

OFG BANCORP  
Form 10-Q  
August 05, 2016

**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, 2016**

**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 x 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 x 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<br>Company | Accelerated Filer <input checked="" type="checkbox"/> | Non-Accelerated Filer<br>(Do not check if a smaller reporting company) | Smaller Reporting<br>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:**

43,913,719 common shares (\$1.00 par value per share) outstanding as of July 31, 2016

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## TABLE OF CONTENTS

| <b>PART I – FINANCIAL INFORMATION</b> |   | Page |
|---------------------------------------|---|------|
| <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 (Loss)                              | 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  | 41   |
|                                       | Note 6 – FDIC Indemnification Asset, True-Up Payment Obligation, and FDIC Shared-Loss Expense | 50   |
|                                       | Note 7 – Derivatives  | 52   |
|                                       | Note 8 – Accrued Interest Receivable and Other Assets   | 55   |
|                                       | Note 9 – Deposits and Related Interest  | 56   |
|                                       | Note 10 – Borrowings and Related Interest   | 57   |
|                                       | Note 11 – Offsetting of Financial Assets and Liabilities                                      | 60   |
|                                       | Note 12 – Related Party Transactions  | 61   |
|                                       | Note 13 – Income Taxes  | 62   |
|                                       | Note 14 – Regulatory Capital Requirements   | 63   |
|                                       | Note 15 – Stockholders' Equity  | 65   |
|                                       | Note 16 – Accumulated Other Comprehensive Income  | 66   |
|                                       | Note 17 – Earnings (Loss) per Common Share  | 69   |
|                                       | Note 18 – Guarantees  | 70   |
|                                       | Note 19 – Commitments and Contingencies   | 71   |
|                                       | Note 20 – Fair Value of Financial Instruments   | 73   |
|                                       | Note 21 – Business Segments   | 82   |
| <b>Item 2.</b>                        | Management's Discussion and Analysis of Financial Condition and Results of Operations         | 85   |
|                                       | Critical Accounting Policies and Estimates  | 85   |
|                                       | Overview of Financial Performance:  | 86   |
|                                       | Selected Financial Data   | 86   |
|                                       | Financial Highlights of the Second Quarter of 2016  | 88   |
|                                       | Analysis of Results of Operations   | 89   |

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|                                    |   |     |
|------------------------------------|---|-----|
|                                    | Analysis of Financial Condition                             | 106 |
| <b>Item 3.</b>                     | Quantitative and Qualitative Disclosures about Market Risk  | 132 |
| <b>Item 4.</b>                     | Controls and Procedures                                     | 136 |
| <b>PART II – OTHER INFORMATION</b> |   |     |
| <b>Item 1.</b>                     | Legal Proceedings   | 137 |
| <b>Item 1A.</b>                    | Risk Factors  | 137 |
| <b>Item 2.</b>                     | Unregistered Sales of Equity Securities and Use of Proceeds | 137 |
| <b>Item 3.</b>                     | Default upon Senior Securities                              | 137 |
| <b>Item 4.</b>                     | Mine Safety Disclosures                                     | 137 |
| <b>Item 5.</b>                     | Other Information   | 137 |
| <b>Item 6.</b>                     | Exhibits  | 138 |
| <b>SIGNATURES</b>                  |   | 139 |
| <b>EXHIBIT INDEX</b>               |   |     |

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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 (“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:

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

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**

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**OFG BANCORP**

**UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

**AS OF JUNE 30, 2016 AND DECEMBER 31, 2015**

**ASSETS**

**Cash and cash equivalents:**

Cash and due from banks

Money market investments

**Total cash and cash equivalents**

**Restricted cash**

**Investments:**

Trading securities, at fair value, with amortized cost of \$667 (December 31, 2015 - \$667)

Investment securities available-for-sale, at fair value, with amortized cost of \$645,298 (December 31, 2015 - \$955,646)

Investment securities held-to-maturity, at amortized cost, with fair value of \$643,530 (December 31, 2015 - \$614,679)

Federal Home Loan Bank (FHLB) stock, at cost

Other investments

**Total investments**

**Loans:**

Mortgage loans held-for-sale, at lower of cost or fair value

Loans held for investment, net of allowance for loan and lease losses of \$162,216 (December 31, 2015 - \$234,131)

**Total loans**

**Other assets:**

FDIC indemnification asset

Foreclosed real estate

Accrued interest receivable

Deferred tax asset, net

Premises and equipment, net

Customers' liability on acceptances

Servicing assets

Derivative assets

Goodwill

Other assets

**Total assets**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

**Deposits:**

Demand deposits

Savings accounts

Time deposits

**Total deposits**

**Borrowings:**

Securities sold under agreements to repurchase

Advances from FHLB

Subordinated capital notes

Other borrowings

**Total borrowings**



**Other liabilities:**

Derivative liabilities  
Acceptances executed and outstanding  
Accrued expenses and other liabilities

**Total liabilities**

**Commitments and contingencies (See Note 19)**

**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, 2015 - 1,340,000 shares; 1,380,000 shares; and 960,000 shares)  
\$25 liquidation value  
84,000 shares of Series C issued and outstanding (December 31, 2015 - 84,000 shares); \$1,000 liquidation value  
Common stock, \$1 par value; 100,000,000 shares authorized; 52,625,869 shares issued:  
43,913,719 shares outstanding (December 31, 2015 - 52,625,869; 43,867,909)  
Additional paid-in capital  
Legal surplus  
Retained earnings  
Treasury stock, at cost, 8,712,150 shares (December 31, 2015 - 8,757,960 shares)  
Accumulated other comprehensive income, net of tax of -\$456 (December 31, 2015 \$1,182)

**Total stockholders' equity**

**Total liabilities and stockholders' equity**

**See notes to unaudited consolidated financial statements**

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2016 AND 2015

|  | Quarter Ended June<br>30,                |                | Six-Month Period<br>Ended June 30,       |                |
|--|--|----------------|--|----------------|
|  | 2016                                     | 2015           | 2016                                     | 2015           |
|  | (In thousands, except<br>per share data) |                | (In thousands, except<br>per share data) |                |
| <b>Interest income:</b>  |  |                |  |                |
| Loans  | \$ 79,675                                | \$ 90,504      | \$ 160,827                               | \$ 187,987     |
| Mortgage-backed securities   | 7,220                                    | 7,998          | 16,217                                   | 16,587         |
| Investment securities and other                                      | 1,013                                    | 911            | 2,170                                    | 1,840          |
| <b>Total interest income</b>   | <b>87,908</b>                            | <b>99,413</b>  | <b>179,214</b>                           | <b>206,414</b> |
| <b>Interest expense:</b>   |  |                |  |                |
| Deposits   | 7,367                                    | 6,604          | 14,491                                   | 13,708         |
| Securities sold under agreements to repurchase                       | 4,258                                    | 7,394          | 10,358                                   | 14,558         |
| Advances from FHLB and other borrowings                              | 2,098                                    | 2,248          | 4,337                                    | 4,483          |
| Subordinated capital notes   | 873                                      | 875            | 1,741                                    | 1,738          |
| <b>Total interest expense</b>  | <b>14,596</b>                            | <b>17,121</b>  | <b>30,927</b>                            | <b>34,487</b>  |
| <b>Net interest income</b>   | <b>73,312</b>                            | <b>82,292</b>  | <b>148,287</b>                           | <b>171,927</b> |
| Provision for loan and lease losses, net                             | 14,445                                   | 15,539         | 28,234                                   | 57,732         |
| <b>Net interest income after provision for loan and lease losses</b> | <b>58,867</b>                            | <b>66,753</b>  | <b>120,053</b>                           | <b>114,195</b> |
| <b>Non-interest income:</b>  |  |                |  |                |
| Banking service revenue  | 10,219                                   | 10,212         | 20,337                                   | 20,417         |
| Wealth management revenue  | 7,041                                    | 7,285          | 13,193                                   | 14,440         |
| Mortgage banking activities  | 1,024                                    | 1,862          | 1,879                                    | 3,725          |
| <b>Total banking and financial service revenues</b>                  | <b>18,284</b>                            | <b>19,359</b>  | <b>35,409</b>                            | <b>38,582</b>  |
| FDIC shared-loss expense, net  | (3,420)                                  | (23,245)       | (7,449)                                  | (36,329)       |
| Net gain (loss) on:  |  |                |  |                |
| Sale of securities   | 211                                      | -              | 12,207                                   | 2,572          |
| Derivatives  | (10)                                     | 77             | (13)                                     | (13)           |
| Early extinguishment of debt   | -  | -              | (12,000)                                 | -              |
| Other non-interest income (loss)                                     | 90                                       | (847)          | 504                                      | (2,587)        |
| <b>Total non-interest income (loss), net</b>                         | <b>15,155</b>                            | <b>(4,656)</b> | <b>28,658</b>                            | <b>2,225</b>   |
| <b>Non-interest expense:</b>   |  |                |  |                |
| Compensation and employee benefits                                   | 18,531                                   | 19,260         | 38,815                                   | 39,440         |
| Professional and service fees  | 3,511                                    | 4,143          | 7,138                                    | 8,324          |
| Occupancy and equipment  | 8,107                                    | 8,883          | 15,929                                   | 17,519         |
| Insurance  | 3,155                                    | 2,251          | 6,305                                    | 4,204          |
| Electronic banking charges   | 4,947                                    | 5,851          | 10,536                                   | 11,218         |
| Information technology expenses                                      | 1,606                                    | 1,543          | 3,262                                    | 2,997          |
| Advertising, business promotion, and strategic initiatives           | 1,343                                    | 1,558          | 2,786                                    | 3,186          |
| Foreclosure, repossession and other real estate expenses             | 5,164                                    | 10,337         | 7,971                                    | 15,783         |
| Loan servicing and clearing expenses                                 | 1,926                                    | 2,594          | 4,007                                    | 4,947          |

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|   |                  |                   |                  |                    |
|---|------------------|-------------------|------------------|--------------------|
| Taxes, other than payroll and income taxes                | 2,330            | 2,703             | 5,001            | 4,182              |
| Communication   | 581              | 770               | 1,400            | 1,460              |
| Printing, postage, stationary and supplies                | 600              | 582               | 1,325            | 1,219              |
| Director and investor relations                           | 301              | 289               | 579              | 583                |
| Other   | 1,723            | 3,673             | 3,628            | 5,707              |
| <b>Total non-interest expense</b>                         | <b>53,825</b>    | <b>64,437</b>     | <b>108,682</b>   | <b>120,769</b>     |
| <b>Income (loss) before income taxes</b>                  | <b>20,197</b>    | <b>(2,340)</b>    | <b>40,029</b>    | <b>(4,349)</b>     |
| Income tax expense  | 5,858            | 769               | 11,519           | 1,748              |
| <b>Net income (loss)</b>                                  | <b>14,339</b>    | <b>(3,109)</b>    | <b>28,510</b>    | <b>(6,097)</b>     |
| Less: dividends on preferred stock                        | (3,466)          | (3,466)           | (6,931)          | (6,931)            |
| <b>Net income (loss) available to common shareholders</b> | <b>\$ 10,873</b> | <b>\$ (6,575)</b> | <b>\$ 21,579</b> | <b>\$ (13,028)</b> |
| <b>Earnings (loss) per common share:</b>                  |                  |                   |                  |                    |
| Basic   | \$ 0.25          | \$ (0.15)         | \$ 0.49          | (0.29)             |
| Diluted   | \$ 0.25          | \$ (0.15)         | \$ 0.49          | (0.29)             |
| <b>Average common shares outstanding and equivalents</b>  | <b>51,095</b>    | <b>51,774</b>     | <b>51,081</b>    | <b>51,876</b>      |
| <b>Cash dividends per share of common stock</b>           | <b>\$ 0.06</b>   | <b>\$ 0.10</b>    | <b>\$ 0.12</b>   | <b>0.20</b>        |

See notes to unaudited consolidated financial statements

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

## FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2016 AND 2015

|   | Quarter Ended June 30, |                    | Six-Month Period Ended<br>June 30, |                    |
|---|------------------------|--------------------|------------------------------------|--------------------|
|   | 2016                   | 2015               | 2016                               | 2015               |
|   | (In thousands)         |                    | (In thousands)                     |                    |
| <b>Net income (loss)</b>  | \$ 14,339              | \$ (3,109)         | \$ 28,510                          | \$ (6,097)         |
| <b>Other comprehensive income (loss) before tax:</b>                    |                        |                    |                                    |                    |
| Unrealized gain (loss) on securities available-for-sale                 | 3,719                  | (12,916)           | 12,364                             | (5,541)            |
| Realized gain on investment securities included in net<br>income (loss) | (211)                  | -                  | (12,207)                           | (2,572)            |
| Unrealized gain on cash flow hedges                                     | 663                    | 2,016              | 652                                | 2,071              |
| <b>Other comprehensive income (loss) before taxes</b>                   | <b>4,171</b>           | <b>(10,900)</b>    | <b>809</b>                         | <b>(6,042)</b>     |
| Income tax effect   | (650)                  | 877                | 999                                | 632                |
| <b>Other comprehensive income (loss) after taxes</b>                    | <b>3,521</b>           | <b>(10,023)</b>    | <b>1,808</b>                       | <b>(5,410)</b>     |
| <b>Comprehensive income (loss)</b>                                      | <b>\$ 17,860</b>       | <b>\$ (13,132)</b> | <b>\$ 30,318</b>                   | <b>\$ (11,507)</b> |

See notes to unaudited consolidated financial statements

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2016 AND 2015

|  | Six-Month Period Ended June 30, |                   |
|--|---------------------------------|-------------------|
|  | 2016                            | 2015              |
|  | (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                             | 52,626                          | 52,626            |
| <b>Balance at end of period</b>                            | <b>52,626</b>                   | <b>52,626</b>     |
| <b>Additional paid-in capital:</b>                         |                                 |                   |
| Balance at beginning of period                             | 540,512                         | 539,311           |
| Stock-based compensation expense                           | 698                             | 794               |
| Lapsed restricted stock units                              | (505)                           | (436)             |
| <b>Balance at end of period</b>                            | <b>540,705</b>                  | <b>539,669</b>    |
| <b>Legal surplus:</b>                                      |                                 |                   |
| Balance at beginning of period                             | 70,435                          | 70,467            |
| Transfer from (to) retained earnings                       | 2,830                           | (533)             |
| <b>Balance at end of period</b>                            | <b>73,265</b>                   | <b>69,934</b>     |
| <b>Retained earnings:</b>                                  |                                 |                   |
| Balance at beginning of period                             | 148,886                         | 181,152           |
| Net income (loss)  | 28,510                          | (6,097)           |
| Cash dividends declared on common stock                    | (5,272)                         | (8,920)           |
| Cash dividends declared on preferred stock                 | (6,931)                         | (6,931)           |
| Transfer (to) from legal surplus                           | (2,830)                         | 533               |
| <b>Balance at end of period</b>                            | <b>162,363</b>                  | <b>159,737</b>    |
| <b>Treasury stock:</b>                                     |                                 |                   |
| Balance at beginning of period                             | (105,379)                       | (97,070)          |
| Stock repurchased  | -                               | (4,238)           |
| Lapsed restricted stock units                              | 505                             | 640               |
| <b>Balance at end of period</b>                            | <b>(104,874)</b>                | <b>(100,668)</b>  |
| <b>Accumulated other comprehensive income, net of tax:</b> |                                 |                   |
| Balance at beginning of period                             | 13,997                          | 19,711            |
| Other comprehensive income (loss), net of tax              | 1,808                           | (5,410)           |
| <b>Balance at end of period</b>                            | <b>15,805</b>                   | <b>14,301</b>     |
| <b>Total stockholders' equity</b>                          | <b>\$ 915,890</b>               | <b>\$ 911,599</b> |

See notes to unaudited consolidated financial statements

## OFG BANCORP

**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2016 AND 2015**

|   | <b>Six-Month Period</b> |               |
|---|-------------------------|---------------|
|   | <b>Ended June 30,</b>   |               |
|   | <b>2016</b>             | <b>2015</b>   |
|   | <b>(In thousands)</b>   |               |
| <b>Cash flows from operating activities:</b>  |                         |               |
| Net income (loss)   | \$ 28,510               | \$ (6,097)    |
| <b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b> |                         |               |
| Amortization of deferred loan origination fees, net of costs                                    | 1,977                   | 1,813         |
| Amortization of fair value premiums, net of discounts, on acquired loans                        | 39                      | 2,766         |
| Amortization of investment securities premiums, net of accretion of discounts                   | 4,356                   | 5,931         |
| Amortization of core deposit and customer relationship intangibles                              | 839                     | 953           |
| Amortization of fair value premiums on acquired deposits  | 189                     | 478           |
| FDIC shared-loss expense, net   | 7,449                   | 36,329        |
| Depreciation and amortization of premises and equipment   | 5,025                   | 5,930         |
| Deferred income tax expense (benefit), net  | 3,543                   | (1,316)       |
| Provision for loan and lease losses, net  | 28,234                  | 57,732        |
| Stock-based compensation  | 698                     | 794           |
| (Gain) loss on:   |                         |               |
| Sale of securities  | (12,207)                | (2,572)       |
| Sale of mortgage loans held-for-sale  | (809)                   | (2,010)       |
| Derivatives   | 88                      | (113)         |
| Early extinguishment of debt  | 12,000                  | -             |
| Foreclosed real estate  | 7,287                   | (706)         |
| Sale of other repossessed assets  | (1,235)                 | 3,427         |
| Sale of premises and equipment  | 13                      | 10            |
| Originations of loans held-for-sale   | (90,052)                | (111,433)     |
| Proceeds from sale of loans held-for-sale   | 32,212                  | 46,678        |
| Net (increase) decrease in:   |                         |               |
| Trading securities  | (60)                    | 808           |
| Accrued interest receivable   | 628                     | 2,091         |
| Servicing assets  | (477)                   | 1,216         |
| Other assets  | (4,872)                 | (19,813)      |
| Net increase (decrease) in:   |                         |               |
| Accrued interest on deposits and borrowings   | (373)                   | (608)         |
| Accrued expenses and other liabilities  | 8,253                   | 24,219        |
| <b>Net cash provided by operating activities</b>  | <b>31,255</b>           | <b>46,507</b> |
| <b>Cash flows from investing activities:</b>  |                         |               |
| Purchases of:   |                         |               |
| Investment securities available-for-sale  | (302)                   | (1,671)       |
| Investment securities held-to-maturity  | (51,717)                | (399,206)     |
| FHLB stock  | (8,512)                 | -             |
| Maturities and redemptions of:  |                         |               |

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|   |                |                 |
|---|----------------|-----------------|
| Investment securities available-for-sale                                  | 74,208         | 121,121         |
| Investment securities held-to-maturity                                    | 34,304         | 10,725          |
| FHLB stock  | 9,457          | 343             |
| Proceeds from sales of:   |                |                 |
| Investment securities available-for-sale                                  | 300,483        | 103,831         |
| Foreclosed real estate and other repossessed assets, including write-offs | 25,779         | 34,136          |
| Proceeds from sale of loans held-for-sale                                 | 478            | -               |
| Premises and equipment  | 44             | 10              |
| Mortgage servicing rights   | -              | 5,927           |
| Origination and purchase of loans, excluding loans held-for-sale          | (373,927)      | (414,725)       |
| Principal repayment of loans, including covered loans                     | 386,477        | 491,330         |
| Reimbursements from the FDIC on shared-loss agreements                    | 738            | 31,657          |
| Additions to premises and equipment                                       | (3,077)        | (1,838)         |
| Net change in restricted cash   | 319            | 2,321           |
| <b>Net cash provided by (used in) investing activities</b>                | <b>394,752</b> | <b>(16,039)</b> |

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX-MONTHS PERIODS ENDED JUNE 30, 2016 AND 2015 – (CONTINUED)

|  | Six-Month Period Ended June 30, |                    |
|--|---------------------------------|--------------------|
|  | 2016                            | 2015               |
|  | (In thousands)                  |                    |
| <b>Cash flows from financing activities:</b>                                       |                                 |                    |
| Net increase (decrease) in:  |                                 |                    |
| Deposits   | (87,864)                        | (209,272)          |
| Securities sold under agreements to repurchase                                     | (320,000)                       | 181,129            |
| FHLB advances, federal funds purchased, and other borrowings                       | (25,951)                        | (2,845)            |
| Subordinated capital notes   | 350                             | 525                |
| Exercise of stock options and restricted units lapsed, net                         | -                               | 204                |
| Purchase of treasury stock   | -                               | (4,238)            |
| Dividends paid on preferred stock  | (6,931)                         | (6,931)            |
| Dividends paid on common stock   | (5,272)                         | (8,932)            |
| <b>Net cash used in financing activities</b>                                       | <b>\$ (445,668)</b>             | <b>\$ (50,360)</b> |
| <b>Net change in cash and cash equivalents</b>                                     | <b>(19,661)</b>                 | <b>(19,892)</b>    |
| Cash and cash equivalents at beginning of period                                   | 536,709                         | 573,427            |
| <b>Cash and cash equivalents at end of period</b>                                  | <b>\$ 517,048</b>               | <b>\$ 553,535</b>  |
| <b>Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:</b>      |                                 |                    |
| Interest paid  | \$ 30,454                       | \$ 34,403          |
| Income taxes paid  | \$ 3,642                        | \$ 6,730           |
| Mortgage loans securitized into mortgage-backed securities                         | \$ 53,872                       | \$ 61,854          |
| Transfer from loans to foreclosed real estate and other repossessed assets         | \$ 21,865                       | \$ 15,390          |
| Reclassification of loans held-for-investment portfolio to held-for-sale portfolio | \$ -                            | \$ 1,473           |
| Reclassification of loans held-for-sale portfolio to held-for-investment portfolio | \$ 182                          | \$ 156             |

See notes to unaudited consolidated financial statements



**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 (the “Bank”), a securities broker-dealer, Oriental Financial Services Corp. (“Oriental Financial Services”), an insurance agency, Oriental Insurance, LLC (“Oriental Insurance”) and a retirement plan administrator, Oriental Pension Consultants, Inc. (“OPC”). 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 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 these acquisitions have been integrated with the Company’s existing business.

