

OFG BANCORP
Form 10-Q
November 12, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

or

.. 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 <input type="checkbox"/>	Accelerated Filer <input checked="" type="checkbox"/>	Non-Accelerated Filer <input type="checkbox"/>	Smaller Reporting Company <input type="checkbox"/>
		(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:

45,660,537 common shares (\$1.00 par value per share) outstanding as of October 31, 2013

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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, formerly known as Oriental Financial Group Inc. (“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 by the U.S. or Puerto Rico governments or a downgrade in the credit ratings of the U.S. or Puerto Rico governments;
- 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 stock and bond 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 SEPTEMBER 30, 2013 AND DECEMBER 31, 2012

		September 30,		December 31,	
		2013		2012	
		(In thousands, except share data)			
ASSETS					
Cash and cash equivalents:					
Cash and due from banks	\$	645,869	\$	855,490	
Money market investments		11,651		13,205	
Total cash and cash equivalents		657,520		868,695	
Securities purchased under agreements to resell		85,000		80,000	
Investments:					
Trading securities, at fair value, with amortized cost of \$2,606 (December 31, 2012 - \$508)		2,124		495	
Investment securities available-for-sale, at fair value, with amortized cost of \$1,654,133 (December 31, 2012 - \$2,118,825)		1,677,248		2,194,286	
Federal Home Loan Bank (FHLB) stock, at cost		24,470		38,411	
Other investments		65		73	
Total investments		1,703,907		2,233,265	
Loans:					
Mortgage loans held-for-sale, at lower of cost or fair value		47,085		64,145	
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$49,614 (December 31, 2012 - \$39,921)		4,720,174		4,698,185	
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$56,555 (December 31, 2012 - \$54,124)		361,564		395,307	
Total loans, net		5,128,823		5,157,637	
Other assets:					
FDIC shared-loss indemnification asset		207,908		286,799	
Foreclosed real estate covered under shared-loss agreements with the FDIC		28,022		22,283	
Foreclosed real estate not covered under shared-loss agreements with the FDIC		56,432		51,890	
Accrued interest receivable		19,456		14,654	
Deferred tax asset, net		147,968		126,652	
Premises and equipment, net		83,145		84,997	
Customers' liability on acceptances		31,881		26,996	

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Servicing assets			13,651			10,795
Derivative assets			21,345			21,889
Goodwill			86,069			86,069
Other assets			109,098			123,641
Total assets		\$	8,380,225		\$	9,196,262
LIABILITIES AND STOCKHOLDERS' EQUITY						
Deposits:						
Demand deposits		\$	2,177,090			2,447,151
Savings accounts			1,083,953			634,819
Time deposits			2,349,394			2,608,597
Total deposits			5,610,437			5,690,567
Borrowings:						
Short term borrowings			-			92,210
Securities sold under agreements to repurchase			1,267,423			1,695,247
Advances from FHLB			336,578			536,542
Subordinated capital notes			99,486			146,038
Other borrowings			16,634			16,627
Total borrowings			1,720,121			2,486,664
Other liabilities:						
Derivative liabilities			16,741			26,260
Acceptances executed and outstanding			31,881			26,996
Accrued expenses and other liabilities			121,319			102,169
Total liabilities			7,500,499			8,332,656
Commitments and contingencies (See Note 16)						
Stockholders' equity:						
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, 2012 - 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, 2012 - 84,000); \$1,000 liquidation value			84,000			84,000
Common stock, \$1 par value; 100,000,000 shares authorized; 52,690,623 shares issued;						
45,660,522 shares outstanding (December 31, 2012 - 52,670,878; 45,580,281)			52,691			52,671
Additional paid-in capital			538,231			537,453
Legal surplus			59,867			52,143
Retained earnings			122,747			70,734
Treasury stock, at cost, 7,030,101 shares (December 31, 2012 - 7,090,597 shares)			(80,642)			(81,275)
Accumulated other comprehensive income, net of tax of \$786 (December 31, 2012 - \$1,802)			10,832			55,880

Total stockholders' equity			879,726			863,606
Total liabilities and stockholders' equity		\$	8,380,225		\$	9,196,262
See notes to unaudited consolidated financial statements.						

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UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND 2012

						Nine-Month Period Ended					
	Quarter Ended September 30,						September 30,				
	2013			2012			2013			2012	
	(In thousands, except per share data)										
Interest income:											
Loans not covered under shared-loss agreements with the FDIC	\$	87,196		\$	17,964		\$	258,070		\$	53,308
Loans covered under shared-loss agreements with the FDIC		21,657			22,283			65,884			64,167
Total interest income from loans		108,853			40,247			323,954			117,475
Mortgage-backed securities		9,662			23,986			29,559			73,622
Investment securities and other		2,127			1,453			6,564			5,296
Total interest income		120,642			65,686			360,077			196,393
Interest expense:											
Deposits		11,334			6,714			30,756			22,592
Securities sold under agreements to repurchase		7,211			15,344			21,569			49,414
Advances from FHLB and other borrowings		2,321			2,561			6,275			8,595
FDIC-guaranteed term notes		-			-			-			909
Subordinated capital notes		1,144			323			3,973			972
Total interest expense		22,010			24,942			62,573			82,482
Net interest income		98,632			40,744			297,504			113,911
Provision for non-covered loan and lease losses		9,900			3,600			55,343			10,400
Provision for covered loan and lease losses, net		3,074			221			4,957			8,845
Total provision for loan and lease losses		12,974			3,821			60,300			19,245
Net interest income after provision for loan and lease losses		85,658			36,923			237,204			94,666
Non-interest income:											
Banking service revenue		12,642			3,006			38,358			9,231

