate a dialogue with PREPA, which is actively ongoing, regarding the future of the line of credit. This credit facility was rated Special Mention as of June 30, 2014.

We also have loans to various municipalities for which the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment. These municipalities are required by law to levy special property taxes in such amounts as required for the payment of all of its general obligation bonds and notes. Another portion of these loans consists of special obligations of various municipalities that are payable from the basic real and personal property taxes collected within such municipalities. The good faith and credit obligations of the municipalities have a first lien on the basic property taxes.

Furthermore, as of June 30, 2014, we had approximately \$22.4 million in obligations issued and guaranteed by the Puerto Rico government, including certain instrumentalities or public corporations, as part of our investment securities portfolio. We continue to closely monitor the economic and fiscal situation of Puerto Rico and evaluate the portfolio for any declines in value that management may consider being other-than-temporary.

Approximately 49% of our Puerto Rico government loans and obligations mature in the next 12 months or less. At June 30, 2014, we also had deposits of approximately \$362.8 million from the government of Puerto Rico.

If the Company's public corporation debtors seek relief under the Recovery Act or are otherwise unable to pay their obligations as they become due, or under certain other circumstances, the Company and its banking subsidiary may be required to adversely classify such loans and provision for losses in connection therewith. Such provision may significantly impact the Company's financial condition and its regulatory capital ratios.

**ITEM 2. *UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS***

None.

**ITEM 3. *DEFAULTS UPON SENIOR SECURITIES***

None.

**ITEM 4. *MINE SAFETY DISCLOSURES***

Not applicable.

**ITEM 5. *OTHER INFORMATION***

None.

**ITEM 6. *EXHIBITS***

**Exhibit No.**

**Description of Document:**

3.1 Bylaws, as amended effective May 28, 2014.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following materials from OFG Bancorp's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Statements of Financial Condition, (ii) Unaudited Consolidated Statements of Operations, (iii) Unaudited Consolidated Statements of Comprehensive Income, (iv) Unaudited Consolidated Statements of Changes in Stockholders' Equity, (v) Unaudited Consolidated Statements of Cash Flows, and (vi) Notes to Unaudited Consolidated Financial Statements.



**Signatures**

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

**OFG Bancorp**

**(Registrant)**

By: /s/ José Rafael Fernández

Date: August 8, 2014

José Rafael Fernández  
President and Chief Executive Officer

By: /s/ Ganesh Kumar

Date: August 8, 2014

Ganesh Kumar  
Executive Vice President and Chief Financial  
Officer

By: /s/ Maritza Arizmendi

Date: August 8, 2014

Maritza Arizmendi  
Senior Vice President and Chief Accounting  
Officer