*Recent Accounting Developments*

In June 2016, the Financial Accounting Standards Board (FASB) issued new accounting guidance that will require the earlier recognition of credit losses on loans and other financial instruments based on an expected loss model, replacing the incurred loss model that is currently in use. Under the new guidance, an entity will measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The expected loss model will apply to loans and leases, unfunded lending commitments, held-to-maturity (HTM) debt securities and other debt instruments measured at amortized cost. The impairment model for available-for-sale (AFS) debt securities will require the recognition of credit losses through a valuation allowance when fair value is less than amortized cost, regardless of whether the impairment is considered to be other-than-temporary. The new guidance is effective on January 1, 2020, with early adoption permitted on January 1, 2019. The Company is in the process of evaluating the impact of the provisions of this new accounting guidance.

In March 2016, the FASB issued new accounting guidance that simplifies certain aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new guidance is effective on January 1, 2017, with early adoption permitted. The Company does not expect the provisions of this new accounting guidance to have a material impact on its consolidated financial position or results of operations.

In February 2016, the FASB issued new accounting guidance that requires substantially all leases to be recorded as assets and liabilities on the balance sheet. This new accounting guidance is effective on January 1, 2019, with early adoption permitted. Upon adoption, the Company will record a right of use asset and a lease payment obligation associated with arrangements previously accounted for as operating leases. The Company is in the process of evaluating the impact of the provisions of this new accounting guidance on its consolidated financial position, but does not expect the new accounting guidance to have a material impact on its consolidated financial position or results of operations.

In January 2016, the FASB issued new accounting guidance on recognition and measurement of financial instruments. The new guidance makes targeted changes to existing GAAP including, among other provisions, requiring certain equity investments to be measured at fair value with changes in fair value reported in earnings and requiring changes in instrument-specific credit risk. The new guidance is effective on January 1, 2018. The Company does not expect the provisions of this new accounting guidance to have a material impact on its consolidated financial position or results of operations.

In May 2014, the FASB issued new accounting guidance to clarify the principles for recognizing revenue from contracts with customers. This new accounting guidance is effective on January 1, 2018. The Company does not expect the provisions of this new accounting guidance to have a material impact on its consolidated financial position or results of operations.

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

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

|   | <b>June 30,<br/>2016</b> |           | <b>December 31,<br/>2015</b> |
|---|--------------------------|-----------|------------------------------|
|   | <b>(In thousands)</b>    |           |                              |
| Cash pledged as collateral to other financial institutions to secure: |                          |           |                              |
| Derivatives   | \$ 1,980                 | \$        | 1,980                        |
| Obligations under agreement of loans sold with recourse               | 1,050                    |           | 1,369                        |
|   | <b>\$ 3,030</b>          | <b>\$</b> | <b>3,349</b>                 |

At June 30, 2016 and December 31, 2015, the Bank's international banking entities, Oriental International Bank Inc. ("OIB") and Oriental Overseas, a division of the Bank, each held unencumbered certificates of deposit in the amount of \$300 thousand as the legal reserve required for international banking entities under Puerto Rico law. Each certificate of deposit cannot be withdrawn by OIB or Oriental Overseas without prior written approval of the Office of the Commissioner of Financial Institutions of Puerto Rico.

As part of its derivative activities, the Company has entered into collateral agreements with certain financial counterparties. At June 30, 2016 and December 31, 2015, the Company had delivered \$2.0 million of cash as collateral for such derivatives activities.

As part of the BBVA Acquisition, the Company assumed a contract with FNMA which required collateral to guarantee the repurchase, if necessary, of loans sold with recourse. At June 30, 2016 and December 31, 2015, the Company delivered as collateral cash amounting to \$1.1 million and \$1.4 million, respectively.

The Bank is required by Puerto Rico law to maintain average weekly reserve balances to cover demand deposits. The amount of those minimum average reserve balances for the week that covered June 30, 2016 was \$178.1 million (December 31, 2015 - \$148.3 million). At June 30, 2016 and December 31, 2015, the Bank complied with such requirement. Cash and due from bank as well as other short-term, highly liquid securities are used to cover the required average reserve balances.

**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, 2016 and December 31, 2015, money market instruments included as part of cash and cash equivalents amounted to \$5.7 million and \$4.7 million, respectively.

## OFG BANCORP

## NOTES TO 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, 2016 and December 31, 2015 were as follows:

|   | June 30, 2016       |                              |                               |                     | Weighted<br>Average<br>Yield |
|---|---------------------|------------------------------|-------------------------------|---------------------|------------------------------|
|   | Amortized<br>Cost   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value       |                              |
|   | (In thousands)      |                              |                               |                     |                              |
| <b>Available-for-sale</b>   |                     |                              |                               |                     |                              |
| <b>Mortgage-backed securities</b>                                     |                     |                              |                               |                     |                              |
| FNMA and FHLMC certificates   | \$ 402,557          | \$ 14,414                    | \$ -                          | \$ 416,971          | 2.61%                        |
| GNMA certificates   | 109,214             | 5,064                        | -                             | 114,278             | 3.06%                        |
| CMOs issued by US government-sponsored agencies                       | 120,238             | 416                          | 179                           | 120,475             | 1.87%                        |
| <b>Total mortgage-backed securities</b>                               | <b>632,009</b>      | <b>19,894</b>                | <b>179</b>                    | <b>651,724</b>      | <b>2.55%</b>                 |
| <b>Investment securities</b>  |                     |                              |                               |                     |                              |
| Obligations of US government-sponsored agencies                       | 4,468               | 34                           | -                             | 4,502               | 1.37%                        |
| Obligations of Puerto Rico government and<br>public instrumentalities | 6,720               | -                            | 872                           | 5,848               | 5.55%                        |
| Other debt securities   | 2,101               | 127                          | -                             | 2,228               | 2.94%                        |
| <b>Total investment securities</b>                                    | <b>13,289</b>       | <b>161</b>                   | <b>872</b>                    | <b>12,578</b>       | <b>3.73%</b>                 |
| <b>Total securities available for sale</b>                            | <b>\$ 645,298</b>   | <b>\$ 20,055</b>             | <b>\$ 1,051</b>               | <b>\$ 664,302</b>   | <b>2.57%</b>                 |
| <b>Held-to-maturity</b>   |                     |                              |                               |                     |                              |
| <b>Mortgage-backed securities</b>                                     |                     |                              |                               |                     |                              |
| FNMA and FHLMC certificates   | \$ 610,384          | 8,121                        | -                             | 618,505             | 2.20%                        |
| <b>Investment securities</b>  |                     |                              |                               |                     |                              |
| US Treasury securities  | 25,015              | 10                           | -                             | 25,025              | 0.49%                        |
| <b>Total securities held to maturity</b>                              | <b>635,399</b>      | <b>8,131</b>                 | <b>-</b>                      | <b>643,530</b>      | <b>2.13%</b>                 |
| <b>Total</b>  | <b>\$ 1,280,697</b> | <b>\$ 28,186</b>             | <b>\$ 1,051</b>               | <b>\$ 1,307,832</b> | <b>2.36%</b>                 |

|   | December 31, 2015 |                              |                               |                | Weighted<br>Average<br>Yield |
|---|-------------------|------------------------------|-------------------------------|----------------|------------------------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value  |                              |
|   | (In thousands)    |                              |                               |                |                              |
| <b>Available-for-sale</b>                       |                   |                              |                               |                |                              |
| <b>Mortgage-backed securities</b>               |                   |                              |                               |                |                              |
| FNMA and FHLMC certificates                     | \$ 735,363        | \$ 25,791                    | \$ 1,509                      | \$ 759,645     | 2.97%                        |
| GNMA certificates                               | 57,129            | 1,366                        | -                             | 58,495         | 3.19%                        |
| CMOs issued by US government-sponsored agencies | 137,787           | 27                           | 2,741                         | 135,073        | 1.85%                        |
| <b>Total mortgage-backed securities</b>         | <b>930,279</b>    | <b>27,184</b>                | <b>4,250</b>                  | <b>953,213</b> | <b>2.82%</b>                 |
| <b>Investment securities</b>                    |                   |                              |                               |                |                              |

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|   |                     |                  |                  |                     |              |
|---|---------------------|------------------|------------------|---------------------|--------------|
| Obligations of US government-sponsored agencies                       | 5,122               | -                | 29               | 5,093               | 1.36%        |
| Obligations of Puerto Rico government and<br>public instrumentalities | 17,801              | -                | 4,070            | 13,731              | 6.24%        |
| Other debt securities   | 2,444               | 128              | -                | 2,572               | 2.98%        |
| <b>Total investment securities</b>                                    | <b>25,367</b>       | <b>128</b>       | <b>4,099</b>     | <b>21,396</b>       | <b>4.94%</b> |
| <b>Total securities available-for-sale</b>                            | <b>\$ 955,646</b>   | <b>\$ 27,312</b> | <b>\$ 8,349</b>  | <b>\$ 974,609</b>   | <b>2.87%</b> |
| <b>Held-to-maturity</b>   |                     |                  |                  |                     |              |
| <b>Mortgage-backed securities</b>                                     |                     |                  |                  |                     |              |
| FNMA and FHLMC certificates   | 595,157             | 426              | 5,865            | 589,718             | 2.24%        |
| <b>Investment securities</b>  |                     |                  |                  |                     |              |
| US Treasury securities  | 25,032              | -                | 71               | 24,961              | 0.49%        |
| <b>Total securities held to maturity</b>                              | <b>620,189</b>      | <b>426</b>       | <b>5,936</b>     | <b>614,679</b>      | <b>2.17%</b> |
| <b>Total</b>  | <b>\$ 1,575,835</b> | <b>\$ 27,738</b> | <b>\$ 14,285</b> | <b>\$ 1,589,288</b> | <b>2.60%</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The amortized cost and fair value of the Company's investment securities at June 30, 2016, 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, 2016      |                   |                   |                   |
|---|--------------------|-------------------|-------------------|-------------------|
|   | Available-for-sale |                   | Held-to-maturity  |                   |
|   | Amortized<br>Cost  | Fair Value        | Amortized<br>Cost | Fair Value        |
|   | (In thousands)     |                   | (In thousands)    |                   |
| <b>Mortgage-backed securities</b>                               |                    |                   |                   |                   |
| Due from 5 to 10 years  |                    |                   |                   |                   |
| FNMA and FHLMC certificates                                     | \$ 12,650          | \$ 12,996         | \$ -              | \$ -              |
| <b>Total due from 5 to 10 years</b>                             | <b>12,650</b>      | <b>12,996</b>     | -                 | -                 |
| Due after 10 years  |                    |                   |                   |                   |
| FNMA and FHLMC certificates                                     | 389,907            | 403,975           | 610,384           | 618,505           |
| GNMA certificates   | 109,214            | 114,278           | -                 | -                 |
| CMOs issued by US government-sponsored agencies                 | 120,238            | 120,475           | -                 | -                 |
| <b>Total due after 10 years</b>                                 | <b>619,359</b>     | <b>638,728</b>    | <b>610,384</b>    | <b>618,505</b>    |
| <b>Total mortgage-backed securities</b>                         | <b>632,009</b>     | <b>651,724</b>    | <b>610,384</b>    | <b>618,505</b>    |
| <b>Investment securities</b>                                    |                    |                   |                   |                   |
| Due from 1 to 5 years   |                    |                   |                   |                   |
| US Treasury securities  | -                  | -                 | 25,015            | 25,025            |
| Obligations of Puerto Rico government and                       |                    |                   |                   |                   |
| public instrumentalities  | 6,720              | 5,848             | -                 | -                 |
| <b>Total due from 1 to 5 years</b>                              | <b>6,720</b>       | <b>5,848</b>      | <b>25,015</b>     | <b>25,025</b>     |
| Due from 5 to 10 years  |                    |                   |                   |                   |
| Obligations of US government and sponsored agencies             | 4,468              | 4,502             | -                 | -                 |
| Other debt securities   | 2,101              | 2,228             | -                 | -                 |
| <b>Total due from 5 to 10 years</b>                             | <b>6,569</b>       | <b>6,730</b>      | -                 | -                 |
| <b>Total investment securities</b>                              | <b>13,289</b>      | <b>12,578</b>     | <b>25,015</b>     | <b>25,025</b>     |
| <b>Total securities available-for-sale and held-to-maturity</b> | <b>\$ 645,298</b>  | <b>\$ 664,302</b> | <b>\$ 635,399</b> | <b>\$ 643,530</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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, 2016, the Company retained securitized Government National Mortgage Association ("GNMA") pools totaling \$54.2 million amortized cost, at a yield of 3.01% from its own originations. Previously, the Company was selling all securitized GNMA pools. The GNMA pools were sold until June 2015. During the six-month period ended June 30, 2015, the Company sold \$63.5 million of available-for-sale GNMA certificates as part of its recurring mortgage loan origination and securitization activities. These sales did not realize any gains or losses during such period.

During the six-month period ended June 30, 2016, the Company sold \$277.2 million of mortgage-backed securities and \$11.1 million of Puerto Rico government bonds, and recorded a net gain on sale of securities of \$12.2 million. Among the 2016 sales, the Company sold all but one of the Puerto Rico government bonds it held. The Company had other-than-temporary impairment charges on such securities sold totaling \$1.5 million during the second half of 2015. During the six-month period ended June 30, 2015, the Company sold \$101.3 million of mortgage-backed securities and recorded a net gain on sale of securities of \$2.6 million. The table below presents the gross realized gains and gross realized losses by category for such periods.

| <u>Description</u>  | Six-Month Period Ended June 30, 2016 |                       |                  |                 |
|---|--------------------------------------|-----------------------|------------------|-----------------|
|   | Sale Price                           | Book Value<br>at Sale | Gross Gains      | Gross<br>Losses |
|   | (In thousands)                       |                       |                  |                 |
| <b>Sale of securities available-for-sale</b>                          |                                      |                       |                  |                 |
| <b>Mortgage-backed securities</b>                                     |                                      |                       |                  |                 |
| FNMA and FHLMC certificates   | \$ 293,505                           | \$ 277,181            | \$ 16,324        | \$ -            |
| <b>Investment securities</b>  |                                      |                       |                  |                 |
| Obligations of Puerto Rico government and<br>public instrumentalities | 6,978                                | 11,095                | -                | 4,117           |
| <b>Total</b>  | <b>\$ 300,483</b>                    | <b>\$ 288,276</b>     | <b>\$ 16,324</b> | <b>\$ 4,117</b> |

| <u>Description</u>                           | Six-Month Period Ended June 30, 2015 |                       |             |                 |
|--|--------------------------------------|-----------------------|-------------|-----------------|
|  | Sale Price                           | Book Value<br>at Sale | Gross Gains | Gross<br>Losses |
|  | (In thousands)                       |                       |             |                 |
| <b>Sale of securities available-for-sale</b> |                                      |                       |             |                 |
| <b>Mortgage-backed securities</b>            |                                      |                       |             |                 |
| FNMA and FHLMC certificates                  | \$ 40,307                            | \$ 37,735             | \$ 2,571    | \$ -            |
| GNMA certificates                            | 63,524                               | 63,523                | 1           | -               |



|              |    |                |    |                |    |              |    |          |
|--------------|----|----------------|----|----------------|----|--------------|----|----------|
| <b>Total</b> | \$ | <b>103,831</b> | \$ | <b>101,258</b> | \$ | <b>2,572</b> | \$ | <b>-</b> |
|--------------|----|----------------|----|----------------|----|--------------|----|----------|

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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, 2016 and December 31, 2015:

|  | <b>June 30, 2016</b>     |                   |                  |
|--|--------------------------|-------------------|------------------|
|  | <b>12 months or more</b> |                   |                  |
|  | <b>Amortized</b>         | <b>Unrealized</b> | <b>Fair</b>      |
|  | <b>Cost</b>              | <b>Loss</b>       | <b>Value</b>     |
|  | <b>(In thousands)</b>    |                   |                  |
| <b>Securities available-for-sale</b>                               |                          |                   |                  |
| CMOs issued by US government-sponsored agencies                    | \$ 54,449                | \$ 179            | \$ 54,270        |
| Obligations of Puerto Rico government and public instrumentalities | 6,720                    | 872               | 5,848            |
|  | <b>\$ 61,169</b>         | <b>\$ 1,051</b>   | <b>\$ 60,118</b> |

At June 30, 2016 there were no securities available-for-sale or held-to-maturity in a continuous unrealized loss position for less than twelve months. There were no securities held-to-maturity in a continuous unrealized loss position for twelve months or more.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|   | Amortized<br>Cost | December 31, 2015<br>12 months or more<br>Unrealized<br>Loss<br>(In thousands) | Fair<br>Value     |
|---|-------------------|--|-------------------|
| <b>Securities available-for-sale</b>                                  |                   |  |                   |
| Obligations of Puerto Rico Government and public<br>instrumentalities | \$ 17,801         | \$ 4,070   | \$ 13,731         |
| CMOs issued by US government-sponsored agencies                       | 103,340           | 2,410  | 100,930           |
|   | <b>\$ 121,141</b> | <b>\$ 6,480</b>  | <b>\$ 114,661</b> |
|   |                   |  |                   |
|   | Amortized<br>Cost | Less than 12 months<br>Unrealized<br>Loss<br>(In thousands)                    | Fair<br>Value     |
| <b>Securities available-for-sale</b>                                  |                   |  |                   |
| CMOs issued by US government-sponsored agencies                       | 25,736            | 331  | 25,405            |
| FNMA and FHLMC certificates   | 149,480           | 1,509  | 147,971           |
| Obligations of US government and sponsored agencies                   | 5,122             | 29   | 5,093             |
| <b>Securities held to maturity</b>                                    |                   |  |                   |
| FNMA and FHLMC certificates   | 468,487           | 5,865  | 462,622           |
| US Treasury Securities  | 25,032            | 71   | 24,961            |
|   | <b>\$ 673,857</b> | <b>\$ 7,805</b>  | <b>\$ 666,052</b> |
|   |                   |  |                   |
|   | Amortized<br>Cost | Total<br>Unrealized<br>Loss<br>(In thousands)                                  | Fair<br>Value     |
| <b>Securities available-for-sale</b>                                  |                   |  |                   |
| CMOs issued by US government-sponsored agencies                       | 129,076           | 2,741  | 126,335           |
| FNMA and FHLMC certificates   | 149,480           | 1,509  | 147,971           |
| Obligations of Puerto Rico Government and public<br>instrumentalities | 17,801            | 4,070  | 13,731            |
| Obligations of US government and sponsored agencies                   | 5,122             | 29   | 5,093             |
|   | <b>\$ 301,479</b> | <b>\$ 8,349</b>  | <b>\$ 293,130</b> |
| <b>Securities held to maturity</b>                                    |                   |  |                   |
| FNMA and FHLMC certificates   | 468,487           | 5,865  | 462,622           |
| US Treasury Securities  | 25,032            | 71   | 24,961            |
|   | <b>\$ 794,998</b> | <b>\$ 14,285</b>   | <b>\$ 780,713</b> |

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 the statements of operations

with the remaining noncredit-related component recognized in other comprehensive income (loss). 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.

**OFG BANCORP**

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

Most of the investments (\$54.5 million, amortized cost, or 89%) with an unrealized loss position at June 30, 2016 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 (\$6.7 million, amortized cost, or 11%) with an unrealized loss position at June 30, 2016 consist of obligations issued or guaranteed by the government of Puerto Rico and its public instrumentalities. The decline in the market value of this security 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 the government's credit default, a protracted economic recession, sizable government debt-service obligations and structural budget deficits, high unemployment and a shrinking population.

As of June 30, 2016, the Company applied a discounted cash flow analysis to the Puerto Rico government bond to calculate the cash flows expected to be collected and determine if any portion of the decline in market value of these investments was considered an other-than-temporary impairment. The analysis derives an estimate of value based on the present value of risk-adjusted future cash flows of the underlying investments, and included the following components:

- The contractual future cash flows of the bonds are projected based on the key terms as set forth in the official statements for each investment. Such key terms include among others the interest rate, amortization schedule, if any, and maturity date.
- The risk-adjusted cash flows are calculated based on a monthly default probability and recovery rate assumptions based on the credit rating of each investment. Constant monthly default rates are assumed throughout the life of the bonds which are based on the respective security's credit rating as of the date of the analysis.
- The adjusted future cash flows are then discounted at the original effective yield of each investment based on the purchase price and expected risk-adjusted future cash flows as of the purchase date of each investment.