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Financial service revenue		7,394		6,042		23,084		17,835
Mortgage banking activities		2,098		2,204		7,776		7,142
Total banking and financial service revenues		22,134		11,252		69,218		34,208
FDIC shared-loss expense, net		(15,965)		(8,096)		(48,801)		(18,505)
Net gain (loss) on:								
Sale of securities		-		36,366		-		55,703
Derivatives		(574)		(1,811)		(224)		(2,944)
Early extinguishment of debt		-		(24,312)		1,061		(24,312)
Other non-interest income		(1,774)		982		574		199
Total non-interest income, net		3,821		14,381		21,828		44,349
Non-interest expense:								
Compensation and employee benefits		22,590		11,323		69,927		32,873
Professional and service fees		7,138		5,844		23,970		16,488
Occupancy and equipment		8,270		4,197		25,552		12,698
Insurance		1,828		1,594		7,229		4,856
Electronic banking charges		3,729		1,415		11,551		4,581
Advertising, business promotion, and strategic initiatives		1,471		1,594		4,550		4,006
Merger and restructuring charges		2,252		-		13,060		-
Foreclosure, repossession and other real estate expenses		2,178		1,060		5,839		2,745
Loan servicing and clearing expenses		2,133		607		5,493		2,530
Taxes, other than payroll and income taxes		4,024		1,091		11,778		2,158
Loss on sale of foreclosed real estate and other repossessed assets		3,561		1,203		7,134		2,485
Communication		782		391		2,481		1,172
Printing, postage, stationary and supplies		824		299		2,841		929
Director and investor relations		230		158		843		809
Other		2,263		873		6,655		2,426
Total non-interest expense		63,273		31,649		198,903		90,756
Income before income taxes		26,206		19,655		60,129		48,259
Income tax expense (benefit)		6,585		1,894		(18,223)		4,888
Net income		19,621		17,761		78,352		43,371
Less: dividends on preferred stock		(3,465)		(3,039)		(10,396)		(5,440)
Income available to common shareholders	\$	16,156	\$	14,722	\$	67,956	\$	37,931

Earnings per common share:										
Basic	\$	0.35	\$	0.36	\$	1.49	\$	0.93		
Diluted	\$	0.34	\$	0.35	\$	1.39	\$	0.92		
Average common shares outstanding and equivalents		53,322		47,978		53,053		43,316		
Cash dividends per share of common stock	\$	0.06	\$	0.06	\$	0.18	\$	0.18		
See notes to unaudited consolidated financial statements.										

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UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE QUARTERS AND NINE-MONTHS PERIODS ENDED SEPTEMBER 30, 2013 AND 2012

						Nine-Month Period Ended September 30,							
	Quarter Ended September 30,						September 30,						
	2013			2012			2013			2012			
	(In thousands)						(In thousands)						
Net income	\$	19,621		\$	17,761		\$	78,352		\$	43,371		
Other comprehensive loss before tax:													
Unrealized gain (loss) on securities available-for-sale		(5,779)			25,220			(52,346)			34,220		
Realized gain on investment securities included in net income		-			(36,366)			-			(55,703)		
Unrealized gain (loss) on cash flow hedges		233			(2,052)			4,711			(10,844)		
Other comprehensive loss before taxes		(5,546)			(13,198)			(47,635)			(32,327)		
Income tax effect		611			999			2,587			4,259		
Other comprehensive loss after taxes		(4,935)			(12,199)			(45,048)			(28,068)		
Comprehensive income	\$	14,686		\$	5,562		\$	33,304		\$	15,303		
See notes to unaudited consolidated financial statements.													

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UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND 2012

	Nine-Month Period Ended September 30,				
	2013			2012	
	(In thousands)				
Preferred stock:					
Balance at beginning and end of period	\$	176,000		\$	152,000
Common stock:					
Balance at beginning of period		52,671			47,809
Exercised stock options		20			33
Balance at end of period		52,691			47,842
Additional paid-in capital:					
Balance at beginning of period		537,453			499,096
Stock-based compensation expense		1,360			1,159
Exercised stock options		187			361
Lapsed restricted stock units		(728)			(483)
Common stock issuance costs		(16)			-
Preferred stock issuance costs		(25)			(4,978)
Balance at end of period		538,231			495,155
Legal surplus:					
Balance at beginning of period		52,143			50,178
Transfer from retained earnings		7,724			4,229
Balance at end of period		59,867			54,407
Retained earnings:					
Balance at beginning of period		70,734			68,149
Net income		78,352			43,371
Cash dividends declared on common stock		(8,219)			(7,331)
Cash dividends declared on preferred stock		(10,396)			(5,440)
Transfer to legal surplus		(7,724)			(4,229)
Balance at end of period		122,747			94,520
Treasury stock:					
Balance at beginning of period		(81,275)			(74,808)
Stock repurchased		-			(7,022)
Lapsed restricted stock units		556			483
Stock used to match defined contribution plan		77			47
Balance at end of period		(80,642)			(81,300)
Accumulated other comprehensive income, net of tax:					

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Balance at beginning of period		55,880			37,131
Other comprehensive loss, net of tax		(45,048)			(28,068)
Balance at end of period		10,832			9,063
Total stockholders' equity	\$	879,726		\$	771,687
See notes to unaudited consolidated financial statements.					

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND 2012

	Nine-Month Period Ended September 30,			
	2013		2012	
	(In thousands)			
Cash flows from operating activities:				
Net income	\$	78,352	\$	43,371
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of deferred loan origination fees, net of costs		733		462
Amortization of fair value discounts on acquired loans		8,239		-
Amortization of investment securities premiums, net of accretion of discounts		17,116		33,480
Amortization of core deposit and customer relationship intangibles		1,932		107
Amortization of fair value premiums on acquired deposits		12,032		-
FDIC shared-loss expense, net		48,801		18,505
Amortization of prepaid FDIC assessment		-		3,894
Other impairments on securities		8		-
Depreciation and amortization of premises and equipment		7,703		3,424
Deferred income taxes, net		(18,816)		(785)
Provision for covered and non-covered loan and lease losses, net		60,300		19,245
Stock-based compensation		1,360		1,159
(Gain) loss on:				
Sale of securities		-		(55,703)
Sale of mortgage loans held-for-sale		(2,009)		(4,658)
Derivatives		224		2,944
Early extinguishment of debt		(1,061)		24,312
Foreclosed real estate		5,321		2,493
Sale of other repossessed assets		1,813		(8)
Sale of premises and equipment		-		(85)
Originations of loans held-for-sale		(239,804)		(140,925)
Proceeds from sale of loans held-for-sale		125,245		74,815
Net (increase) decrease in:				
Trading securities		(1,629)		(1,334)

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Accrued interest receivable		(4,802)			5,247
Servicing assets		(2,856)			(188)
Other assets		15,984			(254)
Net increase (decrease) in:					
Accrued interest on deposits and borrowings		(1,658)			(8,227)
Accrued expenses and other liabilities		13,937			(8,578)
Net cash provided by operating activities		126,465			12,713
Cash flows from investing activities:					
Purchases of:					
Investment securities available-for-sale		(32,874)			(1,102,606)
Investment securities held-to-maturity		-			(119,026)
FHLB stock		(32,562)			(454)
Swaps options		-			(6,755)
Maturities and redemptions of:					
Investment securities available-for-sale		477,610			691,246
Investment securities held-to-maturity		-			160,502
FHLB stock		46,503			1,368
Proceeds from sales of:					
Investment securities available-for-sale		120,526			1,145,555
Foreclosed real estate and other repossessed assets		44,754			13,593
Premises and equipment		896			369
Origination and purchase of loans, excluding loans held-for-sale		(911,443)			(172,376)
Principal repayment of loans, including covered loans		806,676			195,336
Reimbursements from the FDIC on shared-loss agreements		32,732			63,272
Additions to premises and equipment		(6,747)			(1,457)
Net change in securities purchased under agreements to resell		(5,000)			(270,000)
Net cash provided by investing activities		541,071			598,567