The only obligation issued or guaranteed by the government of Puerto Rico and its instrumentalities held at the end of the second quarter of 2016 by the Company was the Puerto Rico Highways and Transportation Authority ("PRHTA") – Teodoro Moscoso Bridge revenue bond. The pledge income sources of this bond comes from gross revenues from Teodoro Moscoso Bridge operations. Although PRHTA is included in the Puerto Rico Governor's executive order of November 30, 2015 ordering the "clawback" of certain government revenues, the toll bridge revenues for the repayment of such bonds were not subject to the "clawback." All other Puerto Rico government securities were sold during the first quarter of 2016. The PRHTA bond with a principal amount of \$6.7 million had an aggregate fair value of \$5.8 million at June 30, 2016 (87% of the bond's cost). The discounted cash flow analysis for the investments showed a cumulative default probability at maturity of 10.20%, thus reflecting that it is more likely than not that the

bond will not default during its remaining term. Based on this analysis, the Company determined that it is more likely than not that it will recover all interest and principal invested in this Puerto Rico government bond and is, therefore, not required to recognize a credit loss as of June 30, 2016. Also, the Company's conclusion is based on the assessment of the specific source of repayment of the outstanding bond, which continues to perform. PRHTA started principal repayments on July 1, 2014. All scheduled principal and interest payments to date have been collected. On July 1, 2016, the Company received the scheduled principal payment of \$2.0 million. The next payment is due on July 1, 2017. As a result of the aforementioned analysis, no other-than-temporary losses were recorded during the quarter ended June 30, 2016.

The following table presents a roll-forward of credit-related impairment losses recognized in earnings for the six-month period ended June 30, 2016 and 2015 on available-for-sale securities:

|   | <b>Six-Month Period Ended June 30,</b> |             |
|---|--|-------------|
|   | <b>2016</b>                            | <b>2015</b> |
| Balance at beginning of period                              | \$ 1,490                               | \$ -        |
| Reductions for securities sold during the period (realized) | (1,490)                                | -           |
| Balance at end of period                                    | \$ -                                   | \$ -        |

**OFG BANCORP****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****NOTE 4 - LOANS**

The Company's loan portfolio is composed of two segments, loans initially accounted for under the amortized cost method (referred to as "originated and other" loans) and loans acquired (referred to as "acquired" loans). Acquired loans are further segregated between acquired BBVAPR loans and acquired Eurobank loans. Acquired Eurobank loans were purchased subject to loss-sharing agreements with the FDIC. The FDIC loss-share coverage related to commercial and other-non single family acquired Eurobank loans expired on June 30, 2015. Notwithstanding the expiration of loss share coverage of commercial loans, on July 2, 2015, the Company entered into an agreement with the FDIC pursuant to which the FDIC concurred with a potential sale of a pool of loss-share assets covered under the commercial loss-sharing agreement. Pursuant to such agreement, and as further discussed below, the FDIC agreed to and paid \$20 million in loss share coverage with respect to the aggregate loss resulting from any portfolio sale within 120 days of the agreement. This sale was completed on September 28, 2015. Covered loans are no longer a material amount. Therefore, the Company changed its loan disclosures during 2015.

The coverage for the single family residential loans will expire on June 30, 2020. At June 30, 2016, the remaining covered loans, amounting to \$65.8 million, net carrying amount (\$76.8 million gross amount), are included as part of acquired Eurobank loans under the name "loans secured by 1-4 family residential properties." At December 31, 2015, covered loans amounted to \$67.2 million, net carrying amount (\$92.3 million gross amount). Interest income recognized for covered loans during the six-month periods ended June 30, 2016 and 2015 was \$4.3 million and \$28.3 million, respectively. The decrease in interest income recognized for covered loans is due to the expiration of the FDIC loss-share coverage related to commercial and other-non single family residential loans on June 30, 2015.

Effective June 30, 2016, pursuant to supervisory direction, the Company changed the purchase credit impaired policy for all loans accounted for under ASC 310-30 (*Loans and Debt Securities Acquired with Deteriorated Credit Quality*). Under the revised policy, the Company writes-off the loan's recorded investment and derecognizes the associated allowance for loan and lease losses for loans that exit the acquired pools. The revised policy will be implemented prospectively due to the immaterial impact of retrospective adoption. Prior to June 30, 2016, the pool's carrying value and allowance was determined by discounting expected cash flows at the pool's effective yield. The allowance for loan and lease losses was maintained until all of the loans in the pool were paid off or charged-off. The transition to this revised policy on June 30, 2016 resulted in the de-recognition of \$8.5 million and \$72.2 million in the recorded investment balance and associated allowance for loans that had exited the pools, for acquired BBVAPR loans and acquired Eurobank loans, respectively, with no impact to the provision for loan and lease losses. Refer to Note 5 Allowances for Loan and Lease Losses.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The composition of the Company's loan portfolio at June 30, 2016 and December 31, 2015 was as follows:

|   | <b>June 30,<br/>2016</b> |
|---|--------------------------|
|   | <b>(In thousands)</b>    |
| <b>Originated and other loans and leases held for investment:</b>   |                          |
| Mortgage  | \$ 741,917               |
| Commercial  | 1,476,613                |
| Consumer  | 265,269                  |
| Auto and leasing  | 712,268                  |
|   | <b>3,196,067</b>         |
| Allowance for loan and lease losses on originated and other loans and leases  | (112,812)                |
|   | <b>3,083,255</b>         |
| Deferred loan costs, net  | 4,619                    |
| <b>Total originated and other loans held for investment, net</b>  | <b>3,087,874</b>         |
| <b>Acquired loans:</b>  |                          |
| <b>Acquired BBVAPR loans:</b>   |                          |
| <b>Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b>                       |                          |
| Commercial  | 4,559                    |
| Consumer  | 35,194                   |
| Auto  | 77,118                   |
|   | <b>116,871</b>           |
| Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-20                             | (4,487)                  |
|   | <b>112,384</b>           |
| <b>Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy) (a)</b> |                          |
| Mortgage  | 591,029                  |
| Commercial  | 246,188                  |
| Construction  | 76,917                   |
| Consumer  | 7,331                    |
| Auto  | 117,038                  |
|   | <b>1,038,503</b>         |
| Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-30 (b)                         | (22,801)                 |
|   | <b>1,015,702</b>         |
| <b>Total acquired BBVAPR loans, net</b>   | <b>1,128,086</b>         |
| <b>Acquired Eurobank loans: (a)</b>   |                          |
| Loans secured by 1-4 family residential properties  | 76,777                   |
| Commercial and construction   | 83,377                   |
| Consumer  | 1,410                    |
| <b>Total acquired Eurobank loans</b>  | <b>161,564</b>           |
| Allowance for loan and lease losses on Eurobank loans (b)   | (22,116)                 |



|   |                        |
|---|------------------------|
| <b>Total acquired Eurobank loans, net</b> | <b>139,448</b>         |
| <b>Total acquired loans, net</b>          | <b>1,267,534</b>       |
| <b>Total held for investment, net</b>     | <b>4,355,408</b>       |
| Mortgage loans held-for-sale              | 18,209                 |
| <b>Total loans, net</b>                   | <b>\$ 4,373,617 \$</b> |

(a) Current period amounts have been re-measured using the revised derecognition policy for purchased credit impaired loans.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on J 2016 due to the revision in the derecognition policy for these loans.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*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, 2016 and December 31, 2015 by class of loans. Mortgage loans past due include 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, 2016                |                              |                            |                      |                               |                     |                | Loans<br>90+<br>Days<br>Past<br>Due<br>and<br>Still<br>Accruing |
|------------------------------------|------------------------------|------------------------------|----------------------------|----------------------|-------------------------------|---------------------|----------------|---|
|                                    | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | 90+<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Current<br>in Non-<br>Accrual | Current<br>Accruing | Total<br>Loans |   |
| (In thousands)                     |                              |                              |                            |                      |                               |                     |                |   |
| <b>Mortgage</b>                    |                              |                              |                            |                      |                               |                     |                |   |
| Traditional (by origination year): |                              |                              |                            |                      |                               |                     |                |   |
| Up to the year 2002                | \$ 260                       | \$ 2,024                     | \$ 2,973                   | \$ 5,257             | \$ -                          | \$ 48,801           | \$ 54,058      | \$ 227  |
| Years 2003 and 2004                | 343                          | 3,936                        | 6,201                      | 10,480               | 65                            | 84,208              | 94,753         | -   |
| Year 2005                          | -                            | 1,878                        | 3,826                      | 5,704                | 64                            | 46,293              | 52,061         | -   |
| Year 2006                          | 743                          | 2,243                        | 6,741                      | 9,727                | 50                            | 64,109              | 73,886         | -   |
| Years 2007, 2008                   |                              |                              |                            |                      |                               |                     |                |   |
| and 2009                           | 854                          | 1,414                        | 11,793                     | 14,061               | -                             | 69,957              | 84,018         | 699   |
| Years 2010, 2011, 2012, 2013       | 498                          | 1,307                        | 9,420                      | 11,225               | 142                           | 133,384             | 144,751        | 416   |
| Years 2014, 2015 and 2016          | -                            | 189                          | 901                        | 1,090                | 62                            | 98,209              | 99,361         | -   |
|                                    | 2,698                        | 12,991                       | 41,855                     | 57,544               | 383                           | 544,961             | 602,888        | 1,342   |
| Non-traditional                    | -                            | 938                          | 5,217                      | 6,155                | 12                            | 20,028              | 26,195         | -   |
| Loss mitigation program            | 9,898                        | 6,574                        | 15,738                     | 32,210               | 3,857                         | 68,014              | 104,081        | 3,770   |
|                                    | 12,596                       | 20,503                       | 62,810                     | 95,909               | 4,252                         | 633,003             | 733,164        | 5,112   |
| Home equity secured personal loans | -                            | -                            | -                          | -                    | -                             | 384                 | 384            | -   |
| GNMA's buy-back option program     | -                            | -                            | 8,369                      | 8,369                | -                             | -                   | 8,369          | -   |
| <b>Total mortgage</b>              | <b>12,596</b>                | <b>20,503</b>                | <b>71,179</b>              | <b>104,278</b>       | <b>4,252</b>                  | <b>633,387</b>      | <b>741,917</b> | <b>5,112</b>  |

**Commercial**

## Commercial secured by real estate:

|                                  |              |              |               |               |                |                  |                  |   |  |
|----------------------------------|--------------|--------------|---------------|---------------|----------------|------------------|------------------|---|--|
| Corporate                        | -            | -            | -             | -             | -              | 230,296          | 230,296          | - |  |
| Institutional                    | -            | -            | -             | -             | -              | 27,838           | 27,838           | - |  |
| Middle market                    | -            | 125          | 8,589         | 8,714         | 2,255          | 209,127          | 220,096          | - |  |
| Retail                           | 96           | 1,226        | 5,871         | 7,193         | 3,327          | 236,171          | 246,691          | - |  |
| Floor plan                       | -            | -            | -             | -             | -              | 2,826            | 2,826            | - |  |
| Real estate                      | -            | -            | -             | -             | -              | 16,079           | 16,079           | - |  |
|                                  | 96           | 1,351        | 14,460        | 15,907        | 5,582          | 722,337          | 743,826          | - |  |
| Other commercial and industrial: |              |              |               |               |                |                  |                  |   |  |
| Corporate                        | -            | -            | -             | -             | -              | 140,192          | 140,192          | - |  |
| Institutional                    | -            | -            | -             | -             | 183,020        | 193,258          | 376,278          | - |  |
| Middle market                    | 2,007        | -            | -             | 2,007         | 1,421          | 102,112          | 105,540          | - |  |
| Retail                           | 896          | 529          | 582           | 2,007         | 135            | 74,823           | 76,965           | - |  |
| Floor plan                       | 6            | 38           | 40            | 84            | -              | 33,728           | 33,812           | - |  |
|                                  | 2,909        | 567          | 622           | 4,098         | 184,576        | 544,113          | 732,787          | - |  |
| <b>Total commercial</b>          | <b>3,005</b> | <b>1,918</b> | <b>15,082</b> | <b>20,005</b> | <b>190,158</b> | <b>1,266,450</b> | <b>1,476,613</b> | - |  |

17

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

June 30, 2016

|                                | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | 90+<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Current<br>in Non-<br>Accrual | Current<br>Accruing | Total<br>Loans      | Loans<br>90+<br>Days<br>Past<br>Due<br>and<br>Still<br>Accruing |
|--------------------------------|------------------------------|------------------------------|----------------------------|----------------------|-------------------------------|---------------------|---------------------|---|
| (In thousands)                 |                              |                              |                            |                      |                               |                     |                     |   |
| <b>Consumer</b>                |                              |                              |                            |                      |                               |                     |                     |   |
| Credit cards                   | 459                          | 177                          | 432                        | 1,068                | -                             | 23,809              | 24,877              | -   |
| Overdrafts                     | 15                           | 1                            | -                          | 16                   | -                             | 204                 | 220                 | -   |
| Personal lines of credit       | 42                           | 14                           | 94                         | 150                  | -                             | 2,281               | 2,431               | -   |
| Personal loans                 | 1,854                        | 1,137                        | 898                        | 3,889                | 875                           | 216,884             | 221,648             | -   |
| Cash collateral personal loans | 63                           | 3                            | 1                          | 67                   | -                             | 16,026              | 16,093              | -   |
| <b>Total consumer</b>          | <b>2,433</b>                 | <b>1,332</b>                 | <b>1,425</b>               | <b>5,190</b>         | <b>875</b>                    | <b>259,204</b>      | <b>265,269</b>      | <b>-</b>  |
| <b>Auto and leasing</b>        | <b>44,433</b>                | <b>19,438</b>                | <b>7,322</b>               | <b>71,193</b>        | <b>15</b>                     | <b>641,060</b>      | <b>712,268</b>      | <b>-</b>  |
| <b>Total</b>                   | <b>\$ 62,467</b>             | <b>\$ 43,191</b>             | <b>\$ 95,008</b>           | <b>\$ 200,666</b>    | <b>\$ 195,300</b>             | <b>\$ 2,800,101</b> | <b>\$ 3,196,067</b> | <b>\$ 5,112</b>   |

18

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|                                    | December 31, 2015 |               |               |                |              |                |                |              |  |
|------------------------------------|-------------------|---------------|---------------|----------------|--------------|----------------|----------------|--------------|--|
|                                    | 30-59             | 60-89         | 90+           | Total          | Current      |                |                | Loans        |  |
|                                    | Days              | Days          | Days          | Past           | in Non-      | Current        |                | 90+          |  |
|                                    | Past              | Past          | Past          | Due            | Accrual      | Accruing       | Total          | Days         |  |
|                                    | Due               | Due           | Due           | (In thousands) |              |                | Loans          | Past         |  |
|                                    |                   |               |               |                |              |                |                | Due          |  |
|                                    |                   |               |               |                |              |                |                | and          |  |
|                                    |                   |               |               |                |              |                |                | Still        |  |
|                                    |                   |               |               |                |              |                |                | Accruing     |  |
| <b>Mortgage</b>                    |                   |               |               |                |              |                |                |              |  |
| Traditional (by origination year): |                   |               |               |                |              |                |                |              |  |
| Up to the year 2002                | \$ 80             | \$ 2,217      | \$ 3,889      | \$ 6,186       | \$ 41        | \$ 51,562      | \$ 57,789      | \$ 144       |  |
| Years 2003 and 2004                | 251               | 5,036         | 5,536         | 10,823         | -            | 88,623         | 99,446         | -            |  |
| Year 2005                          | 79                | 2,553         | 3,549         | 6,181          | -            | 48,040         | 54,221         | -            |  |
| Year 2006                          | 551               | 2,878         | 7,934         | 11,363         | 176          | 66,864         | 78,403         | -            |  |
| Years 2007, 2008                   |                   |               |               |                |              |                |                |              |  |
|                                    | 170               | 2,053         | 14,733        | 16,956         | -            | 74,590         | 91,546         | 526          |  |
| and 2009                           |                   |               |               |                |              |                |                |              |  |
| Years 2010, 2011, 2012, 2013       | 662               | 1,673         | 10,519        | 12,854         | 141          | 137,749        | 150,744        | 72           |  |
| Years 2014 and 2015                | -                 | 65            | 663           | 728            | -            | 85,128         | 85,856         | -            |  |
|                                    | 1,793             | 16,475        | 46,823        | 65,091         | 358          | 552,556        | 618,005        | 742          |  |
| Non-traditional                    | -                 | 977           | 5,079         | 6,056          | 13           | 23,483         | 29,552         | -            |  |
| Loss mitigation program            | 9,958             | 6,887         | 14,930        | 31,775         | 5,593        | 64,548         | 101,916        | 3,083        |  |
|                                    | 11,751            | 24,339        | 66,832        | 102,922        | 5,964        | 640,587        | 749,473        | 3,825        |  |
| Home equity secured personal loans | -                 | -             | 64            | 64             | -            | 346            | 410            | -            |  |
| GNMA's buy-back option program     | -                 | -             | 7,945         | 7,945          | -            | -              | 7,945          | -            |  |
| <b>Total mortgage</b>              | <b>11,751</b>     | <b>24,339</b> | <b>74,841</b> | <b>110,931</b> | <b>5,964</b> | <b>640,933</b> | <b>757,828</b> | <b>3,825</b> |  |
| <b>Commercial</b>                  |                   |               |               |                |              |                |                |              |  |
| Commercial secured by real estate: |                   |               |               |                |              |                |                |              |  |
| Corporate                          | -                 | -             | -             | -              | -            | 227,557        | 227,557        | -            |  |
| Institutional                      | 213               | -             | -             | 213            | -            | 33,594         | 33,807         | -            |  |
| Middle market                      | 1,174             | 712           | 9,113         | 10,999         | 1,730        | 194,219        | 206,948        | -            |  |
| Retail                             | 686               | 466           | 6,921         | 8,073          | 1,177        | 231,840        | 241,090        | -            |  |
| Floor plan                         | -                 | -             | -             | -              | -            | 2,892          | 2,892          | -            |  |
| Real estate                        | -                 | -             | -             | -              | -            | 16,662         | 16,662         | -            |  |
|                                    | 2,073             | 1,178         | 16,034        | 19,285         | 2,907        | 706,764        | 728,956        | -            |  |
| Other commercial and industrial:   |                   |               |               |                |              |                |                |              |  |
| Corporate                          | -                 | -             | -             | -              | -            | 108,582        | 108,582        | -            |  |
| Institutional                      | -                 | -             | -             | -              | 190,290      | 190,695        | 380,985        | -            |  |
| Middle market                      | -                 | -             | -             | -              | 1,565        | 105,748        | 107,313        | -            |  |
| Retail                             | 282               | 639           | 604           | 1,525          | 783          | 75,489         | 77,797         | -            |  |
| Floor plan                         | 238               | 51            | 39            | 328            | -            | 37,688         | 38,016         | -            |  |
|                                    | 520               | 690           | 643           | 1,853          | 192,638      | 518,202        | 712,693        | -            |  |

|                         |              |              |               |               |                |                  |                  |          |
|-------------------------|--------------|--------------|---------------|---------------|----------------|------------------|------------------|----------|
| <b>Total commercial</b> | <b>2,593</b> | <b>1,868</b> | <b>16,677</b> | <b>21,138</b> | <b>195,545</b> | <b>1,224,966</b> | <b>1,441,649</b> | <b>-</b> |
|-------------------------|--------------|--------------|---------------|---------------|----------------|------------------|------------------|----------|

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19

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2015

|                                | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | 90+ Days<br>Past Due | Total<br>Past<br>Due | Current<br>in Non-<br>Accrual | Current<br>Accruing | Total<br>Loans      | Loans<br>90+<br>Days<br>Past<br>Due<br>and<br>Still<br>Accruing |
|--------------------------------|------------------------------|------------------------------|----------------------|----------------------|-------------------------------|---------------------|---------------------|---|
| (In thousands)                 |                              |                              |                      |                      |                               |                     |                     |   |
| <b>Consumer</b>                |                              |                              |                      |                      |                               |                     |                     |   |
| Credit cards                   | 449                          | 182                          | 369                  | 1,000                | -                             | 21,766              | 22,766              | -   |
| Overdrafts                     | 24                           | -                            | -                    | 24                   | -                             | 166                 | 190                 | -   |
| Personal lines of credit       | 74                           | -                            | 45                   | 119                  | 19                            | 2,106               | 2,244               | -   |
| Personal loans                 | 2,078                        | 1,179                        | 627                  | 3,884                | 414                           | 196,858             | 201,156             | -   |
| Cash collateral personal loans | 125                          | 17                           | 2                    | 144                  | -                             | 16,450              | 16,594              | -   |
| <b>Total consumer</b>          | <b>2,750</b>                 | <b>1,378</b>                 | <b>1,043</b>         | <b>5,171</b>         | <b>433</b>                    | <b>237,346</b>      | <b>242,950</b>      | <b>-</b>  |
| <b>Auto and leasing</b>        | <b>53,566</b>                | <b>16,898</b>                | <b>8,293</b>         | <b>78,757</b>        | <b>49</b>                     | <b>590,357</b>      | <b>669,163</b>      | <b>-</b>  |
| <b>Total</b>                   | <b>\$ 70,660</b>             | <b>\$ 44,483</b>             | <b>\$ 100,854</b>    | <b>\$ 215,997</b>    | <b>\$ 201,991</b>             | <b>\$ 2,693,602</b> | <b>\$ 3,111,590</b> | <b>\$ 3,825</b>   |

During 2015, the Company changed its early delinquency reporting on mortgage loans from one scheduled payment due to two scheduled payments due to be comparable with local peers, except for troubled-debt restructured loans which continue using one scheduled payment due for delinquency reporting. During the quarter ended June 30, 2016, the Company changed its early delinquency reporting on consumer and auto loans from one scheduled payment due to two scheduled payments to report consistently its retail portfolio. The change resulted in a \$19 thousand and \$5.9 million reduction in early and total delinquency for consumer and auto loans, respectively.

At June 30, 2016 and December 31, 2015, the Company had carrying balances of \$327.0 million and \$334.6 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. All loans granted to the Puerto Rico government were current at June 30, 2016 and December 31, 2015. As part of a bank syndicate, on November 5, 2015 the Company entered into a Restructuring Support Agreement with a view towards restructuring a line of credit to the Puerto Rico Electric Power Authority ("PREPA") on terms that provide for full repayment of the debt to the Bank. In the third quarter of 2014, the Company classified the credit as substandard and a troubled-debt restructuring. The Company conducted an impairment analysis considering the probability of collection of principal and interest, which included a financial model to project the future liquidity status of PREPA under various scenarios and its capacity to service its financial obligations, and concluded that PREPA had sufficient cash flows for the repayment of the line of credit. Despite the Company's analysis showing PREPA's capacity to repay the line of credit, the Company classified the credit as doubtful, placed its participation in non-accrual and recorded a \$24 million provision during the first quarter of 2015. During the fourth quarter of 2015, the Company recorded an additional \$29.3 million provision for loan and lease losses on PREPA. Since it was placed in non-accrual, interest payments have been applied to principal. At June 30, 2016 and December 31, 2015, the allowance for loan and lease losses to PREPA was \$53.3 million.





## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Acquired Loans*

Acquired loans were initially measured at fair value and subsequently accounted for under either ASC 310-30 or ASC 310-20 (*Non-refundable fees and Other Costs*). We have acquired loans in two bank acquisitions, BBVAPR and Eurobank.

*Acquired BBVAPR 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, excluding the acquired Eurobank loan 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. Acquired BBVAPR loans 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 BBVAPR loans accounted for under ASC 310-20 as of June 30, 2016 and December 31, 2015, by class of loans:

| <b>June 30, 2016</b>                   |  |                                      |                               |  |                             |                        |  |  | <b>Loans<br/>90+<br/>Days<br/>Past<br/>Due<br/>and<br/>Still<br/>Accruing</b> |
|--|--|--------------------------------------|-------------------------------|--|-----------------------------|------------------------|--|--|---|
| <b>30-59<br/>Days<br/>Past<br/>Due</b> | <b>60-89<br/>Days<br/>Past<br/>Due</b> | <b>90+<br/>Days<br/>Past<br/>Due</b> | <b>Total<br/>Past<br/>Due</b> | <b>Current<br/>in<br/>Non-<br/>Accrual</b> | <b>Current<br/>Accruing</b> | <b>Total<br/>Loans</b> |  |  |   |
| (In thousands)                         |  |                                      |                               |  |                             |                        |  |  |   |

**Commercial**

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|                                   |           |              |           |              |           |              |           |               |           |          |           |                |           |                |           |          |
|-----------------------------------|-----------|--------------|-----------|--------------|-----------|--------------|-----------|---------------|-----------|----------|-----------|----------------|-----------|----------------|-----------|----------|
| Commercial secured by real estate |           |              |           |              |           |              |           |               |           |          |           |                |           |                |           |          |
| Retail                            | \$        | -            | \$        | -            | \$        | 197          | \$        | 197           | \$        | -        | \$        | -              | \$        | 197            | \$        | -        |
| Floor plan                        |           | -            |           | -            |           | 446          |           | 446           |           | -        |           | 2,309          |           | 2,755          |           | -        |
|                                   |           | -            |           | -            |           | 643          |           | 643           |           | -        |           | 2,309          |           | 2,952          |           | -        |
| Other commercial and industrial   |           |              |           |              |           |              |           |               |           |          |           |                |           |                |           |          |
| Retail                            |           | 37           |           | 17           |           | 120          |           | 174           |           | -        |           | 1,426          |           | 1,600          |           | -        |
| Floor plan                        |           | -            |           | -            |           | 7            |           | 7             |           | -        |           | -              |           | 7              |           | -        |
|                                   |           | 37           |           | 17           |           | 127          |           | 181           |           | -        |           | 1,426          |           | 1,607          |           | -        |
|                                   |           | <b>37</b>    |           | <b>17</b>    |           | <b>770</b>   |           | <b>824</b>    |           | -        |           | <b>3,735</b>   |           | <b>4,559</b>   |           | -        |
| <b>Consumer</b>                   |           |              |           |              |           |              |           |               |           |          |           |                |           |                |           |          |
| Credit cards                      |           | 731          |           | 290          |           | 704          |           | 1,725         |           | -        |           | 30,573         |           | 32,298         |           | -        |
| Personal loans                    |           | 116          |           | 14           |           | 60           |           | 190           |           | -        |           | 2,706          |           | 2,896          |           | -        |
|                                   |           | <b>847</b>   |           | <b>304</b>   |           | <b>764</b>   |           | <b>1,915</b>  |           | -        |           | <b>33,279</b>  |           | <b>35,194</b>  |           | -        |
| <b>Auto</b>                       |           | <b>5,088</b> |           | <b>2,196</b> |           | <b>562</b>   |           | <b>7,846</b>  |           | -        |           | <b>69,272</b>  |           | <b>77,118</b>  |           | -        |
| <b>Total</b>                      | <b>\$</b> | <b>5,972</b> | <b>\$</b> | <b>2,517</b> | <b>\$</b> | <b>2,096</b> | <b>\$</b> | <b>10,585</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>106,286</b> | <b>\$</b> | <b>116,871</b> | <b>\$</b> | <b>-</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2015

|                                   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | 90+<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Current<br>in<br>Non-<br>Current<br>Accrual | Current<br>Accruing | Total<br>Loans    | Loans<br>90+<br>Days<br>Past<br>Due<br>and<br>Still<br>Accruing |
|-----------------------------------|------------------------------|------------------------------|----------------------------|----------------------|---|---------------------|-------------------|---|
| (In thousands)                    |                              |                              |                            |                      |   |                     |                   |   |
| <b>Commercial</b>                 |                              |                              |                            |                      |   |                     |                   |   |
| Commercial secured by real estate |                              |                              |                            |                      |   |                     |                   |   |
| Retail                            | \$ -                         | \$ -                         | \$ 228                     | \$ 228               | \$ -  | \$ -                | \$ 228            | \$ -  |
| Floor plan                        | -                            | -                            | 467                        | 467                  | -   | 2,422               | 2,889             | -   |
|                                   | -                            | -                            | 695                        | 695                  | -   | 2,422               | 3,117             | -   |
| Other commercial and industrial   |                              |                              |                            |                      |   |                     |                   |   |
| Retail                            | 186                          | 29                           | 178                        | 393                  | -   | 3,331               | 3,724             | -   |
| Floor plan                        | -                            | -                            | 7                          | 7                    | -   | 609                 | 616               | -   |
|                                   | 186                          | 29                           | 185                        | 400                  | -   | 3,940               | 4,340             | -   |
|                                   | <b>186</b>                   | <b>29</b>                    | <b>880</b>                 | <b>1,095</b>         | -   | <b>6,362</b>        | <b>7,457</b>      | -   |
| <b>Consumer</b>                   |                              |                              |                            |                      |   |                     |                   |   |
| Credit cards                      | 930                          | 384                          | 489                        | 1,803                | -   | 33,414              | 35,217            | -   |
| Personal loans                    | 14                           | 29                           | 46                         | 89                   | -   | 3,079               | 3,168             | -   |
|                                   | <b>944</b>                   | <b>413</b>                   | <b>535</b>                 | <b>1,892</b>         | -   | <b>36,493</b>       | <b>38,385</b>     | -   |
| <b>Auto</b>                       | <b>7,553</b>                 | <b>2,279</b>                 | <b>831</b>                 | <b>10,663</b>        | -   | <b>96,248</b>       | <b>106,911</b>    | -   |
| <b>Total</b>                      | <b>\$ 8,683</b>              | <b>\$ 2,721</b>              | <b>\$ 2,246</b>            | <b>\$ 13,650</b>     | <b>\$ -</b>                                 | <b>\$ 139,103</b>   | <b>\$ 152,753</b> | <b>\$ -</b>   |

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

Acquired BBVAPR loans, 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 acquired BBVAPR loans with deteriorated credit quality, including those accounted under ASC 310-30 by analogy, in the statements of financial condition at June 30, 2016 and December 31, 2015 is as follows:

|   | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|--------------------------|------------------------------|
|   | (In thousands)           |                              |
| Contractual required payments receivable (a)  | \$ 1,788,121             | \$ 1,945,098                 |
| Less: Non-accretable discount                 | 394,500                  | 434,190                      |
| Cash expected to be collected                 | 1,393,621                | 1,510,908                    |
| Less: Accretable yield                        | 355,118                  | 361,688                      |
| Carrying amount, gross                        | 1,038,503                | 1,149,220                    |
| Less: allowance for loan and lease losses (b) | 22,801                   | 25,785                       |
| <b>Carrying amount, net</b>                   | <b>\$ 1,015,702</b>      | <b>\$ 1,123,435</b>          |

(a) Current period amounts have been re-measured using the revised derecognition policy for purchased credit impaired loans.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

At June 30, 2016 and December 31, 2015, the Company had \$71.6 million and \$80.9 million, respectively, in loans granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of its acquired BBVAPR loans accounted for under ASC 310-30. This entire amount was current at June 30, 2016 and December 31, 2015

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following tables describe the accretable yield and non-accretable discount activity of acquired BBVAPR loans accounted for under ASC 310-30 for the quarters and six-month periods ended June 30, 2016 and 2015:

|  | Quarter Ended June 30, 2016 |                  |                  |                  |                  |                   |
|--|-----------------------------|------------------|------------------|------------------|------------------|-------------------|
|  | Mortgage                    | Commercial       | Construction     | Auto             | Consumer         | Total             |
|  | (In thousands)              |                  |                  |                  |                  |                   |
| <b>Accretable Yield Activity:</b>          |                             |                  |                  |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 260,557                  | \$ 40,102        | \$ 17,156        | \$ 17,587        | \$ 5,261         | \$ 340,663        |
| Accretion                                  | (8,294)                     | (5,272)          | (1,307)          | (3,616)          | (870)            | (19,359)          |
| Change in expected cash flows              | -                           | 3,062            | (408)            | 630              | (1)              | 3,283             |
| Transfer from (to) non-accretable discount | 31,560                      | (833)            | (193)            | (498)            | 495              | 30,531            |
| <b>Balance at end of period</b>            | <b>\$ 283,823</b>           | <b>\$ 37,059</b> | <b>\$ 15,248</b> | <b>\$ 14,103</b> | <b>\$ 4,885</b>  | <b>\$ 355,118</b> |
| <b>Non-Accretable Discount Activity:</b>   |                             |                  |                  |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 370,155                  | \$ 10,716        | \$ 7,432         | \$ 21,938        | \$ 18,735        | \$ 428,976        |
| Change in actual and expected losses       | (2,442)                     | (967)            | (206)            | (315)            | (15)             | (3,945)           |
| Transfer (to) from accretable yield        | (31,560)                    | 833              | 193              | 498              | (495)            | (30,531)          |
| <b>Balance at end of period</b>            | <b>\$ 336,153</b>           | <b>\$ 10,582</b> | <b>\$ 7,419</b>  | <b>\$ 22,121</b> | <b>\$ 18,225</b> | <b>\$ 394,500</b> |

|  | Six-Month Period Ended June 30, 2016 |                  |                  |                  |                  |                   |
|--|--------------------------------------|------------------|------------------|------------------|------------------|-------------------|
|  | Mortgage                             | Commercial       | Construction     | Auto             | Consumer         | Total             |
|  | (In thousands)                       |                  |                  |                  |                  |                   |
| <b>Accretable Yield Activity:</b>          |                                      |                  |                  |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 268,794                           | \$ 45,411        | \$ 19,615        | \$ 21,578        | \$ 6,290         | \$ 361,688        |
| Accretion                                  | (16,601)                             | (11,111)         | (3,176)          | (7,827)          | (1,808)          | (40,523)          |
| Change in expected cash flows              | -                                    | 3,190            | (208)            | 631              | (1)              | 3,612             |
| Transfer from (to) non-accretable discount | 31,630                               | (431)            | (983)            | (279)            | 404              | 30,341            |
| <b>Balance at end of period</b>            | <b>\$ 283,823</b>                    | <b>\$ 37,059</b> | <b>\$ 15,248</b> | <b>\$ 14,103</b> | <b>\$ 4,885</b>  | <b>\$ 355,118</b> |
| <b>Non-Accretable Discount Activity:</b>   |                                      |                  |                  |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 374,772                           | \$ 11,781        | \$ 6,764         | \$ 22,039        | \$ 18,834        | \$ 434,190        |
| Change in actual and expected losses       | (6,989)                              | (1,630)          | (328)            | (197)            | (205)            | (9,349)           |
| Transfer (to) from accretable yield        | (31,630)                             | 431              | 983              | 279              | (404)            | (30,341)          |
| <b>Balance at end of period</b>            | <b>\$ 336,153</b>                    | <b>\$ 10,582</b> | <b>\$ 7,419</b>  | <b>\$ 22,121</b> | <b>\$ 18,225</b> | <b>\$ 394,500</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | <b>Quarter Ended June 30, 2015</b> |                   |                     |                  |                  |                   |
|--|------------------------------------|-------------------|---------------------|------------------|------------------|-------------------|
|  | <b>Mortgage</b>                    | <b>Commercial</b> | <b>Construction</b> | <b>Auto</b>      | <b>Consumer</b>  | <b>Total</b>      |
|  | <b>(In thousands)</b>              |                   |                     |                  |                  |                   |
| <b>Accretable Yield Activity:</b>          |                                    |                   |                     |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 284,612                         | \$ 57,330         | \$ 19,390           | \$ 47,097        | \$ 5,601         | \$ 414,030        |
| Accretion                                  | (8,813)                            | (9,597)           | (2,143)             | (6,163)          | (1,287)          | (28,003)          |
| Change in actual and expected losses       | -                                  | 23,695            | 9,867               | -                | -                | 33,562            |
| Transfer from (to) non-accretable discount | 81                                 | 135               | (2,501)             | (9,403)          | 4,147            | (7,541)           |
| <b>Balance at end of period</b>            | <b>\$ 275,880</b>                  | <b>\$ 71,563</b>  | <b>\$ 24,613</b>    | <b>\$ 31,531</b> | <b>\$ 8,461</b>  | <b>\$ 412,048</b> |
| <b>Non-Accretable Discount Activity:</b>   |                                    |                   |                     |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 392,609                         | \$ 15,826         | \$ 3,957            | \$ 14,543        | \$ 23,576        | \$ 450,511        |
| Change in actual and expected losses       | (3,421)                            | (4,921)           | 536                 | (256)            | (73)             | (8,135)           |
| Transfer (to) from accretable yield        | (81)                               | (135)             | 2,501               | 9,403            | (4,147)          | 7,541             |
| <b>Balance at end of period</b>            | <b>\$ 389,107</b>                  | <b>\$ 10,770</b>  | <b>\$ 6,994</b>     | <b>\$ 23,690</b> | <b>\$ 19,356</b> | <b>\$ 449,917</b> |

|  | <b>Six-Month Period Ended June 30, 2015</b> |                   |                     |                  |                  |                   |
|--|---|-------------------|---------------------|------------------|------------------|-------------------|
|  | <b>Mortgage</b>                             | <b>Commercial</b> | <b>Construction</b> | <b>Auto</b>      | <b>Consumer</b>  | <b>Total</b>      |
|  | <b>(In thousands)</b>                       |                   |                     |                  |                  |                   |
| <b>Accretable Yield Activity:</b>          |   |                   |                     |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 298,364                                  | \$ 61,196         | \$ 25,829           | \$ 53,998        | \$ 6,559         | \$ 445,946        |
| Accretion                                  | (17,800)                                    | (20,356)          | (5,953)             | (13,151)         | (2,213)          | (59,473)          |
| Change in actual and expected losses       | -   | 23,695            | 9,867               | -                | -                | 33,562            |
| Transfer (to) from non-accretable discount | (4,684)                                     | 7,028             | (5,130)             | (9,316)          | 4,115            | (7,987)           |
| <b>Balance at end of period</b>            | <b>\$ 275,880</b>                           | <b>71,563</b>     | <b>24,613</b>       | <b>31,531</b>    | <b>8,461</b>     | <b>412,048</b>    |
| <b>Non-Accretable Discount Activity:</b>   |   |                   |                     |                  |                  |                   |
| <b>Balance at beginning of period</b>      | \$ 389,839                                  | \$ 23,069         | \$ 3,486            | \$ 16,215        | \$ 24,018        | \$ 456,627        |
| Change in actual and expected losses       | (5,416)                                     | (5,271)           | (1,622)             | (1,841)          | (547)            | (14,697)          |
| Transfer from (to) accretable yield        | 4,684                                       | (7,028)           | 5,130               | 9,316            | (4,115)          | 7,987             |
| <b>Balance at end of period</b>            | <b>\$ 389,107</b>                           | <b>\$ 10,770</b>  | <b>\$ 6,994</b>     | <b>\$ 23,690</b> | <b>\$ 19,356</b> | <b>\$ 449,917</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Acquired Eurobank Loans

The carrying amount of acquired Eurobank loans at June 30, 2016 and December 31, 2015 is as follows:

|   |           | June 30<br>2016 |           | December 31<br>2015 |
|---|-----------|-----------------|-----------|---------------------|
|   |           | (In thousands)  |           |                     |
| Contractual required payments receivable (a)  | \$        | 252,801         | \$        | 342,511             |
| Less: Non-accretable discount                 |           | 11,555          |           | 21,156              |
| Cash expected to be collected                 |           | 241,246         |           | 321,355             |
| Less: Accretable yield                        |           | 79,682          |           | 84,391              |
| Carrying amount, gross                        |           | 161,564         |           | 236,964             |
| Less: Allowance for loan and lease losses (b) |           | 22,116          |           | 90,178              |
| <b>Carrying amount, net</b>                   | <b>\$</b> | <b>139,448</b>  | <b>\$</b> | <b>146,786</b>      |

(a) Current period amounts have been re-measured using the revised derecognition policy for purchased credit impaired loans.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

The following tables describe the accretable yield and non-accretable discount activity of acquired Eurobank loans for the quarters and six-months periods ended June 30, 2016 and 2015:

|  | Quarter Ended June 30, 2016                                       |   |                 |  |             |             |                              |
|--|---|---|-----------------|--|-------------|-------------|------------------------------|
|  | Loans<br>Secured<br>by 1-4<br>Family<br>Residential<br>Properties |   |                 | Construction<br>&<br>Development<br>Secured<br>by 1-4<br>Family<br>Residential<br>Properties |             |             | Leasing<br>Consumer<br>Total |
|  |   | Commercial<br>and Other<br>Construction |                 |  |             |             |                              |
|  | (In thousands)  |   |                 |  |             |             |                              |
| <b>Accretable Yield Activity:</b>          |   |   |                 |  |             |             |                              |
| <b>Balance at beginning of period</b>      | \$ 50,787   | \$ 33,203                               | \$ 2,237        | \$ -   | \$ -        | \$ -        | \$ 86,227                    |
| Accretion                                  | (2,263)   | (4,528)                                 | (33)            | 2  | (76)        |             | (6,898)                      |
| Change in expected cash flows              | (198)   | 1,619                                   | -               | (77)   | 81          |             | 1,425                        |
| Transfer from (to) non-accretable discount | 10  | (1,152)                                 | -               | 75   | (5)         |             | (1,072)                      |
| <b>Balance at end of year</b>              | <b>\$ 48,336</b>  | <b>\$ 29,142</b>                        | <b>\$ 2,204</b> | <b>\$ -</b>  | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 79,682</b>             |

**Non-Accretable Discount Activity:**

|                                       |                  |             |             |             |             |                  |
|---------------------------------------|------------------|-------------|-------------|-------------|-------------|------------------|
| <b>Balance at beginning of period</b> | \$ 12,703        | \$ -        | \$ -        | \$ -        | \$ -        | \$ 12,703        |
| Change in actual and expected losses  | (1,138)          | (1,152)     | -           | 75          | (5)         | (2,220)          |
| Transfer from (to) accretable yield   | (10)             | 1,152       | -           | (75)        | 5           | 1,072            |
| <b>Balance at end of period</b>       | <b>\$ 11,555</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 11,555</b> |