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND 2012

	Nine-Month Period Ended September 30,				
	2013			2012	
	(In thousands)				
Cash flows from financing activities:					
Net increase (decrease) in:					
Deposits		(96,552)			(222,408)
Short term borrowings		(92,210)			-
Securities sold under agreements to repurchase		(427,931)			(424,312)
FHLB advances		(199,731)			5,013
Subordinated capital notes		(45,491)			-
FDIC-guaranteed term notes		-			(105,000)
Exercise of stock options		207			394
Issuance of common stock costs		(16)			-
Issuance of preferred stock costs		(25)			79,022
Purchase of treasury stock		-			(7,022)
Termination of derivative instruments		1,483			(125)
Dividends paid on preferred stock		(10,226)			(5,440)
Dividends paid on common stock		(8,219)			(7,331)
Net cash used in financing activities		(878,711)			(687,209)
Net change in cash and cash equivalents		(211,175)			(75,929)
Cash and cash equivalents at beginning of period		868,695			591,487
Cash and cash equivalents at end of period	\$	657,520		\$	515,558
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:					
Interest paid	\$	64,272		\$	63,266
Income taxes paid	\$	378		\$	8,031
Mortgage loans securitized into mortgage-backed securities	\$	117,687		\$	37,730
Transfer from loans to foreclosed real estate and other repossessed assets	\$	65,716		\$	11,723
Reclassification of loans held-for-investment portfolio to held-for-sale portfolio	\$	42,289		\$	5,182
See notes to unaudited consolidated financial statements					

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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”). The Company also has a special purpose entity, Oriental Financial (PR) Statutory Trust II (the “Statutory Trust II”). 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, leasing, 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 December 18, 2012, the Company purchased from Banco Bilbao Vizcaya Argentaria, S. A. (“BBVA”), all of the outstanding common stock of each of (i) BBVAPR Holding Corporation (“BBVAPR Holding”), the sole shareholder of Banco Bilbao Vizcaya Argentaria Puerto Rico (“BBVAPR Bank”), a Puerto Rico chartered commercial bank, and BBVA Seguros, Inc. (“BBVA Seguros”), an insurance agency, and (ii) BBVA Securities of Puerto Rico, Inc. (“BBVA Securities”), a registered broker-dealer. This transaction is referred to as the BBVAPR Acquisition” and BBVAPR Holding, BBVAPR Bank, BBVA Seguros and BBVA Securities are collectively referred to as the “BBVAPR Companies” or “BBVAPR.”

Basis of Presentation and Use of Estimates

The accounting and reporting policies of the Company conform with U.S. generally accepted accounting principles (“GAAP”) and to banking industry practices.

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial information and should be read in conjunction with the audited consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2012 (the “2012 Form 10-K”). All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts

reported in the unaudited consolidated financial statements and related disclosures. These estimates are based on information available as of the date of the consolidated financial statements. While management makes its best judgment, actual amounts or results could differ from these estimates. Interim period results are not necessarily indicative of the results to be expected for the full year.

Certain reclassifications have been made to 2012 unaudited consolidated financial statements and notes to the financial statements to conform to the 2013 presentation, relating to remeasurement adjustments from the BBVAPR Acquisition in December 18, 2012.

Significant Accounting Policies

We provide a summary of our significant accounting policies in our 2012 Form 10-K under “Notes to Consolidated Financial Statements—Note 1—Summary of Significant Accounting Policies.” During the quarter ended September 30, 2013, management changed the methodology of the general reserve calculation in order to adapt the calculation to the new Company structure after the BBVAPR Acquisition, and better capture the risk characteristics of the different portfolio segments. Principal changes are concentrated in the commercial, consumer and auto and leasing portfolios, as follows:

The commercial portfolio was further segmented by business line (corporate, institutional, middle market, corporate retail, floor plan, and real estate), by collateral type (secured by real estate and other commercial and industrial), and by risk rating/classification (pass, special mention, substandard, doubtful, and individually measured for impairment). The loss factor used for the general valuation reserve (“GVA”) of these loans is established considering the Bank's past twelve-month historical loss experience of each segment and the consideration of environmental factors. The sum of the loss experience factors and the environmental factors will be the GVA factor to be used for the determination of the allowance for loan and lease losses on each category.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The consumer portfolio consists of smaller retail loans such as retail credit cards, overdrafts, unsecured personal lines of credit, and personal unsecured loans. The allowance factor, consisting of the historical loss factors and the environmental risk factors will be calculated for each sub-class of loans by delinquency bucket.

The allowance factor on auto and leasing portfolio is impacted by the historical losses, the environmental risk factors and by delinquency buckets. For the determination of the allowance factor, the portfolio will be segmented by FICO score.

The methodology explained before will apply to originated and other loans and to acquired loans accounted for under ASC 310-20.

Below we describe recent accounting changes:

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income - In February 2013, the Financial Accounting Standards Board (the “FASB”) issued an amendment to enhance current disclosure requirements of reclassifications out of accumulated other comprehensive income and their corresponding effect on net income to be presented, in one place, information about significant amounts reclassified and, in some cases, cross-reference to related footnote disclosures. Previously, this information was presented in different places throughout the financial statements. The amendments require disclosure of information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, it requires the presentation, either on the face of the statement where net income is presented or in the notes, of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, the Company is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The amended guidance was effective for annual and interim reporting periods beginning on or after December 15, 2012, prospectively. Our adoption of the guidance is presented in “Note 14 – Stockholders’ Equity and Earnings per Common Share.”

Testing Indefinite-Lived Intangible Assets for Impairment - In July 2012, the FASB issued Accounting Standard Update (ASU) No. 2012-02, *Intangibles*—

Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. The ASU is intended to simplify the guidance for testing the decline in the realizable value (impairment) of indefinite-lived intangible assets other than goodwill. Some examples of intangible assets subject to the guidance include indefinite-lived trademarks,

licenses and distribution rights. The ASU allows companies to perform a qualitative assessment about the likelihood of impairment of an indefinite-lived intangible asset to determine whether further impairment testing is necessary, similar in approach to the goodwill impairment test. The ASU became effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Our adoption of the guidance had no effect on our unaudited consolidated financial statements.