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Six-Month Period Ended June 30, 2016

|  | Loans Secured by 1-4 Family Residential Properties |                  | Construction and Other Properties |             | Development Secured by 1-4 Family Residential Properties |                  | Leasing | Consumer | Total |
|--|--|------------------|-----------------------------------|-------------|--|------------------|---------|----------|-------|
|  |  |                  |                                   |             |  |                  |         |          |       |
|  | (In thousands)                                     |                  |                                   |             |  |                  |         |          |       |
| <b>Accretable Yield Activity:</b>          |  |                  |                                   |             |  |                  |         |          |       |
| <b>Balance at beginning of period</b>      | \$ 51,954  | \$ 26,970        | \$ 2,255                          | \$ -        | \$ 3,213   | \$ 84,392        |         |          |       |
| Accretion                                  | (4,529)  | (8,623)          | (47)                              | 2           | (1,261)  | (14,458)         |         |          |       |
| Change in expected cash flows              | 786  | 12,712           | (23)                              | (77)        | (1,947)  | 11,451           |         |          |       |
| Transfer from (to) non-accretable discount | 125  | (1,917)          | 19                                | 75          | (5)  | (1,703)          |         |          |       |
| <b>Balance at end of period</b>            | <b>\$ 48,336</b>                                   | <b>\$ 29,142</b> | <b>\$ 2,204</b>                   | <b>\$ -</b> | <b>\$ -</b>  | <b>\$ 79,682</b> |         |          |       |
| <b>Non-Accretable Discount Activity:</b>   |  |                  |                                   |             |  |                  |         |          |       |
| <b>Balance at beginning of period</b>      | \$ 12,869  | \$ -             | \$ -                              | \$ -        | \$ 8,287   | \$ 21,156        |         |          |       |
| Change in actual and expected losses       | (1,189)  | (1,917)          | 19                                | 75          | (8,292)  | (11,304)         |         |          |       |
| Transfer (to) from accretable yield        | (125)  | 1,917            | (19)                              | (75)        | 5  | 1,703            |         |          |       |
| <b>Balance at end of period</b>            | <b>\$ 11,555</b>                                   | <b>\$ -</b>      | <b>\$ -</b>                       | <b>\$ -</b> | <b>\$ -</b>  | <b>\$ 11,555</b> |         |          |       |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## Quarter Ended June 30, 2015

## Construction

## &amp;

## Development

## Secured by

## 1-4 Family

## Residential

## Properties

## (In thousands)

## Accretable Yield Activity:

|                                       | Loans Secured by 1-4 Family Residential Properties | Commercial and Other Construction | 1-4 Family Residential Properties | Leasing         | Consumer        | Total             |
|---------------------------------------|--|-----------------------------------|-----------------------------------|-----------------|-----------------|-------------------|
| <b>Balance at beginning of period</b> | \$ 58,332  | \$ 33,481                         | \$ 20,806                         | \$ 1,665        | \$ 2,004        | \$ 116,288        |
| Accretion                             | (3,276)  | (8,047)                           | (405)                             | (937)           | (93)            | (12,758)          |
| Transfer from non-accretable discount | 750  | 2,039                             | (2,052)                           | 375             | (1)             | 1,111             |
| <b>Balance at end of period</b>       | <b>\$ 55,806</b>                                   | <b>\$ 27,473</b>                  | <b>\$ 18,349</b>                  | <b>\$ 1,103</b> | <b>\$ 1,910</b> | <b>\$ 104,641</b> |

## Non-Accretable Discount Activity:

|                                       |                  |             |             |             |                 |                  |
|---------------------------------------|------------------|-------------|-------------|-------------|-----------------|------------------|
| <b>Balance at beginning of period</b> | \$ 12,557        | \$ 10,493   | \$ -        | \$ -        | \$ 9,662        | \$ 32,712        |
| Change in actual and expected losses  | (405)            | (8,454)     | (2,052)     | 375         | 67              | (10,469)         |
| Transfer to accretable yield          | (750)            | (2,039)     | 2,052       | (375)       | 1               | (1,111)          |
| <b>Balance at end of period</b>       | <b>\$ 11,402</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 9,730</b> | <b>\$ 21,132</b> |

## Six-Month Period Ended June 30, 2015

## Construction

## &amp;

## Development

## Secured

## by 1-4

## Family

## Residential

## Properties

## (In thousands)

## Accretable Yield Activity:

|  | Loans Secured by 1-4 Family Residential Properties | Commercial and Other Construction | 1-4 Family Residential Properties | Leasing         | Consumer        | Total             |
|--|--|-----------------------------------|-----------------------------------|-----------------|-----------------|-------------------|
| <b>Balance at beginning of period</b>      | \$ 47,636  | \$ 37,919                         | \$ 20,753                         | \$ 2,479        | \$ 1,072        | \$ 109,859        |
| Accretion                                  | (6,794)  | (17,902)                          | (1,024)                           | (2,329)         | (213)           | (28,262)          |
| Transfer from (to) non-accretable discount | 14,964   | 7,456                             | (1,380)                           | 953             | 1,051           | 23,044            |
| <b>Balance at end of period</b>            | <b>\$ 55,806</b>                                   | <b>\$ 27,473</b>                  | <b>\$ 18,349</b>                  | <b>\$ 1,103</b> | <b>\$ 1,910</b> | <b>\$ 104,641</b> |

## Non-Accretable Discount Activity:

|  |                  |             |             |             |                 |                  |
|--|------------------|-------------|-------------|-------------|-----------------|------------------|
| <b>Balance at beginning of period</b>    | \$ 27,348        | \$ 24,464   | \$ -        | \$ -        | \$ 10,598       | \$ 62,410        |
| Change in actual and expected cash flows | (982)            | (17,008)    | (1,380)     | 953         | 183             | (18,234)         |
| Transfer (to) from accretable yield      | (14,964)         | (7,456)     | 1,380       | (953)       | (1,051)         | (23,044)         |
| <b>Balance at end of period</b>          | <b>\$ 11,402</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 9,730</b> | <b>\$ 21,132</b> |

## OFG BANCORP

## NOTES TO 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, 2016 and December 31, 2015:

|   | June 30,<br>2016 |    | December 31,<br>2015 |
|---|------------------|----|----------------------|
|   | (In thousands)   |    |                      |
| <b><u>Originated and other loans and leases held for investment</u></b> |                  |    |                      |
| <b>Mortgage</b>   |                  |    |                      |
| Traditional (by origination year):                                      |                  |    |                      |
| Up to the year 2002   | \$ 2,812         | \$ | 3,786                |
| Years 2003 and 2004   | 6,359            |    | 5,737                |
| Year 2005   | 3,889            |    | 3,627                |
| Year 2006   | 7,135            |    | 8,189                |
| Years 2007, 2008 and 2009   | 11,292           |    | 14,625               |
| Years 2010, 2011, 2012, 2013  | 9,311            |    | 10,588               |
| Years 2014, 2015 and 2016   | 963              |    | 663                  |
|   | 41,761           |    | 47,215               |
| Non-traditional   | 5,229            |    | 5,092                |
| Loss mitigation program   | 18,769           |    | 20,172               |
|   | <b>65,759</b>    |    | <b>72,479</b>        |
| Home equity loans, secured personal loans                               | -                |    | 64                   |
|   | <b>65,759</b>    |    | <b>72,543</b>        |
| <b>Commercial</b>   |                  |    |                      |
| Commercial secured by real estate                                       |                  |    |                      |
| Middle market   | 10,969           |    | 12,729               |
| Retail  | 10,352           |    | 8,726                |
|   | 21,321           |    | 21,455               |
| Other commercial and industrial   |                  |    |                      |
| Institutional   | 183,020          |    | 190,290              |
| Middle market   | 1,421            |    | 1,565                |
| Retail  | 1,966            |    | 1,932                |
| Floor plan  | 40               |    | 39                   |
|   | 186,447          |    | 193,826              |
|   | <b>207,768</b>   |    | <b>215,281</b>       |
| <b>Consumer</b>   |                  |    |                      |
| Credit cards  | 432              |    | 369                  |
| Personal lines of credit  | 94               |    | 100                  |
| Personal loans  | 1,812            |    | 1,146                |
| Cash collateral personal loans  | 1                |    | 16                   |
|   | <b>2,339</b>     |    | <b>1,631</b>         |
| <b>Auto and leasing</b>   | <b>7,337</b>     |    | <b>8,418</b>         |

|   |    |                |    |                |
|---|----|----------------|----|----------------|
| <b>Total non-accrual originated loans</b> | \$ | <b>283,203</b> | \$ | <b>297,873</b> |
|---|----|----------------|----|----------------|

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|   | June 30,<br>2016  | December<br>31,<br>2015 |
|---|-------------------|-------------------------|
|   | (In thousands)    |                         |
| <b><u>Acquired BBVAPR loans accounted for under ASC 310-20</u></b>            |                   |                         |
| <b>Commercial</b>   |                   |                         |
| Commercial secured by real estate   |                   |                         |
| Retail  | \$ 197            | \$ 228                  |
| Floor plan  | 446               | 467                     |
|   | 643               | 695                     |
| Other commercial and industrial   |                   |                         |
| Retail  | 120               | 178                     |
| Floor plan  | 7                 | 7                       |
|   | 127               | 185                     |
|   | <b>770</b>        | <b>880</b>              |
| <b>Consumer</b>   |                   |                         |
| Credit cards  | 704               | 489                     |
| Personal loans  | 60                | 46                      |
|   | <b>764</b>        | <b>535</b>              |
| <b>Auto</b>   | <b>562</b>        | <b>831</b>              |
| <b>Total non-accrual acquired BBVAPR loans accounted for under ASC 310-20</b> | <b>2,096</b>      | <b>2,246</b>            |
| <b>Total non-accrual loans</b>  | <b>\$ 285,299</b> | <b>\$ 300,119</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 or are accounted for under the cost recovery method.

Delinquent residential mortgage loans insured or guaranteed under applicable Federal Housing Administration ("FHA") and U.S. Department of Veterans Affairs ("VA") programs are classified as non-performing loans when they become 90 days or more past due, but are not placed in non-accrual status until they become 18 months or more past due, since they are insured loans. Therefore, these loans are included as non-performing loans but excluded from non-accrual loans.

During the first quarter of 2015, the revolving line of credit to PREPA was classified as non-accrual. At June 30, 2016, this line of credit had an unpaid principal balance of \$183.0 million. Since the second quarter of 2015, interest payments have been applied to principal. As of June 30, 2016, the specific reserve for the PREPA line of credit is \$53.3 million.

At June 30, 2016 and December 31, 2015, loans whose terms have been extended and which are classified as troubled-debt restructurings that are not included in non-accrual loans amounted to \$97.2 million and \$93.6 million, respectively, as they are performing under their new terms.

## OFG BANCORP

## NOTES TO 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 \$219.4 million and \$235.8 million at June 30, 2016 and December 31, 2015, respectively. Impaired commercial loans at June 30, 2016 and December 31, 2015 included the PREPA line of credit with an unpaid principal balance of \$183.0 million and \$190.3 million, 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 \$56.8 million at June 30, 2016 and \$55.9 million at December 31, 2015. The valuation allowance for impaired commercial loans at June 30, 2016 and December 31, 2015 included \$53.3 million of specific allowance for PREPA. The total investment in impaired mortgage loans was \$90.9 million and \$90.0 million at June 30, 2016 and December 31, 2015, 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 \$8.9 million at June 30, 2016 and \$9.2 million at December 31, 2015.

*Originated and Other Loans and Leases Held for Investment*

The Company's recorded investment in 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, 2016 and December 31, 2015 are as follows:

|   | <b>Unpaid<br/>Principal</b> | <b>June 30, 2016<br/>Recorded<br/>Investment<br/>(In thousands)</b> | <b>Related<br/>Allowance</b> | <b>Coverage</b> |
|---|-----------------------------|---|------------------------------|-----------------|
| Impaired loans with specific allowance:                 |                             |   |                              |                 |
| Commercial  | \$ 212,876                  | \$ 194,084  | \$ 56,758                    | 29%             |
| Residential impaired and troubled-debt<br>restructuring | 99,145                      | 90,948  | 8,864                        | 10%             |
| Impaired loans with no specific allowance:              |                             |   |                              |                 |
| Commercial  | 30,228                      | 23,876  | -                            | 0%              |
| <b>Total investment in impaired loans</b>               | <b>\$ 342,249</b>           | <b>\$ 308,908</b>   | <b>\$ 65,622</b>             | <b>21%</b>      |

|  | <b>Unpaid<br/>Principal</b> | <b>December 31, 2015<br/>Recorded<br/>Investment<br/>(In thousands)</b> | <b>Related<br/>Allowance</b> | <b>Coverage</b> |
|--|-----------------------------|---|------------------------------|-----------------|
|--|-----------------------------|---|------------------------------|-----------------|

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|  |    |                |    |                |                             |
|--|----|----------------|----|----------------|-----------------------------|
| Impaired loans with specific allowance:              |    |                |    |                |                             |
| Commercial   | \$ | 210,718        | \$ | 199,366        | \$ 55,947 28%               |
| Residential impaired and troubled-debt restructuring |    | 97,424         |    | 89,973         | 9,233 10%                   |
| Impaired loans with no specific allowance            |    |                |    |                |                             |
| Commercial   |    | 42,110         |    | 35,928         | - 0%                        |
| <b>Total investment in impaired loans</b>            | \$ | <b>350,252</b> | \$ | <b>325,267</b> | \$ <b>65,180</b> <b>20%</b> |



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

The Company's recorded investment in acquired BBVAPR commercial 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, 2016 and December 31, 2015 are as follows:

|   | June 30, 2016       |  |                      |           |
|---|---------------------|--|----------------------|-----------|
|   | Unpaid<br>Principal | Recorded<br>Investment<br>(In thousands) | Related<br>Allowance | Coverage  |
| Impaired loans with no specific allowance |                     |  |                      |           |
| Commercial                                | \$ 1,450            | \$ 1,433                                 | \$ -                 | 0%        |
| <b>Total investment in impaired loans</b> | <b>\$ 1,450</b>     | <b>\$ 1,433</b>                          | <b>\$ -</b>          | <b>0%</b> |

|   | December 31, 2015   |  |                       |           |
|---|---------------------|--|-----------------------|-----------|
|   | Unpaid<br>Principal | Recorded<br>Investment<br>(In thousands) | Specific<br>Allowance | Coverage  |
| Impaired loans with no specific allowance |                     |  |                       |           |
| Commercial                                | \$ 486              | \$ 474                                   | \$ -                  | 0%        |
| <b>Total investment in impaired loans</b> | <b>\$ 486</b>       | <b>\$ 474</b>                            | <b>\$ -</b>           | <b>0%</b> |

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

The Company's recorded investment in acquired BBVAPR loan pools accounted for under ASC 310-30 that have recorded impairments and their related allowance for loan and lease losses at June 30, 2016 and December 31, 2015 are as follows:

|   | June 30, 2016       |  |           |  |
|---|---------------------|--|-----------|--|
|   | Unpaid<br>Principal | Recorded<br>Investment<br>(In thousands) | Allowance | Coverage<br>to<br>Recorded<br>Investment |
| Impaired loan pools with specific allowance: (a)(b) |                     |  |           |  |
| Mortgage  | \$ 591,029          | \$ 591,056                               | \$ 1,585  | 0%                                       |
| Commercial  | 246,142             | 173,949                                  | 11,884    | 7%                                       |

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|  |                     |                   |                  |           |
|--|---------------------|-------------------|------------------|-----------|
| Construction                                   | 76,677              | 56,457            | 3,979            | 7%        |
| Auto   | 117,038             | 117,043           | 5,353            | 5%        |
| <b>Total investment in impaired loan pools</b> | <b>\$ 1,030,886</b> | <b>\$ 938,505</b> | <b>\$ 22,801</b> | <b>2%</b> |

(a) Current period amounts have been re-measured using the revised derecognition policy for purchased credit impaired loans.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | December 31, 2015   |                     |                  | Coverage<br>to<br>Recorded<br>Investment |
|--|---------------------|---------------------|------------------|--|
|  | Unpaid              | Recorded            |                  |  |
|  | Principal           | Investment          | Allowance        |  |
|  |                     |                     |                  |  |
|  |                     | (In thousands)      |                  |  |
| Impaired loan pools with specific allowance:   |                     |                     |                  |  |
| Mortgage                                       | \$ 608,294          | \$ 608,294          | \$ 1,761         | 0%                                       |
| Commercial                                     | 287,311             | 168,107             | 15,455           | 9%                                       |
| Construction                                   | 88,180              | 87,983              | 5,707            | 6%                                       |
| Auto   | 153,592             | 153,592             | 2,862            | 2%                                       |
| <b>Total investment in impaired loan pools</b> | <b>\$ 1,137,377</b> | <b>\$ 1,017,976</b> | <b>\$ 25,785</b> | <b>3%</b>                                |

The tables above only present information with respect to acquired BBVAPR loans and pools accounted for under ASC 310-30 if there is a recorded impairment to such loans or loan pools and a specific allowance for loan losses.

Acquired Eurobank Loans

The Company's recorded investment in acquired Eurobank loan pools that have recorded impairments and their related allowance for loan and lease losses as of June 30, 2016 and December 31, 2015 are as follows:

|   | June 30, 2016     |                   |                  | Coverage<br>to<br>Recorded<br>Investment |
|---|-------------------|-------------------|------------------|--|
|   | Unpaid            | Recorded          |                  |  |
|   | Principal         | Investment        | Allowance        |  |
|   |                   |                   |                  |  |
|   |                   | (In thousands)    |                  |  |
| Impaired loan pools with specific allowance: (a)(b) |                   |                   |                  |  |
| Loans secured by 1-4 family residential properties  | \$ 95,755         | \$ 76,777         | \$ 11,016        | 14%                                      |
| Commercial and construction                         | 114,932           | 83,377            | 11,096           | 13%                                      |
| Consumer  | 1,252             | 1,410             | 4                | 0%                                       |
| <b>Total investment in impaired loan pools</b>      | <b>\$ 211,939</b> | <b>\$ 161,564</b> | <b>\$ 22,116</b> | <b>14%</b>                               |

(a) Current period amounts have been re-measured using the revised derecognition policy for purchased credit impaired loans.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

|  | <b>December 31, 2015</b>    |   |                               | <b>Coverage<br/>to<br/>Recorded<br/>Investment</b> |
|--|-----------------------------|---|-------------------------------|--|
|  | <b>Unpaid<br/>Principal</b> | <b>Recorded<br/>Investment<br/>(In thousands)</b> | <b>Specific<br/>Allowance</b> |  |
| Impaired loan pools with specific allowance        |                             |   |                               |  |
| Loans secured by 1-4 family residential properties | \$ 101,444                  | \$ 92,273   | \$ 22,570                     | 24%  |
| Commercial and construction                        | 133,148                     | 142,377   | 67,365                        | 47%  |
| Consumer   | 6,713                       | 2,314   | 243                           | 11%  |
| <b>Total investment in impaired loan pools</b>     | <b>\$ 241,305</b>           | <b>\$ 236,964</b>                                 | <b>\$ 90,178</b>              | <b>38%</b>   |

The tables above only present information with respect to acquired Eurobank loans and loan pools accounted for under ASC 310-30 if there is a recorded impairment to such loans or loan pools and a specific allowance for loan losses.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the interest recognized in 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, 2016 and 2015:

|  | Quarter Ended June 30,           |   |                                  |                                   |
|--|----------------------------------|---|----------------------------------|-----------------------------------|
|  | 2016                             |   | 2015                             |                                   |
|  | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment<br>(In thousands) | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment |
| <b>Originated and other loans held for investment:</b> |                                  |   |                                  |                                   |
| Impaired loans with specific allowance                 |                                  |   |                                  |                                   |
| Commercial   | \$ 75                            | \$ 194,759  | \$ 45                            | \$ 212,414                        |
| Residential troubled-debt restructuring                | 791                              | 91,007  | 781                              | 89,041                            |
| Impaired loans with no specific allowance              |                                  |   |                                  |                                   |
| Commercial   | 149                              | 29,579  | 316                              | 30,015                            |
|  | <b>1,015</b>                     | <b>315,345</b>                                      | <b>1,142</b>                     | <b>331,470</b>                    |
| <b>Acquired loans accounted for under ASC 310-20:</b>  |                                  |   |                                  |                                   |
| Impaired loans with no specific allowance              |                                  |   |                                  |                                   |
| Commercial   | 15                               | 789   | 11                               | 1,446                             |
| <b>Total interest income from impaired loans</b>       | <b>\$ 1,030</b>                  | <b>\$ 316,134</b>                                   | <b>\$ 1,153</b>                  | <b>\$ 332,916</b>                 |

|  | Six-Month Period Ended June 30,  |   |                                  |                                   |
|--|----------------------------------|---|----------------------------------|-----------------------------------|
|  | 2016                             |   | 2015                             |                                   |
|  | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment<br>(In thousands) | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment |
| <b>Originated and other loans held for investment:</b> |                                  |   |                                  |                                   |
| Impaired loans with specific allowance                 |                                  |   |                                  |                                   |
| Commercial   | \$ 150                           | \$ 195,777  | \$ 90                            | \$ 146,144                        |
| Residential troubled-debt restructuring                | 1,591                            | 90,650  | 1,563                            | 91,216                            |
| Impaired loans with no specific allowance              |                                  |   |                                  |                                   |
| Commercial   | 298                              | 31,603  | 631                              | 95,791                            |
| <b>Total interest income from impaired loans</b>       | <b>\$ 2,039</b>                  | <b>\$ 318,030</b>                                   | <b>\$ 2,284</b>                  | <b>\$ 333,151</b>                 |
| <b>Acquired loans accounted for under SC 310-20:</b>   |                                  |   |                                  |                                   |
| Impaired loans with no specific allowance              |                                  |   |                                  |                                   |
| Commercial   | 30                               | 628   | 21                               | 1,923                             |
| <b>Total interest income from impaired loans</b>       | <b>\$ 2,069</b>                  | <b>\$ 318,658</b>                                   | <b>\$ 2,305</b>                  | <b>\$ 335,074</b>                 |



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Modifications*

The following tables present the troubled-debt restructurings during the quarters and six-month periods ended June 30, 2016 and 2015.