Offsetting Financial Assets and Liabilities - In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The ASU is intended to enhance current disclosure requirements on offsetting financial assets and liabilities. The new disclosures enable financial statement users to compare balance sheets prepared under GAAP and IFRS, which are subject to different offsetting models. The guidance requires disclosure of both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to an agreement similar to a master netting arrangement. The disclosures are required irrespective of whether such instruments are presented gross or net on the balance sheet. In January 2013, the FASB issued ASU No. 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, which clarify that the scope of this guidance applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amended guidance was effective for annual and interim reporting periods beginning on or after January 1, 2013, with comparative retrospective disclosures required for all periods presented. We adopted the guidance in the first quarter of 2013. Our adoption of the guidance had no effect on our financial condition, results of operations or liquidity since it only impacts disclosures only. The new disclosures required by the amended guidance are included in “Note 11 – Offsetting of Financial Assets and Liabilities” hereto.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution— FASB ASU 2012-06, “Business Combinations” (Topic 805) was issued in October 2012. This update addresses the diversity in practice about how to interpret the terms “on the same basis” and “contractual limitations” when subsequently measuring an indemnification asset recognized in a government-assisted (Federal Deposit Insurance Corporation) acquisition of a financial institution that includes a loss-sharing agreement (indemnification agreement). When a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and subsequently the cash flows expected to be collected on the indemnification asset change as a result of a change in cash flows expected to be collected on the assets subject to indemnification, the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement, that is, the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets. The amendments in this update are effective for fiscal years and interim periods within those years, beginning on or after December 15, 2012. The adoption of this guidance did not have a material effect on the unaudited consolidated financial statements, since the Company already followed the same basis approach.

Future Application of Accounting Standards

Accounting for Financial Instruments—Credit Losses - In December 2012, the FASB issued a proposed ASU, *Financial Instruments—Credit Losses*. This proposed ASU, or exposure draft, was issued for public comment in order to allow stakeholders the opportunity to review the proposal and provide comments to the FASB, and does not constitute accounting guidance until a final ASU is issued. The exposure draft contains proposed guidance developed by the FASB with the goal of improving financial reporting about expected credit losses on loans, securities and other financial assets held by banks, financial institutions, and other public and private organizations. The exposure draft proposes a new accounting model intended to require earlier recognition of credit losses, while also providing additional transparency about credit risk. The FASB’s proposed model would utilize a single “expected credit loss” measurement objective for the recognition of credit losses, replacing the multiple existing impairment models in GAAP which generally require that a loss be “incurred” before it is recognized. The FASB’s proposed model represents a significant departure from existing GAAP, and may result in material changes to the Company’s accounting for financial instruments. The impact of the FASB’s final ASU to the Company’s financial statements will be assessed when it is issued. The exposure draft does not contain a proposed effective date. This would be included in the final ASU, when issued.

Other Potential Amendments to Current Accounting Standards - The FASB and International Accounting Standards Board, either jointly or separately, are currently working on several major projects, including amendments to existing accounting standards governing financial instruments, leases, and consolidation and investment companies. As part of the joint financial instruments project, the FASB has issued a proposed ASU that would result in significant changes to the guidance for recognition and measurement of financial instruments, in addition to the proposed ASU

that would change the accounting for credit losses on financial instruments discussed above. The FASB is also working on a joint project that would require substantially all leases to be capitalized on the balance sheet. Additionally, the FASB has issued a proposal on principal-agent considerations that would change the way the Company needs to evaluate whether to consolidate Variable Interest Entities (“VIE”) and non-VIE partnerships. Furthermore, the FASB has issued a proposed ASU that would change the criteria used to determine whether an entity is subject to the accounting and reporting requirements of an investment company. The principal-agent consolidation proposal would require all VIEs, including those that are investment companies, to be evaluated for consolidation under the same requirements. All of these projects may have significant impacts for the Company. Upon completion of the standards, the Company will need to reevaluate its accounting and disclosures. However, due to ongoing deliberations of the standard setters, the Company is currently unable to determine the effect of future amendments or proposals.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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Legacy goodwill	116,353	(116,353)	-	-
Core deposit intangible	-	8,473	8,473	-
Customer relationship intangible	-	5,060	5,060	-
Other assets	119,286	(7,663)	111,623	(2,936)
Total assets acquired	5,007,604	(177,472)	4,830,132	(22,048)
Liabilities				
Deposits	3,472,951	21,489	3,494,440	-
Securities sold under agreements to repurchase	338,020	20,465	358,485	-
Other borrowings	348,624	1,108	349,732	-
Subordinated capital notes	117,000	(7,159)	109,841	-
Accrued expenses and other liabilities	80,392	(1,438)	78,954	-
Total liabilities assumed	4,356,987	34,465	4,391,452	-
Net assets acquired	\$ 650,617	\$ (211,937)	\$ 438,680	\$ (22,048)
Cash consideration	\$ 500,000	\$ -	\$ 500,000	\$ -
Goodwill			\$ 61,320	\$ 22,048

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Merger and Restructuring Charges

Merger and restructuring charges are recorded in the unaudited consolidated statements of operations and include incremental costs to integrate the operations of the Company and BBVAPR. These charges represent costs associated with these one-time activities and do not represent ongoing costs of the fully integrated combined organization.

The following table presents severance and employee-related charges, systems integrations and other merger-related charges in connection with the BBVAPR Acquisition for the quarter and nine-month period ended September 30, 2013:

	Quarter Ended September 30, 2013		Nine-Month Period Ended September 30, 2013	
	(In thousands)		(In thousands)	
Severance and employee-related charges	\$	248	\$	1,398
Systems integrations and related charges		1,719		4,896
Other-contract cancellation fee		285		6,766
Total merger and restructuring charges	\$	2,252	\$	13,060

Restructuring Reserve

Restructuring reserves are established by a charge to merger and restructuring charges, and the restructuring charges are included in the merger and restructuring charges table.