|            | Quarter Ended June 30, 2016                   |   |  |   |  |   |  |
|------------|---|---|--|---|--|---|--|
|            | Pre-Modification<br>Number<br>of<br>contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Pre-Modification<br>Weighted<br>Average Rate | Pre-Modification<br>Weighted<br>Average Term<br>(in Months) | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Weighted<br>Average Rate | Post-Modification<br>Weighted<br>Average Term (in<br>Months) |
| Mortgage   | 19  | \$ 2,670  | 5.69%  | 372   | \$ 2,670   | 4.54%   | 494  |
| Commercial | 6   | 668   | 6.65%  | 65  | 668  | 5.91%   | 86   |
| Consumer   | 26  | 364   | 12.73%                                       | 75  | 372  | 10.20%  | 70   |

|            | Six-Month Period Ended June 30, 2016          |   |  |   |  |   |  |
|------------|---|---|--|---|--|---|--|
|            | Pre-Modification<br>Number<br>of<br>contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Pre-Modification<br>Weighted<br>Average Rate | Pre-Modification<br>Weighted<br>Average Term<br>(in Months) | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Weighted<br>Average Rate | Post-Modification<br>Weighted<br>Average Term (in<br>Months) |
| Mortgage   | 52  | \$ 6,628  | 5.90%  | 365   | \$ 7,525   | 4.73%   | 493  |
| Commercial | 8   | 1,323   | 6.73%  | 53  | 1,324  | 6.31%   | 61   |
| Consumer   | 47  | 556   | 13.27%                                       | 75  | 603  | 10.56%  | 71   |

|            | Quarter Ended June 30, 2015                   |   |  |   |  |   |  |
|------------|---|---|--|---|--|---|--|
|            | Pre-Modification<br>Number<br>of<br>contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Pre-Modification<br>Weighted<br>Average Rate | Pre-Modification<br>Weighted<br>Average Term<br>(in Months) | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Weighted<br>Average Rate | Post-Modification<br>Weighted<br>Average Term (in<br>Months) |
| Mortgage   | 39  | \$ 4,455  | 5.62%  | 330   | \$ 4,455   | 4.21%   | 330  |
| Commercial | 1   | 29  | 7.25%  | 44  | 29   | 6.50%   | 60   |
| Consumer   | 21  | 250   | 14.40%                                       | 71  | 259  | 13.87%  | 69   |
| Auto       | 1   | 64  | 12.95%                                       | 72  | 65   | 12.95%  | 72   |

|  | Six-Month Period Ended June 30, 2015          |   |  |   |  |   |  |
|--|---|---|--|---|--|---|--|
|  | Pre-Modification<br>Number<br>of<br>contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Pre-Modification<br>Weighted<br>Average Rate | Pre-Modification<br>Weighted<br>Average Term<br>(in Months) | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Weighted<br>Average Rate | Post-Modification<br>Weighted<br>Average Term (in<br>Months) |
|  |   |   |  |   |  |   |  |

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|            |    |           |        |     |           |        |     |
|------------|----|-----------|--------|-----|-----------|--------|-----|
| Mortgage   | 97 | \$ 11,609 | 4.65%  | 348 | \$ 11,594 | 4.13%  | 349 |
| Commercial | 4  | 4,533     | 6.83%  | 80  | 4,533     | 7.00%  | 141 |
| Consumer   | 32 | 396       | 14.50% | 72  | 440       | 14.25% | 68  |
| Auto       | 1  | 64        | 12.95% | 72  | 65        | 12.95% | 72  |



## OFG BANCORP

## NOTES TO 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, 2016 and 2015:

|          | Twelve-Month Period Ended June 30, |  |                        |                        |
|----------|------------------------------------|--|------------------------|------------------------|
|          | 2016                               |  | 2015                   |                        |
|          | Number of<br>Contracts             | Recorded<br>Investment<br>(Dollars in thousands) | Number of<br>Contracts | Recorded<br>Investment |
| Mortgage | 84                                 | \$ 9,869   | 60                     | \$ 6,911               |
| Consumer | 7                                  | \$ 134   | 4                      | \$ 72                  |
| Auto     | 1                                  | \$ 17  | -                      | \$ -                   |

*Credit Quality Indicators*

The Company categorizes 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 CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As of June 30, 2016 and December 31, 2015, and based on the most recent analysis performed, the risk category of gross originated and other loans and BBVAPR acquired loans accounted for under ASC 310-20 subject to risk rating by class of loans is as follows:

|  | Balance             |                     | June 30, 2016      |                 |             |                   | Individually<br>Measured<br>for<br>Impairment |
|--|---------------------|---------------------|--------------------|-----------------|-------------|-------------------|---|
|  |                     |                     | Risk Ratings       |                 |             |                   |   |
|  | Outstanding         | Pass                | Special<br>Mention | Substandard     | Doubtful    |                   |   |
|  | (In thousands)      |                     |                    |                 |             |                   |   |
| <b>Commercial - originated and other loans held for investment</b> |                     |                     |                    |                 |             |                   |   |
| Commercial secured by real estate:                                 |                     |                     |                    |                 |             |                   |   |
| Corporate  | \$ 230,296          | \$ 215,312          | \$ 14,984          | \$ -            | \$ -        | \$ -              |   |
| Institutional  | 27,838              | 26,200              | -                  | -               | -           | 1,638             |   |
| Middle market  | 220,096             | 188,700             | 17,697             | 374             | -           | 13,325            |   |
| Retail   | 246,691             | 222,814             | 7,468              | 4,128           | -           | 12,281            |   |
| Floor plan   | 2,826               | 2,826               | -                  | -               | -           | -                 |   |
| Real estate  | 16,079              | 16,079              | -                  | -               | -           | -                 |   |
|  | 743,826             | 671,931             | 40,149             | 4,502           | -           | 27,244            |   |
| Other commercial and industrial:                                   |                     |                     |                    |                 |             |                   |   |
| Corporate  | 140,192             | 140,192             | -                  | -               | -           | -                 |   |
| Institutional  | 376,278             | 193,258             | -                  | -               | -           | 183,020           |   |
| Middle market  | 105,540             | 95,946              | 5,142              | 181             | -           | 4,271             |   |
| Retail   | 76,965              | 71,933              | 898                | 979             | -           | 3,155             |   |
| Floor plan   | 33,812              | 28,046              | 5,415              | 81              | -           | 270               |   |
|  | 732,787             | 529,375             | 11,455             | 1,241           | -           | 190,716           |   |
| Total  | 1,476,613           | 1,201,306           | 51,604             | 5,743           | -           | 217,960           |   |
| <b>Commercial - acquired loans</b>                                 |                     |                     |                    |                 |             |                   |   |
| <b>(under ASC 310-20)</b>  |                     |                     |                    |                 |             |                   |   |
| Commercial secured by real estate:                                 |                     |                     |                    |                 |             |                   |   |
| Retail   | 197                 | -                   | -                  | 197             | -           | -                 |   |
| Floor plan   | 2,755               | 953                 | 376                | -               | -           | 1,426             |   |
|  | 2,952               | 953                 | 376                | 197             | -           | 1,426             |   |
| Other commercial and industrial:                                   |                     |                     |                    |                 |             |                   |   |
| Retail   | 1,600               | 1,527               | -                  | 73              | -           | -                 |   |
| Floor plan   | 7                   | -                   | -                  | -               | -           | 7                 |   |
|  | 1,607               | 1,527               | -                  | 73              | -           | 7                 |   |
| Total  | 4,559               | 2,480               | 376                | 270             | -           | 1,433             |   |
| <b>Total</b>   | <b>\$ 1,481,172</b> | <b>\$ 1,203,786</b> | <b>\$ 51,980</b>   | <b>\$ 6,013</b> | <b>\$ -</b> | <b>\$ 219,393</b> |   |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | December 31, 2015      |                     |                     |                 |                        | Individually<br>Measured<br>for<br>Impairment |
|--|------------------------|---------------------|---------------------|-----------------|------------------------|---|
|  | Balance<br>Outstanding | Risk Ratings        |                     |                 |                        |   |
|  |                        | Pass                | Special<br>Mentions | Substandard     | Loans<br>in<br>Process |   |
|  |                        | (In thousands)      |                     |                 |                        |   |
| <b>Commercial - originated and other loans held for investment</b> |                        |                     |                     |                 |                        |   |
| Commercial secured by real estate:                                 |                        |                     |                     |                 |                        |   |
| Corporate  | \$ 227,557             | \$ 212,410          | \$ 15,147           | \$ -            | \$ -                   | \$ -  |
| Institutional  | 33,807                 | 25,907              | -                   | -               | -                      | 7,900   |
| Middle market  | 206,948                | 181,916             | 9,697               | -               | -                      | 15,335  |
| Retail   | 241,090                | 217,836             | 7,936               | 5,097           | -                      | 10,221  |
| Floor plan   | 2,892                  | 2,892               | -                   | -               | -                      | -   |
| Real estate  | 16,662                 | 16,662              | -                   | -               | -                      | -   |
|  | 728,956                | 657,623             | 32,780              | 5,097           | -                      | 33,456  |
| Other commercial and industrial:                                   |                        |                     |                     |                 |                        |   |
| Corporate  | 108,582                | 100,826             | -                   | -               | -                      | 7,756   |
| Institutional  | 380,985                | 190,695             | -                   | -               | -                      | 190,290                                       |
| Middle market  | 107,313                | 97,288              | 8,052               | -               | -                      | 1,973   |
| Retail   | 77,797                 | 73,757              | 1,076               | 1,184           | -                      | 1,780   |
| Floor plan   | 38,016                 | 35,862              | 2,115               | -               | -                      | 39  |
|  | 712,693                | 498,428             | 11,243              | 1,184           | -                      | 201,838                                       |
| Total  | 1,441,649              | 1,156,051           | 44,023              | 6,281           | -                      | 235,294                                       |
| <b>Commercial - acquired loans</b>                                 |                        |                     |                     |                 |                        |   |
| <b>(under ASC 310-20)</b>  |                        |                     |                     |                 |                        |   |
| Commercial secured by real estate:                                 |                        |                     |                     |                 |                        |   |
| Retail   | 228                    | -                   | -                   | 228             | -                      | -   |
| Floor plan   | 2,889                  | 602                 | 1,820               | -               | -                      | 467   |
|  | 3,117                  | 602                 | 1,820               | 228             | -                      | 467   |
| Other commercial and industrial:                                   |                        |                     |                     |                 |                        |   |
| Retail   | 3,724                  | 3,637               | -                   | 87              | -                      | -   |
| Floor plan   | 616                    | 609                 | -                   | -               | -                      | 7   |
|  | 4,340                  | 4,246               | -                   | 87              | -                      | 7   |
| Total  | 7,457                  | 4,848               | 1,820               | 315             | -                      | 474   |
| <b>Total</b>   | <b>\$ 1,449,106</b>    | <b>\$ 1,160,899</b> | <b>\$ 45,843</b>    | <b>\$ 6,596</b> | <b>\$ -</b>            | <b>\$ 235,768</b>                             |

**OFG BANCORP**

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

At June 30, 2016 and December 31, 2015, the Company had outstanding credit facilities of approximately \$398.6 million and \$415.4 million, respectively, granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities, included within the portfolios of originated and other loans and acquired BBVAPR loans accounted for under ASC 310-30. A substantial portion of the Company's credit exposure to Puerto Rico's government consists of collateralized loans or obligations that have a specific source of income or revenues identified for their repayment. Approximately \$204 million of these loans are general obligations of municipalities secured by *ad valorem* taxation, without limitation as to rate or amount, on all taxable property within the issuing municipalities. The good faith, credit and unlimited taxing power of each issuing municipality are pledged for the payment of its general obligations.

At June 30, 2016, we had approximately \$194.4 million of credit facilities to central government and public corporations of the Commonwealth, including:

- PREPA with an outstanding balance of \$183.0 million; and
- The Puerto Rico Housing Finance Authority ("PRHFA") with an outstanding balance of \$11.0 million to be repaid from abandoned or unclaimed funds at financial institutions that revert to the government under a Puerto Rico escheat law.

The outstanding balance of credit facilities to central government and public corporations decreased by \$10.0 million during the first quarter of 2016 as a result of a partial repayment by PRHFA.

Oriental Bank is part of a four bank syndicate that provided a \$550 million revolving line of credit to finance the purchase of fuel for PREPA's day-to-day power generation activities. Our participation in the line of credit has an unpaid principal balance of \$183.0 million as of June 30, 2016. As part of the bank syndicate, the Bank entered into a Restructuring Support Agreement on November 5, 2015 with PREPA and certain other creditors. The Restructuring Support Agreement provides for the restructuring of the fuel line of credit subject to the accomplishment of several milestones, including some milestones that depend on the actions of third parties to the agreement, such as the negotiation of agreements with other creditors and legislative action. The Company expects the restructuring to be completed by the end of 2016. The Company conducted an impairment analysis considering the probability of collection of principal and interest, which included a financial model to project the future liquidity status of PREPA under various scenarios and its capacity to service its financial obligations, and concluded that PREPA had sufficient cash flows for the repayment of the line of credit. Despite the Company's analysis showing PREPA's capacity to repay the line of credit, the Company classifies this participation in the substandard risk category and non-accrual and has a \$53.3 million allowance for loan and lease losses recorded for this line of credit. Since April 1, 2015, interest payments have been applied to principal.



## OFG BANCORP

## NOTES TO 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, 2016 and December 31, 2015, and based on the most recent analysis performed, the risk category of gross originated and other loans and acquired BBVAPR loans accounted for under ASC 310-20 not subject to risk rating by class of loans is as follows:

|   | June 30, 2016<br>Delinquency |                |              |               |              |               |               | Individually<br>Measured<br>for<br>Impairment |
|---|------------------------------|----------------|--------------|---------------|--------------|---------------|---------------|---|
|   | Balance<br>Outstanding       | 0-29 days      | 30-59 days   | 60-89 days    | 90-119 days  | 120-364 days  | 365+ days     |   |
| (In thousands)  |                              |                |              |               |              |               |               |   |
| <b><u>Originated and other loans and leases held for investment</u></b> |                              |                |              |               |              |               |               |   |
| <b>Mortgage</b>   |                              |                |              |               |              |               |               |   |
| Traditional   |                              |                |              |               |              |               |               |   |
| (by origination year)   |                              |                |              |               |              |               |               |   |
| Up to the year 2002   | \$ 54,058                    | \$ 48,163      | \$ 259       | \$ 2,023      | \$ 527       | \$ 1,153      | \$ 1,292      | \$ 641  |
| Years 2003 and 2004   | 94,753                       | 82,651         | 343          | 3,936         | 1,864        | 1,859         | 2,312         | 1,788   |
| Year 2005   | 52,061                       | 45,538         | -            | 1,878         | 497          | 918           | 2,410         | 820   |
| Year 2006   | 73,886                       | 60,860         | 511          | 2,244         | 554          | 1,603         | 4,584         | 3,530   |
| Years 2007, 2008  | 84,018                       | 66,997         | 703          | 1,286         | 569          | 1,724         | 8,898         | 3,841   |
| and 2009  |                              |                |              |               |              |               |               |   |
| Years 2010, 2011, 2012  |                              |                |              |               |              |               |               |   |
| 2013  | 144,751                      | 132,451        | 407          | 1,203         | 182          | 1,581         | 5,132         | 3,795   |
| Years 2014, 2015 and 2016   | 99,361                       | 98,270         | -            | 189           | 140          | 398           | 364           | -   |
|   | 602,888                      | 534,930        | 2,223        | 12,759        | 4,333        | 9,236         | 24,992        | 14,415  |
| Non-traditional   | 26,195                       | 20,040         | -            | 938           | 564          | 1,999         | 2,654         | -   |
| Loss mitigation program   | 104,081                      | 18,865         | 1,692        | 1,381         | 940          | 1,306         | 3,364         | 76,533  |
|   | 733,164                      | 573,835        | 3,915        | 15,078        | 5,837        | 12,541        | 31,010        | 90,948  |
| Home equity secured   |                              |                |              |               |              |               |               |   |
| personal loans  | 384                          | 384            | -            | -             | -            | -             | -             | -   |
| GNMA's buy-back   | 8,369                        | -              | -            | -             | 1,498        | 3,228         | 3,643         | -   |
| option program  |                              |                |              |               |              |               |               |   |
|   | <b>741,917</b>               | <b>574,219</b> | <b>3,915</b> | <b>15,078</b> | <b>7,335</b> | <b>15,769</b> | <b>34,653</b> | <b>90,948</b>                                 |
| <b>Consumer</b>   |                              |                |              |               |              |               |               |   |
| Credit cards  | 24,877                       | 23,809         | 459          | 177           | 214          | 218           | -             | -   |
| Overdrafts  | 220                          | 204            | 15           | 1             | -            | -             | -             | -   |
|   | 2,431                        | 2,281          | 42           | 14            | 11           | 83            | -             | -   |

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|   |                     |                     |                  |                  |                  |                  |                  |                  |   |
|---|---------------------|---------------------|------------------|------------------|------------------|------------------|------------------|------------------|---|
| Unsecured personal lines of credit                            |                     |                     |                  |                  |                  |                  |                  |                  |   |
| Unsecured personal loans                                      | 221,648             | 217,759             | 1,854            | 1,137            | 898              | -                | -                | -                | - |
| Cash collateral personal loans                                | 16,093              | 16,026              | 63               | 3                | -                | 1                | -                | -                | - |
|   | <b>265,269</b>      | <b>260,079</b>      | <b>2,433</b>     | <b>1,332</b>     | <b>1,123</b>     | <b>302</b>       | -                | -                | - |
| <b>Auto and Leasing</b>                                       | <b>712,268</b>      | <b>641,075</b>      | <b>44,433</b>    | <b>19,438</b>    | <b>5,492</b>     | <b>1,830</b>     | -                | -                | - |
|   | <b>1,719,454</b>    | <b>1,475,373</b>    | <b>50,781</b>    | <b>35,848</b>    | <b>13,950</b>    | <b>17,901</b>    | <b>34,653</b>    | <b>90,948</b>    |   |
| <b><u>Acquired loans (accounted for under ASC 310-20)</u></b> |                     |                     |                  |                  |                  |                  |                  |                  |   |
| <b>Consumer</b>   |                     |                     |                  |                  |                  |                  |                  |                  |   |
| Credit cards  | 32,298              | 30,573              | 731              | 290              | 290              | 414              | -                | -                | - |
| Personal loans  | 2,896               | 2,707               | 116              | 14               | 26               | 33               | -                | -                | - |
|   | <b>35,194</b>       | <b>33,280</b>       | <b>847</b>       | <b>304</b>       | <b>316</b>       | <b>447</b>       | -                | -                | - |
| <b>Auto</b>   | <b>77,118</b>       | <b>69,272</b>       | <b>5,088</b>     | <b>2,196</b>     | <b>412</b>       | <b>150</b>       | -                | -                | - |
|   | <b>112,312</b>      | <b>102,552</b>      | <b>5,935</b>     | <b>2,500</b>     | <b>728</b>       | <b>597</b>       | -                | -                | - |
| <b>Total</b>  | <b>\$ 1,831,766</b> | <b>\$ 1,577,925</b> | <b>\$ 56,716</b> | <b>\$ 38,348</b> | <b>\$ 14,678</b> | <b>\$ 18,498</b> | <b>\$ 34,653</b> | <b>\$ 90,948</b> |   |

39



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2015

## Delinquency

|  | Balance        |                |               |               |              |               |               | Individually<br>Measured<br>for<br>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  |                |                |               |               |              |               |               |   |
| (by origination year)  |                |                |               |               |              |               |               |   |
| Up to the year 2002  | \$ 57,789      | \$ 50,912      | \$ 82         | \$ 2,218      | \$ 530       | \$ 1,504      | \$ 1,858      | \$ 685  |
| Years 2003 and 2004  | 99,446         | 87,060         | 251           | 4,867         | 1,261        | 1,353         | 2,921         | 1,733   |
| Year 2005  | 54,221         | 47,197         | 79            | 2,553         | 292          | 1,068         | 2,189         | 843   |
| Year 2006  | 78,403         | 63,659         | 318           | 2,878         | 1,168        | 1,895         | 4,871         | 3,614   |
| Years 2007, 2008   |                |                |               |               |              |               |               |   |
|  | 91,546         | 71,439         | 170           | 1,665         | 685          | 2,972         | 10,725        | 3,890   |
| and 2009   |                |                |               |               |              |               |               |   |
| Years 2010, 2011, 2012   |                |                |               |               |              |               |               |   |
| 2013   | 150,744        | 134,945        | 569           | 1,611         | 434          | 1,982         | 6,737         | 4,466   |
| Year 2014 and 2015   | 85,856         | 85,128         | -             | 65            | 148          | 281           | 234           | -   |
|  | 618,005        | 540,340        | 1,469         | 15,857        | 4,518        | 11,055        | 29,535        | 15,231  |
| Non-traditional  | 29,552         | 23,497         | -             | 977           | 552          | 2,621         | 1,905         | -   |
| Loss mitigation program  | 101,916        | 16,031         | 4,173         | 1,977         | 727          | 1,728         | 2,538         | 74,742  |
|  | 749,473        | 579,868        | 5,642         | 18,811        | 5,797        | 15,404        | 33,978        | 89,973  |
| Home equity secured  |                |                |               |               |              |               |               |   |
| personal loans   | 410            | 346            | -             | -             | -            | 64            | -             | -   |
| GNMA's buy-back  |                |                |               |               |              |               |               |   |
|  | 7,945          | -              | -             | -             | 1,593        | 3,578         | 2,774         | -   |
| option program   |                |                |               |               |              |               |               |   |
|  | <b>757,828</b> | <b>580,214</b> | <b>5,642</b>  | <b>18,811</b> | <b>7,390</b> | <b>19,046</b> | <b>36,752</b> | <b>89,973</b>                                 |
| <b>Consumer</b>  |                |                |               |               |              |               |               |   |
| Credit cards   | 22,766         | 21,766         | 449           | 182           | 179          | 190           | -             | -   |
| Overdrafts   | 190            | 166            | 24            | -             | -            | -             | -             | -   |
| Unsecured personal lines of credit                               | 2,244          | 2,125          | 74            | -             | 17           | 28            | -             | -   |
| Unsecured personal loans   | 201,156        | 197,339        | 2,083         | 1,107         | 621          | 6             | -             | -   |
| Cash collateral personal loans                                   | 16,594         | 16,450         | 125           | 17            | 2            | -             | -             | -   |
|  | <b>242,950</b> | <b>237,846</b> | <b>2,755</b>  | <b>1,306</b>  | <b>819</b>   | <b>224</b>    | -             | -   |
| <b>Auto and Leasing</b>  | <b>669,163</b> | <b>590,482</b> | <b>53,549</b> | <b>16,839</b> | <b>5,708</b> | <b>2,585</b>  | -             | -   |