The following table presents the changes in restructuring reserves for the quarter and nine-month period ended September 30, 2013:

	Quarter Ended September 30, 2013		Nine-Month Period Ended September 30, 2013	
	(In thousands)		(In thousands)	
Balance at the beginning of the period	\$	276	\$	4,202
Merger and restructuring charges		2,252		13,060
Cash payments and other		(1,437)		(16,171)
Balance at the end of the period	\$	1,091	\$	1,091

Payments under merger and restructuring reserves associated with the BBVAPR Acquisition are expected to continue in the fourth quarter of 2013 and will be accounted under applicable accounting guidance to the cost being incurred.

OFG BANCORP**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****NOTE 3 – SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL AND INVESTMENTS*****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 September 30, 2013 and December 31, 2012, money market instruments included as part of cash and cash equivalents amounted to \$11.7 million and \$13.2 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 September 30, 2013 and December 31, 2012, securities purchased under agreements to resell amounted to \$85.0 million and \$80.0 million, respectively.

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 September 30, 2013 and December 31, 2012 was approximately \$87.7 million and \$82.1 million, respectively.

Investment Securities

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Company at September 30, 2013 and December 31, 2012 were as follows:

	September 30, 2013						
			Gross		Gross		Weighted
	Amortized		Unrealized		Unrealized	Fair	Average

	Cost			Gains			Losses			Value			Yield	
	(In thousands)													
Available-for-sale														
Mortgage-backed securities														
FNMA and FHLMC certificates	\$	1,253,599		\$	39,733		\$	3,859		\$	1,289,473		2.89%	
GNMA certificates		8,895			465			24			9,336		4.90%	
CMOs issued by US Government sponsored agencies		233,904			76			6,303			227,677		1.78%	
Total mortgage-backed securities		1,496,398			40,274			10,186			1,526,486		2.76%	
Investment securities														
Obligations of US Government sponsored agencies		12,381			-			41			12,340		1.20%	
Obligations of Puerto Rico Government and political subdivisions		121,012			-			6,647			114,365		4.39%	
Other debt securities		24,342			209			494			24,057		3.46%	
Total investment securities		157,735			209			7,182			150,762		4.00%	
Total securities available for sale	\$	1,654,133		\$	40,483		\$	17,368		\$	1,677,248		2.83%	

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2012											
				Gross		Gross						Weighted
	Amortized			Unrealized		Unrealized			Fair			Average
	Cost			Gains		Losses			Value			Yield
	(In thousands)											
Available-for-sale												
Mortgage-backed securities												
FNMA and FHLMC certificates	\$	1,622,037		\$	71,411	\$	1	\$	1,693,447			3.06%
GNMA certificates		14,177			995		8		15,164			4.89%
CMOs issued by US Government sponsored agencies		288,409			3,784		793		291,400			1.85%
Total mortgage-backed securities		1,924,623			76,190		802		2,000,011			2.89%
Investment securities												
US Treasury securities		26,498			-		2		26,496			0.71%
Obligations of US Government sponsored agencies		21,623			224		-		21,847			1.35%
Obligations of Puerto Rico Government and political subdivisions		120,950			9		438		120,521			3.82%
Other debt securities		25,131			280		-		25,411			3.46%
Total investment securities		194,202			513		440		194,275			2.99%
Total securities available-for-sale	\$	2,118,825		\$	76,703	\$	1,242	\$	2,194,286			2.90%

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The amortized cost and fair value of the Company's investment securities at September 30, 2013, 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.

	September 30, 2013				
	Available-for-sale				
	Amortized Cost			Fair Value	
	(In thousands)				
Mortgage-backed securities					
Due after 5 to 10 years					
FNMA and FHLMC certificates	\$	29,982		\$	30,589
Total due after 5 to 10 years		29,982			30,589
Due after 10 years					
FNMA and FHLMC certificates		1,223,617			1,258,884
GNMA certificates		8,895			9,336
CMOs issued by US Government sponsored agencies		233,904			227,677
Total due after 10 years		1,466,416			1,495,897
Total mortgage-backed securities		1,496,398			1,526,486
Investment securities					
Due in less than one year					
Other debt securities		20,000			19,506
Total due in less than one year		20,000			19,506
Due from 1 to 5 years					
Obligations of Puerto Rico Government and political subdivisions		11,859			10,292
Total due from 1 to 5 years		11,859			10,292
Due after 5 to 10 years					
Obligations of US Government and sponsored agencies		12,381			12,340
Total due after 5 to 10 years		12,381			12,340
Due after 10 years					
Obligations of Puerto Rico Government and political subdivisions		109,153			104,073
Other debt securities		4,342			4,551
Total due after 10 years		113,495			108,624
Total investment securities		157,735			150,762
Total securities available-for-sale	\$	1,654,133		\$	1,677,248

Obligations of Puerto Rico Government and political subdivisions include a \$98.7 million bond at September 30, 2013 with maturity date of July 1, 2024, that is subject to mandatory tender offer for purchase by the end of the third year anniversary of the closing date, which is June 1, 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 nine-month period ended September 30, 2013, the Company did not execute any sale of securities from its portfolio other than \$120.5 million of available-for-sale GNMA certificates that were sold as part of its recurring mortgage loan origination and securitization activities. These sales produced a nominal gain during such period.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The BBVAPR Acquisition and the related deleverage of the investment securities portfolio that the Company completed during the second half of 2012 reduced the interest rate risk profile of the Company. For the nine-month period ended September 30, 2012, the Company recorded a net gain on sale of securities of \$55.7 million. The table below presents the gross realized gains by category for such period:

	Nine-Month Period Ended September 30, 2012									
				Book Value						
<u>Description</u>	Sale Price			at Sale			Gross Gains			Gross Losses
	(In thousands)									
Sale of securities available-for-sale										
Mortgage-backed securities and CMOs										
FNMA and FHLMC certificates	\$	936,779		\$	881,834		\$	54,945		\$ -
GNMA certificates		62,639			62,638			1		-
CMOs issued by US Government sponsored agencies		19,725			18,372			1,353		-
Total mortgage-backed securities and CMOs		1,019,143			962,844			56,299		-
Investment securities										
Obligations of U.S. Government sponsored agencies		80,000			80,000			-		-
Obligations of Puerto Rico Government and political subdivisions		35,882			36,478			32		628
Structured credit investments		10,530			10,530			-		-
Total investment securities		126,412			127,008			32		628
Total	\$	1,145,555		\$	1,089,852		\$	56,331		\$ 628

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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The following tables show the Company's gross unrealized losses and fair value of investment securities available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2013 and December 31, 2012:

	September 30, 2013							
	12 months or more							
	Amortized		Unrealized		Fair			
	Cost		Loss		Value			
	(In thousands)							
Securities available-for-sale								
CMOs issued by US Government sponsored agencies	\$	4,150	\$	397	\$			3,753
Obligations of Puerto Rico Government and political subdivisions		1,734		185				1,549
GNMA certificates		81		11				70
	\$	5,965	\$	593	\$			5,372
	Less than 12 months							
	Amortized		Unrealized		Fair			
	Cost		Loss		Value			
	(In thousands)							
Securities available-for-sale								
CMOs issued by US Government sponsored agencies	\$	228,092	\$	5,906	\$			222,186
FNMA and FHLMC certificates		209,370		3,859				205,511
Obligations of Puerto Rico Government and political subdivisions		119,278		6,462				112,816
Other debt securities		20,000		494				19,506
Obligations of US government and sponsored agencies		12,381		41				12,340
GNMA certificates		123		13				110
	\$	589,244	\$	16,775	\$			572,469
	Total							
	Amortized		Unrealized		Fair			
	Cost		Loss		Value			
	(In thousands)							
Securities available-for-sale								
CMOs issued by US Government sponsored agencies	\$	232,242	\$	6,303	\$			225,939
FNMA and FHLMC certificates		209,370		3,859				205,511
Obligations of Puerto Rico Government and political subdivisions		121,012		6,647				114,365
Other debt securities		20,000		494				19,506

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Obligations of US government and sponsored agencies		12,381			41			12,340
GNMA certificates		204			24			180
	\$	595,209		\$	17,368		\$	577,841

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2012						
	12 months or more						
	Amortized		Unrealized			Fair	
	Cost		Loss			Value	
	(In thousands)						
Securities available-for-sale							
Obligations of Puerto Rico Government and political subdivisions	\$ 1,673		\$ 12			\$ 1,661	
CMOs issued by US Government sponsored agencies	2,194		178			2,016	
	\$ 3,867		\$ 190			\$ 3,677	
	Less than 12 months						
	Amortized		Unrealized			Fair	
	Cost		Loss			Value	
	(In thousands)						
Securities available-for-sale							
Obligations of Puerto Rico Government and political subdivisions	\$ 19,086		\$ 426			\$ 18,660	
CMOs issued by US Government sponsored agencies	10,671		615			10,056	
US Treasury securities	11,498		2			11,496	
GNMA certificates	84		8			76	
FNMA and FHLMC certificates	68		1			67	
	\$ 41,407		\$ 1,052			\$ 40,355	
	Total						
	Amortized		Unrealized			Fair	
	Cost		Loss			Value	
	(In thousands)						
Securities available-for-sale							
Obligations of Puerto Rico Government and political subdivisions	\$ 20,759		\$ 438			\$ 20,321	
CMOs issued by US Government sponsored agencies	12,865		793			12,072	
US Treasury securities	11,498		2			11,496	
GNMA certificates	84		8			76	
FNMA and FHLMC certificates	68		1			67	

	\$	45,274		\$	1,242		\$	44,032
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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The valuations of the investment securities are performed 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.

Investments in an unrealized loss position at September 30, 2013 mostly (\$454.2 million, or 76%) consisted 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, and 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 US agencies that either issued or guaranteed the investments. The remaining investments in an unrealized loss position at September 30, 2013 (\$141.0 million, or 24%) consisted of obligations issued or collateralized by the Government of Puerto Rico and its political subdivisions or instrumentalities. The recent decline in the market value of these securities is mainly related to an increase in volatility that is the result of changes in market conditions, and not a result of deterioration in the creditworthiness of the issuer or guarantor. The securities are rated as “investment grade” or are considered by management to be the credit equivalent of investment grade. At September 30, 2013, the Company does not have the intent to sell any of the investments in an unrealized loss position.

NOTE 4 - LOANS

The Company’s loan portfolio is composed of covered loans and non-covered loans. The Company presents loans subject to the loss sharing agreements as “covered loans” in the information below, and loans that are not subject to FDIC loss sharing agreements as “non-covered loans.” The risks of the Eurobank FDIC-assisted acquisition acquired loans are significantly different from those loans not covered under the FDIC loss sharing agreements because of the loss protection provided by the FDIC. Also, 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 segregated between originated 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).

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For a summary of the accounting policy related to loans, interest recognition and allowance for loan and lease losses, please refer to the summary of significant accounting policies included in Note 1 of our 2012 Form 10-K under “Notes to Consolidated Financial Statements”.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The composition of the Company's loan portfolio at September 30, 2013 and December 31, 2012 was as follows:

	September 30,			December 31,	
	2013			2012	
	(In thousands)				
Loans not covered under shared-loss agreements with FDIC:					
Originated and other loans and leases held for investment:					
Mortgage	\$	742,046		\$	805,292
Commercial		1,173,215			349,075
Auto and leasing		313,701			37,577
Consumer		113,509			46,667
		2,342,471			1,238,611
Acquired loans:					
Accounted for under ASC 310-20 (Loans with revolving feature and/or					
acquired at a premium)					
Commercial		97,099			329,463
Commercial secured by real estate		25,398			20,779
Auto		335,528			470,601
Consumer		59,817			70,347
		517,842			891,190
Accounted for under ASC 310-30 (Loans acquired with deteriorated					
credit quality, including those by analogy)					
Mortgage		731,376			801,024
Commercial		548,995			940,402
Construction		131,976			193,442
Auto		416,579			553,075
Consumer		80,429			123,825
		1,909,355			2,611,768
		4,769,668			4,741,569
Deferred loan cost (fees), net		120			(3,463)
Loans receivable		4,769,788			4,738,106
Allowance for loan and lease losses on non-covered loans		(49,614)			(39,921)
Loans receivable, net		4,720,174			4,698,185
Mortgage loans held-for-sale		47,085			64,145
Total loans not covered under shared-loss agreements with FDIC, net		4,767,259			4,762,330

Loans covered under shared-loss agreements with FDIC:					
Loans secured by 1-4 family residential properties		122,001			128,811
Construction and development secured by 1-4 family residential properties		16,674			15,969
Commercial and other construction		272,129			289,070
Leasing		542			7,088
Consumer		6,773			8,493
Total loans covered under shared-loss agreements with FDIC		418,119			449,431
Allowance for loan and lease losses on covered loans		(56,555)			(54,124)
Total loans covered under shared-loss agreements with FDIC, net		361,564			395,307
Total loans, net	\$	5,128,823		\$	5,157,637

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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 held for investment loan transactions 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 September 30, 2013 and December 31, 2012 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.