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|   |                     |                     |                  |                  |                  |                  |                  |                  |
|---|---------------------|---------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|   | <b>1,669,941</b>    | <b>1,408,542</b>    | <b>61,946</b>    | <b>36,956</b>    | <b>13,917</b>    | <b>21,855</b>    | <b>36,752</b>    | <b>89,973</b>    |
| <b><u>Acquired loans (accounted for under ASC 310-20)</u></b> |                     |                     |                  |                  |                  |                  |                  |                  |
| <b>Consumer</b>   |                     |                     |                  |                  |                  |                  |                  |                  |
| Credit cards  | 35,217              | 33,414              | 930              | 384              | 186              | 303              | -                | -                |
| Personal loans  | 3,168               | 3,079               | 14               | 29               | 1                | 45               | -                | -                |
|   | <b>38,385</b>       | <b>36,493</b>       | <b>944</b>       | <b>413</b>       | <b>187</b>       | <b>348</b>       | -                | -                |
| <b>Auto</b>   | <b>106,911</b>      | <b>96,247</b>       | <b>7,553</b>     | <b>2,279</b>     | <b>623</b>       | <b>209</b>       | -                | -                |
|   | <b>145,296</b>      | <b>132,740</b>      | <b>8,497</b>     | <b>2,692</b>     | <b>810</b>       | <b>557</b>       | -                | -                |
| <b>Total</b>  | <b>\$ 1,815,237</b> | <b>\$ 1,541,282</b> | <b>\$ 70,443</b> | <b>\$ 39,648</b> | <b>\$ 14,727</b> | <b>\$ 22,412</b> | <b>\$ 36,752</b> | <b>\$ 89,973</b> |

## OFG BANCORP

## NOTES TO 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, 2016 and December 31, 2015 was as follows:

|   | June 30,<br>2016  |           | December 31,<br>2015 |
|---|-------------------|-----------|----------------------|
|   | (In thousands)    |           |                      |
| <b>Allowance for loans and lease losses on non-acquired loans:</b>  |                   |           |                      |
| <b>Originated and other loans and leases held for investment:</b>   |                   |           |                      |
| Mortgage  | \$ 18,537         | \$        | 18,352               |
| Commercial  | 63,144            |           | 64,791               |
| Consumer  | 11,771            |           | 11,197               |
| Auto and leasing  | 19,259            |           | 18,261               |
| Unallocated   | 101               |           | 25                   |
| <b>Total allowance for originated and other loans and lease losses</b>  | <b>112,812</b>    |           | <b>112,626</b>       |
| <b>Acquired loans:</b>  |                   |           |                      |
| <b>Acquired BBVAPR loans:</b>   |                   |           |                      |
| <b>Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b>                       |                   |           |                      |
| Commercial  | 21                |           | 26                   |
| Consumer  | 3,002             |           | 3,429                |
| Auto  | 1,464             |           | 2,087                |
|   | <b>4,487</b>      |           | <b>5,542</b>         |
| <b>Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy) (a)</b> |                   |           |                      |
| Mortgage  | 1,585             |           | 1,762                |
| Commercial  | 15,863            |           | 21,161               |
| Auto  | 5,353             |           | 2,862                |
|   | <b>22,801</b>     |           | <b>25,785</b>        |
| <b>Total allowance for acquired BBVAPR loans and lease losses</b>   | <b>27,288</b>     |           | <b>31,327</b>        |
| <b>Acquired Eurobank loans: (a)</b>   |                   |           |                      |
| Loans secured by 1-4 family residential properties  | 11,016            |           | 22,570               |
| Commercial and other construction   | 11,096            |           | 67,365               |
| Consumer  | 4                 |           | 243                  |
| <b>Total allowance for acquired Eurobank loan and lease losses (a)</b>  | <b>22,116</b>     |           | <b>90,178</b>        |
| <b>Total allowance for loan and lease losses (a)</b>  | <b>\$ 162,216</b> | <b>\$</b> | <b>234,131</b>       |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these 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.

Effective June 30, 2016, pursuant to supervisory direction, the Company revised its purchase credit impaired policy for all loans accounted for under ASC 310-30. Under the revised policy, the Company writes-off the loan's recorded investment and derecognizes the associated allowance for loan and lease losses for loans that exit the pools. The revised policy will be implemented prospectively due to the immaterial impact of retrospective adoption. Prior to June 30, 2016, the pool's carrying value and allowance was determined by discounting expected cash flows at the pool's effective yield. The allowance for loan and lease losses was maintained until all of the loans in the pool were paid off or charged-off. The transition to this revised policy on June 30, 2016 resulted in the de-

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

recognition of \$8.5 million and \$72.2 million in the recorded investment balance and associated allowance for loans that had exited the pools for acquired BBVAPR loans and acquired Eurobank loans, respectively, with no impact to the provision for loan and lease losses.

Allowance for Originated and Other Loan and Lease Losses Held for Investment

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

|  | Quarter Ended June 30, 2016 |                  |                  |                  |               |                   |
|--|-----------------------------|------------------|------------------|------------------|---------------|-------------------|
|  | Mortgage                    | Commercial       | Consumer         | Auto and Leasing | Unallocated   | Total             |
| <b>Allowance for loan and lease losses for originated and other loans:</b> |                             |                  |                  |                  |               |                   |
| <b>Balance at beginning of period</b>                                      | \$ 18,784                   | \$ 64,206        | \$ 11,414        | \$ 18,716        | \$ 118        | \$ 113,238        |
| Charge-offs  | (1,374)                     | (833)            | (2,811)          | (8,100)          | -             | (13,118)          |
| Recoveries   | 36                          | 228              | 133              | 3,243            | -             | 3,640             |
| Provision (recapture) for originated and other loans and lease losses      | 1,091                       | (457)            | 3,035            | 5,400            | (17)          | 9,082             |
| <b>Balance at end of period</b>  | <b>\$ 18,537</b>            | <b>\$ 63,144</b> | <b>\$ 11,771</b> | <b>\$ 19,259</b> | <b>\$ 101</b> | <b>\$ 112,812</b> |

|  | Six-Month Period Ended June 30, 2016 |                  |                  |                  |               |                   |
|--|--------------------------------------|------------------|------------------|------------------|---------------|-------------------|
|  | Mortgage                             | Commercial       | Consumer         | Auto and Leasing | Unallocated   | Total             |
| <b>Allowance for loan and lease losses for originated and other loans:</b> |                                      |                  |                  |                  |               |                   |
| <b>Balance at beginning of period</b>                                      | \$ 18,352                            | \$ 64,791        | \$ 11,197        | \$ 18,261        | \$ 25         | \$ 112,626        |
| Charge-offs  | (3,036)                              | (1,844)          | (5,138)          | (16,462)         | -             | (26,480)          |
| Recoveries   | 181                                  | 316              | 235              | 6,222            | -             | 6,954             |
| Provision (recapture) for loan and lease losses                            | 3,040                                | (119)            | 5,477            | 11,238           | 76            | 19,712            |
| <b>Balance at end of period</b>  | <b>\$ 18,537</b>                     | <b>\$ 63,144</b> | <b>\$ 11,771</b> | <b>\$ 19,259</b> | <b>\$ 101</b> | <b>\$ 112,812</b> |

|  | June 30, 2016 |            |          |                  |             |       |
|--|---------------|------------|----------|------------------|-------------|-------|
|  | Mortgage      | Commercial | Consumer | Auto and Leasing | Unallocated | Total |
|  |               |            |          |                  |             |       |

**Allowance for loan and lease losses on originated and other loans:**

Ending allowance balance attributable

to loans:

|                                       |                  |                  |                  |                  |               |
|---------------------------------------|------------------|------------------|------------------|------------------|---------------|
| Individually evaluated for impairment | \$ 8,864         | \$ 56,758        | \$ -             | \$ -             | \$ -          |
| Collectively evaluated for impairment | 9,673            | 6,386            | 11,771           | 19,259           | 101           |
| <b>Total ending allowance balance</b> | <b>\$ 18,537</b> | <b>\$ 63,144</b> | <b>\$ 11,771</b> | <b>\$ 19,259</b> | <b>\$ 101</b> |

**Loans:**

|                                       |                   |                     |                   |                   |               |
|---------------------------------------|-------------------|---------------------|-------------------|-------------------|---------------|
| Individually evaluated for impairment | \$ 90,948         | \$ 217,960          | \$ -              | \$ -              | \$ -          |
| Collectively evaluated for impairment | 650,969           | 1,258,653           | 265,269           | 712,268           | - 2           |
| <b>Total ending loan balance</b>      | <b>\$ 741,917</b> | <b>\$ 1,476,613</b> | <b>\$ 265,269</b> | <b>\$ 712,268</b> | <b>\$ - 3</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | Quarter Ended June 30, 2015 |                  |                  |                     |               |                  |
|--|-----------------------------|------------------|------------------|---------------------|---------------|------------------|
|  | Mortgage                    | Commercial       | Consumer         | Auto and<br>Leasing | Unallocated   | Total            |
|  | (In thousands)              |                  |                  |                     |               |                  |
| <b>Allowance for loan and lease losses for originated and other loans:</b> |                             |                  |                  |                     |               |                  |
| <b>Balance at beginning of period</b>                                      | \$ 18,086                   | \$ 33,123        | \$ 9,405         | \$ 15,762           | \$ 383        | \$ 76,759        |
| Charge-offs  | (1,356)                     | (497)            | (2,309)          | (7,662)             | -             | (11,824)         |
| Recoveries   | 67                          | 219              | 390              | 3,425               | -             | 4,101            |
| Provision for originated and<br>other loans and lease losses               | 1,279                       | 1,934            | 2,978            | 3,539               | 223           | 9,953            |
| <b>Balance at end of period</b>  | <b>\$ 18,076</b>            | <b>\$ 34,779</b> | <b>\$ 10,464</b> | <b>\$ 15,064</b>    | <b>\$ 606</b> | <b>\$ 78,989</b> |

|  | Six-Month Period Ended June 30, 2015 |                  |                  |                     |               |                  |
|--|--------------------------------------|------------------|------------------|---------------------|---------------|------------------|
|  | Mortgage                             | Commercial       | Consumer         | Auto and<br>Leasing | Unallocated   | Total            |
|  | (In thousands)                       |                  |                  |                     |               |                  |
| <b>Allowance for loan and lease losses for originated and other loans:</b> |                                      |                  |                  |                     |               |                  |
| <b>Balance at beginning of year</b>  | \$ 19,679                            | \$ 8,432         | \$ 9,072         | \$ 14,255           | \$ 1          | \$ 51,439        |
| Charge-offs  | (2,770)                              | (1,489)          | (3,985)          | (15,798)            | -             | (24,042)         |
| Recoveries   | 67                                   | 309              | 543              | 6,809               | -             | 7,728            |
| Provision for loan and lease losses  | 1,100                                | 27,527           | 4,834            | 9,798               | 605           | 43,864           |
| <b>Balance at end of year</b>  | <b>\$ 18,076</b>                     | <b>\$ 34,779</b> | <b>\$ 10,464</b> | <b>\$ 15,064</b>    | <b>\$ 606</b> | <b>\$ 78,989</b> |

|   | December 31, 2015 |                     |                   |                     |              |                     |
|---|-------------------|---------------------|-------------------|---------------------|--------------|---------------------|
|   | Mortgage          | Commercial          | Consumer          | Auto and<br>Leasing | Unallocated  | Total               |
|   | (In thousands)    |                     |                   |                     |              |                     |
| <b>Allowance for loan and lease losses on originated and other loans:</b> |                   |                     |                   |                     |              |                     |
| Ending allowance balance attributable<br>to loans:                        |                   |                     |                   |                     |              |                     |
| Individually evaluated for impairment                                     | \$ 9,233          | \$ 55,947           | \$ -              | \$ -                | \$ -         | \$ 65,180           |
| Collectively evaluated for impairment                                     | 9,119             | 8,844               | 11,197            | 18,261              | 25           | 47,446              |
| <b>Total ending allowance balance</b>                                     | <b>\$ 18,352</b>  | <b>\$ 64,791</b>    | <b>\$ 11,197</b>  | <b>\$ 18,261</b>    | <b>\$ 25</b> | <b>\$ 112,626</b>   |
| <b>Loans:</b>   |                   |                     |                   |                     |              |                     |
| Individually evaluated for impairment                                     | \$ 89,973         | \$ 235,294          | \$ -              | \$ -                | \$ -         | \$ 335,267          |
| Collectively evaluated for impairment                                     | 667,855           | 1,206,355           | 242,950           | 669,163             | -            | 2,786,323           |
| <b>Total ending loan balance</b>  | <b>\$ 757,828</b> | <b>\$ 1,441,649</b> | <b>\$ 242,950</b> | <b>\$ 669,163</b>   | <b>\$ -</b>  | <b>\$ 3,111,590</b> |





## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Allowance for BBVAPR Acquired Loan LossesLoans 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 BBVAPR acquired loan portfolio, excluding loans accounted for under ASC 310-30, for the periods indicated:

|  | <b>Quarter Ended June 30, 2016</b> |                 |                 |                    |                 |
|--|------------------------------------|-----------------|-----------------|--------------------|-----------------|
|  | <b>Commercial</b>                  | <b>Consumer</b> | <b>Auto</b>     | <b>Unallocated</b> | <b>Total</b>    |
|  | (In thousands)                     |                 |                 |                    |                 |
| <b>Allowance for loan and lease losses</b> |                                    |                 |                 |                    |                 |
| <b>for acquired BBVAPR loans</b>           |                                    |                 |                 |                    |                 |
| <b>accounted for under ASC 310-20:</b>     |                                    |                 |                 |                    |                 |
| <b>Balance at beginning of period</b>      | \$ 23                              | \$ 3,243        | \$ 1,727        | \$ -               | \$ 4,993        |
| Charge-offs                                | (12)                               | (1,013)         | (571)           | -                  | (1,596)         |
| Recoveries                                 | 8                                  | 88              | 446             | -                  | 542             |
| Provision (recapture) for acquired BBVAPR  |                                    |                 |                 |                    |                 |
| loan and lease losses accounted for        | 2                                  | 684             | (138)           | -                  | 548             |
| under ASC 310-20                           |                                    |                 |                 |                    |                 |
| <b>Balance at end of period</b>            | <b>\$ 21</b>                       | <b>\$ 3,002</b> | <b>\$ 1,464</b> | <b>\$ -</b>        | <b>\$ 4,487</b> |

|  | <b>Six-Month Period Ended June 30, 2016</b> |                 |             |                    |              |
|--|---|-----------------|-------------|--------------------|--------------|
|  | <b>Commercial</b>                           | <b>Consumer</b> | <b>Auto</b> | <b>Unallocated</b> | <b>Total</b> |
|  | (In thousands)                              |                 |             |                    |              |
| <b>Allowance for loan and lease losses</b> |   |                 |             |                    |              |
| <b>for acquired BBVAPR loans</b>           |   |                 |             |                    |              |
| <b>accounted for under ASC 310-20:</b>     |   |                 |             |                    |              |
| <b>Balance at beginning of year</b>        | \$ 26                                       | \$ 3,429        | \$ 2,087    | \$ -               | \$ 5,542     |
| Charge-offs                                | (19)  | (1,825)         | (1,308)     | -                  | (3,152)      |
| Recoveries                                 | 40  | 169             | 1,044       | -                  | 1,253        |
| Provision (recapture) for acquired BBVAPR  | (26)  | 1,229           | (359)       | -                  | 844          |

loan and lease losses accounted for

under ASC 310-20

|                               |    |    |    |       |    |       |    |   |    |       |
|-------------------------------|----|----|----|-------|----|-------|----|---|----|-------|
| <b>Balance at end of year</b> | \$ | 21 | \$ | 3,002 | \$ | 1,464 | \$ | - | \$ | 4,487 |
|-------------------------------|----|----|----|-------|----|-------|----|---|----|-------|

|  |    | Commercial     | Consumer | Auto          | Unallocated | Total         |    |          |    |                |
|--|----|----------------|----------|---------------|-------------|---------------|----|----------|----|----------------|
|  |    | June 30, 2016  |          |               |             |               |    |          |    |                |
|  |    | (In thousands) |          |               |             |               |    |          |    |                |
| <b>Allowance for loan and lease losses</b> |    |                |          |               |             |               |    |          |    |                |
| <b>for acquired BBVAPR loans</b>           |    |                |          |               |             |               |    |          |    |                |
| <b>accounted for under ASC 310-20:</b>     |    |                |          |               |             |               |    |          |    |                |
| Ending allowance balance attributable      |    |                |          |               |             |               |    |          |    |                |
| to loans:                                  |    |                |          |               |             |               |    |          |    |                |
| Collectively evaluated for impairment      | \$ | 21             | \$       | 3,002         | \$          | 1,464         | \$ | -        | \$ | 4,487          |
| <b>Total ending allowance balance</b>      | \$ | <b>21</b>      | \$       | <b>3,002</b>  | \$          | <b>1,464</b>  | \$ | <b>-</b> | \$ | <b>4,487</b>   |
| <b>Loans:</b>                              |    |                |          |               |             |               |    |          |    |                |
| Individually evaluated for impairment      | \$ | 1,433          | \$       | -             | \$          | -             | \$ | -        | \$ | 1,433          |
| Collectively evaluated for impairment      |    | 3,126          |          | 35,194        |             | 77,118        |    | -        |    | 115,438        |
| <b>Total ending loan balance</b>           | \$ | <b>4,559</b>   | \$       | <b>35,194</b> | \$          | <b>77,118</b> | \$ | <b>-</b> | \$ | <b>116,871</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | Quarter Ended June 30, 2015 |                 |                 |             | Total           |
|--|-----------------------------|-----------------|-----------------|-------------|-----------------|
|  | Commercial                  | Consumer        | Auto            | Unallocated |                 |
| (In thousands)                             |                             |                 |                 |             |                 |
| <b>Allowance for loan and lease losses</b> |                             |                 |                 |             |                 |
| <b>for acquired BBVAPR loans</b>           |                             |                 |                 |             |                 |
| <b>accounted for under ASC 310-20:</b>     |                             |                 |                 |             |                 |
| <b>Balance at beginning of period</b>      | \$ 49                       | \$ 1,885        | \$ 3,516        | \$ -        | \$ 5,450        |
| Charge-offs                                | (16)                        | (1,303)         | (1,038)         | -           | (2,357)         |
| Recoveries                                 | 7                           | 429             | 502             | -           | 938             |
| Provision (recapture) for acquired         |                             |                 |                 |             |                 |
| loan and lease losses accounted for        | 14                          | 1,605           | (121)           | -           | 1,498           |
| under ASC 310-20                           |                             |                 |                 |             |                 |
| <b>Balance at end of period</b>            | <b>\$ 54</b>                | <b>\$ 2,616</b> | <b>\$ 2,859</b> | <b>\$ -</b> | <b>\$ 5,529</b> |

|  | Six-Month Period Ended June 30, 2015 |                 |                 |             | Total           |
|--|--------------------------------------|-----------------|-----------------|-------------|-----------------|
|  | Commercial                           | Consumer        | Auto            | Unallocated |                 |
| (In thousands)                             |                                      |                 |                 |             |                 |
| <b>Allowance for loan and lease losses</b> |                                      |                 |                 |             |                 |
| <b>for acquired BBVAPR loans</b>           |                                      |                 |                 |             |                 |
| <b>accounted for under ASC 310-20:</b>     |                                      |                 |                 |             |                 |
| <b>Balance at beginning of year</b>        | \$ 65                                | \$ 1,211        | \$ 3,321        | \$ -        | \$ 4,597        |
| Charge-offs                                | (16)                                 | (2,686)         | (2,304)         | -           | (5,006)         |
| Recoveries                                 | 17                                   | 563             | 1,072           | -           | 1,652           |
| Provision (recapture) for acquired         |                                      |                 |                 |             |                 |
| loan and lease losses accounted for        | (12)                                 | 3,528           | 770             | -           | 4,286           |
| under ASC 310-20                           |                                      |                 |                 |             |                 |
| <b>Balance at end of period</b>            | <b>\$ 54</b>                         | <b>\$ 2,616</b> | <b>\$ 2,859</b> | <b>\$ -</b> | <b>\$ 5,529</b> |

|  | December 31, 2015 |          |      |             | Total |
|--|-------------------|----------|------|-------------|-------|
|  | Commercial        | Consumer | Auto | Unallocated |       |
| (In thousands)                             |                   |          |      |             |       |
| <b>Allowance for loan and lease losses</b> |                   |          |      |             |       |
| <b>for acquired BBVAPR loans</b>           |                   |          |      |             |       |
| <b>accounted for under ASC 310-20:</b>     |                   |          |      |             |       |