	September 30, 2013												Loans 90+
													Days Past
													Due and
	30-59 Days	60-89 Days	90+ Days	Total Past									Still
	Past Due	Past Due	Past Due	Due	Current	Total Loans	Accruing						
	(In thousands)												
Mortgage													
Traditional (by origination year):													
Up to the year 2002	\$ -	\$ 2,232	\$ 3,984	\$ 6,216	\$ 79,093	\$ 85,309	\$ 23						
Years 2003 and 2004	-	4,919	3,715	8,634	114,014	122,648	-						
Year 2005	-	1,342	1,933	3,275	62,766	66,041	-						
Year 2006	-	3,737	2,796	6,533	84,429	90,962	-						
Years 2007, 2008 and 2009	-	2,099	2,589	4,688	99,862	104,550	46						

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Years 2010, 2011, 2012 and 2013	-	796	1,643	2,439	106,963	109,402	215
	-	15,125	16,660	31,785	547,127	578,912	284
Non-traditional	-	1,720	1,580	3,300	40,947	44,247	-
Loss mitigation program	-	6,148	14,471	20,619	65,036	85,655	1,071
	-	22,993	32,711	55,704	653,110	708,814	1,355
Home equity secured personal loans	126	-	12	138	583	721	-
GNMA's buy-back option program	-	-	32,511	32,511	-	32,511	-
	126	22,993	65,234	88,353	653,693	742,046	1,355
Commercial							
Commercial secured by real estate	1,993	1,038	19,131	22,162	371,768	393,930	-
Other commercial and industrial	1,256	273	3,559	5,088	774,197	779,285	-
	3,249	1,311	22,690	27,250	1,145,965	1,173,215	-
Consumer	1,414	569	425	2,408	111,101	113,509	-
Auto and leasing	16,682	4,504	2,636	23,822	289,879	313,701	-
Total	\$ 21,471	\$ 29,377	\$ 90,985	\$ 141,833	\$ 2,200,638	\$ 2,342,471	\$ 1,355

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2012														
															Loans 90+
															Days Past
															Due and
	30-59 Days	60-89 Days	90+ Days	Total Past											Still
	Past Due	Past Due	Past Due	Due			Current			Total Loans	Accruing				
	(In thousands)														
Mortgage															
Traditional (by origination year):															
Up to the year 2002	\$ 6,906	\$ 2,116	\$ 11,363	\$ 20,385			\$ 80,883			\$ 101,268			\$ -		
Years 2003 and 2004	12,048	5,206	18,162	35,416			114,446			149,862			-		
Year 2005	4,983	1,746	8,860	15,589			65,312			80,901			-		
Year 2006	9,153	3,525	15,363	28,041			85,045			113,086			-		
Years 2007, 2008 and 2009	2,632	1,682	8,965	13,279			108,358			121,637			-		
Years 2010, 2011 and 2012	632	769	1,162	2,563			64,434			66,997			-		
	36,354	15,044	63,875	115,273			518,478			633,751			-		
Non-traditional	2,850	1,067	11,160	15,077			42,742			57,819			-		
Loss mitigation program	8,933	4,649	19,989	33,571			53,739			87,310					
	48,137	20,760	95,024	163,921			614,959			778,880			-		
Home equity secured personal loans	-	-	10	10			726			736			-		
	-	-	25,676	25,676			-			25,676			-		

GNMA's buy-back option program																	
	48,137		20,760		120,710		189,607		615,685		805,292						-
Commercial																	
Commercial secured by real estate	9,062		271		15,335		24,668		226,606		251,274						-
Other commercial and industrial	345		189		2,378		2,912		94,889		97,801						-
	9,407		460		17,713		27,580		321,495		349,075						-
Consumer	747		92		409		1,248		45,419		46,667						-
Auto and leasing	251		129		131		511		37,066		37,577						-
Total	\$ 58,542		\$ 21,441		\$ 138,963		\$ 218,946		\$ 1,019,665		\$ 1,238,611						\$ -

Delinquency is based on calendar days. This may cause fluctuations from quarter to quarter in the delinquency of mortgage loans, depending in the amount of days each month.

During the quarter ended June 30, 2013, the Company transferred \$55.0 million of non-performing residential mortgage loans held-for-investment to held-for-sale at a fair value of \$27.0 million. The difference between fair value and book value was recorded as charge-offs to the mortgage portfolio. The provision for loan and lease losses during the quarter and six-month period ended June 30, 2013 increased to provide the coverage necessary under the allowance policy for the remaining mortgage loans, following the effects that the aforementioned reclassification had on the mortgage portfolio allowance level.

During the quarter ended September 30, 2013, the Company sold originated performing and non-performing residential mortgage loans held-for-sale with unpaid principal balance of \$62.0 million and recorded a realized loss on the transaction of \$1.4 million.

Increase in delinquencies of the consumer and the auto and leasing portfolios compared to December 31, 2012 is mainly attributed to the fact that during the BBVAPR Acquisition a substantial portion of the acquired non-performing loans were accounted for under ASC 310-30. At September 30, 2013 such portfolios are increasing as new originations are ramping up the balances outstanding. After almost 10 months from the BBVPR Acquisition, those portfolios are beginning to reflect normal delinquency levels as seasoned portfolios.

In addition, during the quarter ended September 30, 2013, the Company sold \$27.3 million non-performing residential mortgage loans acquired in the BBVAPR Acquisition which were accounted for under ASC 310-30, loans acquired with deteriorated credit quality. No realized gain or loss was recorded in the transaction.

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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 BBVAPR Acquisition 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 BBVAPR Acquisition that were accounted for under the provisions of ASC 310-20, which had fully amortized their premium or discount, recorded at the date of acquisition, are removed from the acquired loan category at the end of the reporting period.

The following table presents the aging of the recorded investment in gross acquired loans accounted for under ASC 310-20 as of September 30, 2013 and December 31, 2012 by class of loans:

	September 30, 2013													Loans 90+
														Days Past
														Due and
	30-59 Days		60-89 Days		90+ Days		Total Past							Still
	Past Due		Past Due		Past Due		Due		Current		Total Loans			Accruing
	(In thousands)													
Commercial	\$ 1,607		\$ 767		\$ 762		\$ 3,136		\$ 93,963		\$ 97,099		\$ -	
Commercial secured by real estate	229		395		-		624		24,774		25,398		-	
Auto	11,186		2,698		847		14,731		320,797		335,528		-	
Consumer	1,463		46		1,293		2,802		57,015		59,817		-	
Total	\$ 14,485		\$ 3,906		\$ 2,902		\$ 21,293		\$ 496,549		\$ 517,842		\$ -	

	December 31, 2012													Loans 90+

																		Days Past	
																		Due and	
	30-59 Days		60-89 Days		90+ Days		Total Past										Still		
	Past Due		Past Due		Past Due		Due		Current				Total Loans		Accruing				
	(In thousands)																		
Commercial	\$	715		\$	76		\$	193		\$	984		\$	328,479		\$	329,463	\$	-
Commercial secured by real estate		315			-			-			315			20,464			20,779		-
Auto		6,753			1,023			275			8,051			462,550			470,601		-
Consumer		982			-			1,095			2,077			68,270			70,347		-
Total	\$	8,765		\$	1,099		\$	1,563		\$	11,427		\$	879,763		\$	891,190	\$	-

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)

Loans acquired as part of the BBVAPR Acquisition, 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 September 30, 2013 and December 31, 2012 is as follows:

	September 30, 2013		December 31, 2012
	(In thousands)		
Contractual required payments receivable	\$ 3,064,418		\$ 3,982,063
Less: Non-accretable discount	635,920		714,462
Cash expected to be collected	2,428,498		3,267,601
Less: Accretable yield	519,143		655,833
Carrying amount	\$ 1,909,355		\$ 2,611,768

The following tables describe the accretable yield and non-accretable discount activity of acquired loans accounted for under ASC 310-30 for the quarter and nine-month period ended September 30, 2013, excluding covered loans:

	Quarter Ended September 30, 2013			Nine-Month Period Ended September 30, 2013		
	(In thousands)					
Accretable Yield Activity						
Balance at beginning of period		\$	561,485		\$	655,833
Accretion			(48,352)			(150,447)
Transfer from non-accretable discount			6,010			13,757
Balance at end of period		\$	519,143		\$	519,143
	Quarter Ended September 30, 2013			Nine-Month Period Ended September 30, 2013		

	(In thousands)					
Non-Accretable Discount Activity						
Balance at beginning of period		\$	686,231		\$	714,462
Principal losses			(44,301)			(64,785)
Transfer to accretable yield			(6,010)			(13,757)
Balance at end of period		\$	635,920		\$	635,920

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

The carrying amount of covered loans at September 30, 2013 and December 31, 2012 is as follows:

	September 30, 2013			December 31, 2012	
	(In thousands)				
Contractual required payments receivable	\$	748,091		\$	874,994
Less: Non-accretable discount		161,427			237,555
Cash expected to be collected		586,664			637,439
Less: Accretable yield		168,545			188,008
Carrying amount, gross		418,119			449,431
Less: Allowance for covered loan and lease losses		56,555			54,124
Carrying amount, net	\$	361,564		\$	395,307

The following tables describe the accretable yield and non-accretable discount activity of covered loans for the quarters and nine-month periods ended September 30, 2013 and 2012:

	Quarter Ended September 30,				Nine-Month Period Ended September 30,					
	2013			2012		2013			2012	
	(In thousands)				(In thousands)					
Accretable yield activity										
Balance at beginning of period	\$	167,132		\$	177,248	\$	188,008		\$	188,822
Accretion		(21,657)			(22,283)		(65,884)			(64,167)
Transfer from non-accretable discount		23,070			28,868		46,421			59,178
Balance at end of period	\$	168,545		\$	183,833	\$	168,545		\$	183,833
	Quarter Ended September 30,				Nine-Month Period Ended September 30,					
	2013			2012		2013			2012	
	(In thousands)				(In thousands)					
Non-accretable discount activity										

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Balance at beginning of period	\$	192,259	\$	314,404	\$	237,555	\$	412,170
Principal losses		(7,762)		(21,533)		(29,707)		(88,989)
Transfer to accretable yield		(23,070)		(28,868)		(46,421)		(59,178)
Balance at end of period	\$	161,427	\$	264,003	\$	161,427	\$	264,003

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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 September 30, 2013 and December 31, 2012:

	September 30,			December 31,	
	2013			2012	
	(In thousands)				
<u>Originated and other loans and leases held for investment</u>					
<u>Mortgage</u>					
Traditional (by origination year):					
Up to the year 2002	\$	4,709		\$	11,362
Years 2003 and 2004		2,967			18,162
Year 2005		3,844			8,859
Year 2006		3,206			15,363
Years 2007, 2008 and 2009		1,990			8,967
Years 2010, 2011, 2012 and 2013		2,866			1,162
		19,582			63,875
Non-traditional		1,580			11,160
Loss mitigation program		21,860			39,957
		43,022			114,992
Home equity secured personal loans		12			10
		43,034			115,002
<u>Commercial</u>					
Commercial secured by real estate		25,312			26,517
Other commercial and industrial		5,526			2,989
		30,838			29,506
<u>Consumer</u>		490			442
<u>Auto and leasing</u>		2,661			131
		77,023			145,081
<u>Acquired loans accounted under ASC 310-20</u>					
Commercial		762			193
Auto		847			275
Consumer		1,293			1,095
		2,902			1,563
Total non-accrual loans	\$	79,925		\$	146,644

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 September 30, 2013 and December 31, 2012, loans whose terms have been extended and which are classified as troubled-debt restructurings that are not included in non-accrual loans amounted to \$61.0 million and \$42.2 million, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 5 - ALLOWANCE FOR LOAN AND LEASE LOSSES

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.

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 September 30, 2013													
	Mortgage		Commercial		Consumer		Auto and Leasing		Unallocated		Total			
	(In thousands)													
Allowance for loan and lease losses:														
Balance at beginning of period	\$	21,375	\$	17,624	\$	2,341	\$	3,641	\$	720	\$	45,701		
Charge-offs		(1,758)		(2,234)		(465)		(1,305)		-		(5,762)		
Recoveries		-		28		37		639		-		704		
Provision for non-covered loan and lease losses		1,374		(703)		2,915		3,143		201		6,930		

Balance at end of period	\$	20,991	\$	14,715	\$	4,828	\$	6,118	\$	921	\$	47,573
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	Nine-Month Period Ended September 30, 2013												
									Auto and				
	Mortgage		Commercial		Consumer		Leasing		Unallocated		Total		
	(In thousands)												
Allowance for loan and lease losses:													
Balance at beginning of period	\$	21,092	\$	17,072	\$	856	\$	533	\$	368	\$	39,921	
Charge-offs		(33,465)		(5,678)		(1,034)		(2,105)		-		(42,282)	
Recoveries		-		291		143		855		-		1,289	
Provision for non-covered loan and lease losses		33,364		3,030									