Ending allowance balance attributable

to loans:

|                                       |           |           |           |              |           |              |           |          |           |              |
|---------------------------------------|-----------|-----------|-----------|--------------|-----------|--------------|-----------|----------|-----------|--------------|
| Collectively evaluated for impairment | \$        | 26        | \$        | 3,429        | \$        | 2,087        | \$        | -        | \$        | 5,542        |
| <b>Total ending allowance balance</b> | <b>\$</b> | <b>26</b> | <b>\$</b> | <b>3,429</b> | <b>\$</b> | <b>2,087</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>5,542</b> |

**Loans:**

|                                       |           |              |           |               |           |                |           |          |           |                |
|---------------------------------------|-----------|--------------|-----------|---------------|-----------|----------------|-----------|----------|-----------|----------------|
| Individually evaluated for impairment | \$        | 474          | \$        | -             | \$        | -              | \$        | -        | \$        | 474            |
| Collectively evaluated for impairment |           | 6,983        |           | 38,385        |           | 106,911        |           | -        |           | 152,279        |
| <b>Total ending loan balance</b>      | <b>\$</b> | <b>7,457</b> | <b>\$</b> | <b>38,385</b> | <b>\$</b> | <b>106,911</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>152,753</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 acquired BBVAPR loan portfolio accounted for under ASC 310-30, for the periods indicated:

|  | Quarter Ended June 30, 2016 |                  |             |                 | Total            |
|--|-----------------------------|------------------|-------------|-----------------|------------------|
|  | Mortgage                    | Commercial       | Consumer    | Auto            |                  |
|  | (In thousands)              |                  |             |                 |                  |
| <b>Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:</b> |                             |                  |             |                 |                  |
| <b>Balance at beginning of period</b>  | \$ 1,762                    | \$ 20,430        | \$ -        | \$ 5,555        | \$ 27,747        |
| (Recapture) provision for BBVAPR loans and   |                             |                  |             |                 |                  |
| lease losses accounted for   |                             |                  |             |                 |                  |
| under ASC 310-30   | (163)                       | 3,977            | -           | -               | 3,814            |
| Loan pools fully charged-off   | (14)                        | -                | -           | (202)           | (216)            |
| Allowance de-recognition (a)   | -                           | (8,544)          | -           | -               | (8,544)          |
| <b>Balance at end of period</b>  | <b>\$ 1,585</b>             | <b>\$ 15,863</b> | <b>\$ -</b> | <b>\$ 5,353</b> | <b>\$ 22,801</b> |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

|  | Six-Month Period Ended June 30, 2016 |                  |             |                 | Total            |
|--|--------------------------------------|------------------|-------------|-----------------|------------------|
|  | Mortgage                             | Commercial       | Consumer    | Auto            |                  |
|  | (In thousands)                       |                  |             |                 |                  |
| <b>Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:</b> |                                      |                  |             |                 |                  |
| <b>Balance at beginning of period</b>  | \$ 1,678                             | \$ 21,245        | \$ -        | \$ 2,862        | \$ 25,785        |
| (Recapture) provision for BBVAPR loans and   |                                      |                  |             |                 |                  |
| lease losses accounted for   |                                      |                  |             |                 |                  |
| under ASC 310-30   |                                      |                  |             |                 |                  |
| Loan pools fully charged-off   | (14)                                 | (66)             | -           | (202)           | (282)            |
| Allowance de-recognition (a)   | -                                    | (8,544)          | -           | -               | (8,544)          |
| <b>Balance at end of period</b>  | <b>\$ 1,585</b>                      | <b>\$ 15,863</b> | <b>\$ -</b> | <b>\$ 5,353</b> | <b>\$ 22,801</b> |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | <b>Quarter Ended June 30, 2015</b> |                   |                 |                 |                  |
|--|------------------------------------|-------------------|-----------------|-----------------|------------------|
|  | <b>Mortgage</b>                    | <b>Commercial</b> | <b>Consumer</b> | <b>Auto</b>     | <b>Total</b>     |
|  | <b>(In thousands)</b>              |                   |                 |                 |                  |
| <b>Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:</b> |                                    |                   |                 |                 |                  |
| <b>Balance at beginning of period</b>  | \$ 473                             | \$ 13,687         | \$ 6            | \$ -            | \$ 14,166        |
| Provision for acquired BBVAPR loans and lease losses accounted for under ASC 310-30                  | -                                  | 1,253             | 78              | 2,862           | 4,193            |
| <b>Balance at end of period</b>  | <b>\$ 473</b>                      | <b>\$ 14,940</b>  | <b>\$ 84</b>    | <b>\$ 2,862</b> | <b>\$ 18,359</b> |

|  | <b>Six-Month Period Ended June 30, 2015</b> |                   |                 |                 |                  |
|--|---|-------------------|-----------------|-----------------|------------------|
|  | <b>Mortgage</b>                             | <b>Commercial</b> | <b>Consumer</b> | <b>Auto</b>     | <b>Total</b>     |
|  | <b>(In thousands)</b>                       |                   |                 |                 |                  |
| <b>Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:</b> |   |                   |                 |                 |                  |
| <b>Balance at beginning of period</b>  | \$ -  | \$ 13,476         | \$ 5            | \$ -            | \$ 13,481        |
| Provision for acquired BBVAPR loans and lease losses accounted for under ASC 310-30                  | 473   | 1,464             | 79              | 2,862           | 4,878            |
| <b>Balance at end of period</b>  | <b>\$ 473</b>                               | <b>\$ 14,940</b>  | <b>\$ 84</b>    | <b>\$ 2,862</b> | <b>\$ 18,359</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Allowance for Acquired Eurobank Loan Losses

For loans accounted for under ASC 310-30, 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 acquired Eurobank loans for the quarters and six-month periods ended June 30, 2016 and 2015 were as follows:

|  | <b>Quarter Ended June 30, 2016</b>  |  |                 |                |                  |
|--|---|--|-----------------|----------------|------------------|
|  | <b>Loans<br/>Secured<br/>by 1-4<br/>Family<br/>Residential<br/>Properties</b> | <b>Commercial<br/>and<br/>Construction</b> | <b>Consumer</b> | <b>Leasing</b> | <b>Total</b>     |
|  | (In thousands)  |  |                 |                |                  |
| <b>Allowance for loan and lease losses for acquired Eurobank loans:</b>      |   |  |                 |                |                  |
| <b>Balance at beginning of period</b>  | \$ 23,961   | \$ 68,089                                  | \$ 243          | \$ -           | \$ 92,293        |
| Provision (recapture) for acquired Eurobank loans and lease losses, net      | 237   | 801  | (7)             | -              | 1,031            |
| FDIC shared-loss portion of provision for covered loan and lease losses, net | 951   | -  | -               | -              | 951              |
| Allowance de-recognition (a)   | (14,133)  | (57,794)                                   | (232)           | -              | (72,159)         |
| <b>Balance at end of period</b>  | <b>\$ 11,016</b>  | <b>\$ 11,096</b>                           | <b>\$ 4</b>     | <b>\$ -</b>    | <b>\$ 22,116</b> |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

|  | <b>Six-Month Period Ended June 30, 2016</b>                                   |  |                 |                |              |
|--|---|--|-----------------|----------------|--------------|
|  | <b>Loans<br/>Secured<br/>by 1-4<br/>Family<br/>Residential<br/>Properties</b> | <b>Commercial<br/>and<br/>Construction</b> | <b>Consumer</b> | <b>Leasing</b> | <b>Total</b> |

(In thousands)

**Allowance for loan and lease losses for acquired****Eurobank loans:**

|   |    |               |    |               |    |          |    |          |    |               |
|---|----|---------------|----|---------------|----|----------|----|----------|----|---------------|
| <b>Balance at beginning of period</b>             | \$ | 22,570        | \$ | 67,365        | \$ | 243      | \$ | -        | \$ | 90,178        |
| Provision (recapture) for acquired Eurobank loans |    |               |    |               |    |          |    |          |    |               |
| and   |    |               |    |               |    |          |    |          |    |               |
| lease losses, net                                 |    | 184           |    | 1,659         |    | (7)      |    | -        |    | 1,836         |
| FDIC shared-loss portion of provision for covered |    |               |    |               |    |          |    |          |    |               |
| loan and lease losses, net                        |    | 2,395         |    | -             |    | -        |    | -        |    | 2,395         |
| Loan pools fully charged-off                      |    | -             |    | (134)         |    | -        |    | -        |    | (134)         |
| Allowance de-recognition (a)                      |    | (14,133)      |    | (57,794)      |    | (232)    |    | -        |    | (72,159)      |
| <b>Balance at end of year</b>                     | \$ | <b>11,016</b> | \$ | <b>11,096</b> | \$ | <b>4</b> | \$ | <b>-</b> | \$ | <b>22,116</b> |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|  | Quarter Ended June 30, 2015 |                                   |               |             | Total            |
|--|-----------------------------|-----------------------------------|---------------|-------------|------------------|
|  | Mortgage                    | Commercial<br>and<br>Construction | Consumer      | Leasing     |                  |
|  | (In thousands)              |                                   |               |             |                  |
| <b>Allowance for loan and lease losses for acquired Eurobank loans:</b>      |                             |                                   |               |             |                  |
| <b>Balance at beginning of period</b>  | \$ 17,340                   | \$ 52,922                         | \$ 389        | \$ -        | \$ 70,651        |
| Provision (recapture) for Eurobank loans and lease losses, net               | 148                         | (253)                             | -             | -           | (105)            |
| FDIC shared-loss portion of provision for covered loan and lease losses, net | 105                         | 801                               | -             | -           | 906              |
| <b>Balance at end of period</b>  | <b>\$ 17,593</b>            | <b>\$ 53,470</b>                  | <b>\$ 389</b> | <b>\$ -</b> | <b>\$ 71,452</b> |

|  | Six-Month Period Ended June 30, 2015 |                                   |               |             | Total            |
|--|--------------------------------------|-----------------------------------|---------------|-------------|------------------|
|  | Mortgage                             | Commercial<br>and<br>Construction | Consumer      | Leasing     |                  |
|  | (In thousands)                       |                                   |               |             |                  |
| <b>Allowance for loan and lease losses for Eurobank loans:</b>               |                                      |                                   |               |             |                  |
| <b>Balance at beginning of year</b>  | \$ 15,522                            | \$ 48,334                         | \$ 389        | \$ -        | \$ 64,245        |
| Provision for Eurobank loans and lease losses, net                           | 1,966                                | 2,738                             | -             | -           | 4,704            |
| FDIC shared-loss portion of provision for covered loan and lease losses, net | 105                                  | 2,398                             | -             | -           | 2,503            |
| <b>Balance at end of year</b>  | <b>\$ 17,593</b>                     | <b>\$ 53,470</b>                  | <b>\$ 389</b> | <b>\$ -</b> | <b>\$ 71,452</b> |

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

The FDIC loss sharing obligation, related to commercial and other-non single family acquired Eurobank loans expired on June 30, 2015. The coverage for the single family residential loans will expire on June 30, 2020. The remaining covered loans are included as part of acquired Eurobank loans under the name "loans secured by 1-4 family residential properties." At June 30, 2016 and December 31, 2015, allowance for loan losses on loans covered by the FDIC shared-loss agreement amounted to \$11.0 million and \$22.6 million, respectively. The provision for covered loan and lease losses for the quarters ended June 30, 2016 and 2015 was \$237 thousand and a recapture of \$105 thousand, respectively. The provision for covered loan and lease losses for the six-month periods ended June 30, 2016 and 2015 was \$184 thousand and \$4.7 million, respectively.



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

**NOTE 6- FDIC INDEMNIFICATION ASSET, TRUE-UP PAYMENT OBLIGATION, AND FDIC SHARED-LOSS EXPENSE**

In connection with the FDIC-assisted acquisition, the Bank and the FDIC entered into shared-loss agreements pursuant to 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 end of the quarter of the acquisition. The coverage under the commercial shared-loss agreement expired on June 30, 2015. 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 and six-month periods ended June 30, 2016 and 2015:

|  | <b>Quarter Ended June 30,</b> |                  | <b>Six-Month Period Ended</b> |                  |
|--|-------------------------------|------------------|-------------------------------|------------------|
|  | <b>2016</b>                   | <b>2015</b>      | <b>June 30,</b>               | <b>2015</b>      |
|  | (In thousands)                |                  | (In thousands)                |                  |
| <b><u>FDIC indemnification asset:</u></b>            |                               |                  |                               |                  |
| <b>Balance at beginning of period</b>                | \$ 20,923                     | \$ 75,221        | \$ 22,599                     | \$ 97,378        |
| Shared-loss agreements reimbursements from the FDIC  | (332)                         | (24,387)         | (737)                         | (38,087)         |
| Increase in expected credit losses to be             |                               |                  |                               |                  |
| covered under shared-loss agreements, net            | 951                           | 906              | 2,395                         | 2,503            |
| FDIC indemnification asset expense                   | (1,405)                       | (22,512)         | (4,269)                       | (34,733)         |
| Incurred expenses to be reimbursed under shared-loss |                               |                  |                               |                  |
| agreements   | (1,711)                       | (6,524)          | (1,562)                       | (4,357)          |
| <b>Balance at end of period</b>                      | <b>\$ 18,426</b>              | <b>\$ 22,704</b> | <b>\$ 18,426</b>              | <b>\$ 22,704</b> |
| <b><u>True-up payment obligation:</u></b>            |                               |                  |                               |                  |
| <b>Balance at beginning of period</b>                | \$ 25,235                     | \$ 22,844        | \$ 24,658                     | \$ 21,981        |
| Change in true-up payment obligation                 | 537                           | 733              | 1,114                         | 1,596            |
| <b>Balance at end of period</b>                      | <b>\$ 25,772</b>              | <b>\$ 23,577</b> | <b>\$ 25,772</b>              | <b>\$ 23,577</b> |

The FDIC shared-loss expense bears an inverse relationship with a change in the yield of covered loan pools in accordance with ASC 310-30. ASC 310-30 dictates that such pools should be subject to increases in their yield when the present value of the expected cash flows is higher than the pool's carrying balance. When the increases in cash flow expectations are driven by reductions in the expected credit losses, the Bank recognizes that such losses are no longer expected to be collected from the FDIC. Accordingly, the Bank reduces the FDIC indemnification asset by amortizing the reduction in expected collections throughout the remaining life of the underlying pools. This amortization is recognized in the FDIC shared-loss expense account.

The underlying factors that caused an increase in the expected cash flows and resulting reduction in projected losses are derived from the pool-level cash flow forecasts. Credit loss assumptions used to develop each pool-level cash flow forecast are based on the behavior of defaults, recoveries and losses of the corresponding pool of covered loans.

**OFG BANCORP**

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

The FDIC loss-share coverage for the commercial loans was in effect until June 30, 2015. Accordingly, the Company amortized the remaining portion of the FDIC indemnification asset attributable to non-single family loans at the close of the second quarter of 2015. At June 30, 2016 and December 31, 2015, the FDIC indemnification asset reflects only the balance for single family residential mortgage loans.

The Company has owed payments to the FDIC for the recovery of prior claims for commercial loans. At June 30, 2016, the liability for these payments amounted to \$1.1 million and is recorded in other liabilities in the consolidated statements of financial condition until cash is paid to the FDIC. There was no liability at June 30, 2015.

The FDIC indemnification asset expense decreased to \$1.4 million for the quarter ended June 30, 2016 when compared to \$22.5 million for the same period in 2015. The expense of \$4.3 million for the six-month period ended June 30, 2016 represented a decrease of \$30.5 million when compared to \$34.7 million for the same period in 2015. The decrease during the period was principally driven by the expiration of the FDIC loss-share coverage for commercial loans and other non-single family residential loans.

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 estimated liability is included within accrued expenses and other liabilities in the unaudited consolidated statements of financial condition.

This true-up payment obligation may increase if actual and expected losses decline. The Company measures the true-up payment obligation at fair value. The changes in fair value are included as a change in true-up payment obligation within the FDIC shared-loss expense, net, in the unaudited consolidated statements of operations.

The following table provides the fair value and the undiscounted amount of the true-up payment obligation at June 30, 2016 and December 31, 2015:

|                              |    | <b>June 30,<br/>2016</b> |    | <b>December 31,<br/>2015</b> |
|------------------------------|----|--------------------------|----|------------------------------|
|                              |    | <b>(In thousands)</b>    |    |                              |
| Carrying amount (fair value) | \$ | 25,772                   | \$ | 24,658                       |
| Undiscounted amount          | \$ | 33,782                   | \$ | 34,956                       |

In connection with the FDIC-assisted acquisition, the Company recognized an FDIC shared-loss expense, net, in the unaudited consolidated statements of operations, which consists of the following for the quarters and six-month periods ended June 30, 2016 and 2015:

|  | <b>Quarter Ended June 30,</b> |                  | <b>Six-Month Period Ended June</b> |                  |
|--|-------------------------------|------------------|------------------------------------|------------------|
|  | <b>2016</b>                   | <b>2015</b>      | <b>2016</b>                        | <b>2015</b>      |
|  | <b>(In thousands)</b>         |                  | <b>(In thousands)</b>              |                  |
| FDIC indemnification asset expense         | \$ 1,405                      | \$ 22,512        | \$ 4,269                           | \$ 34,733        |
| Change in true-up payment obligation       | 537                           | 733              | 1,114                              | 1,596            |
| Reimbursement to FDIC for recoveries       | 1,478                         | -                | 2,066                              | -                |
| <b>Total FDIC shared-loss expense, net</b> | <b>\$ 3,420</b>               | <b>\$ 23,245</b> | <b>\$ 7,449</b>                    | <b>\$ 36,329</b> |

## NOTE 7 — DERIVATIVES

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the Company's derivative assets and liabilities at June 30, 2016 and December 31, 2015:

|  | <b>June 30,<br/>2016</b> |              | <b>December 31,<br/>2015</b> |
|--|--------------------------|--------------|------------------------------|
|  | <b>(In thousands)</b>    |              |                              |
| <b>Derivative assets:</b>                          |                          |              |                              |
| Options tied to S&P 500 Index                      | \$                       | 187          | \$ 1,170                     |
| Interest rate swaps not designated as hedges       |                          | 1,703        | 1,819                        |
| Interest rate caps                                 |                          | 36           | 32                           |
| Other  |                          | -            | 4                            |
|  | <b>\$</b>                | <b>1,926</b> | <b>\$ 3,025</b>              |
| <b>Derivative liabilities:</b>                     |                          |              |                              |
| Interest rate swaps designated as cash flow hedges | \$                       | 3,656        | \$ 4,307                     |
| Interest rate swaps not designated as hedges       |                          | 1,703        | 1,819                        |
| Interest rate caps                                 |                          | 36           | 32                           |
| Other  |                          | 18           | 4                            |
|  | <b>\$</b>                | <b>5,413</b> | <b>\$ 6,162</b>              |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*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 the cash flow hedges is recognized in other comprehensive income (loss) and is subsequently reclassified into operations 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 (loss) related to these interest rate swaps to operations in the next twelve months.

The following table shows a summary of these swaps and their terms at June 30, 2016:

| Type                | Notional Amount<br>(In thousands) | Fixed Rate | Variable Rate Index | Trade Date | Settlement Date | Maturity Date |
|---------------------|-----------------------------------|------------|---------------------|------------|-----------------|---------------|
| Interest Rate Swaps | \$ 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      |
|                     | 37,290                            | 2.4210%    | 1-Month LIBOR       | 07/03/13   | 07/03/13        | 08/01/23      |
|                     | \$ 237,290                        |            |                     |            |                 |               |

An accumulated unrealized loss of \$3.7 million and \$4.3 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at June 30, 2016 and December 31, 2015, respectively, and the related liability is being reflected in the accompanying unaudited consolidated statements of financial condition.

At June 30, 2016 and December 31, 2015, interest rate swaps not designated as hedging instruments that were offered to clients represented an asset of \$1.7 million and \$1.8 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, 2016 and December 31, 2015, interest rate swaps not designated as hedging instruments that are the mirror-images of the derivatives offered to clients represented a liability of \$1.7 million and \$1.8 million, respectively, and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition.





## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table shows a summary of these interest rate swaps not designated as hedging instruments and their terms at June 30, 2016:

| Type  | Notional Amount<br>(In thousands) | Fixed Rate | Variable Rate Index | Settlement Date | Maturity Date |
|---|-----------------------------------|------------|---------------------|-----------------|---------------|
| <b>Interest Rate Swaps - Derivatives Offered to Clients</b> | \$ 3,682                          | 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>\$ 16,182</b>                  |            |                     |                 |               |
| <b>Interest Rate Swaps - Mirror Image Derivatives</b>       | \$ 3,682                          | 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>\$ 16,182</b>                  |            |                     |                 |               |

*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, 2016 and December 31, 2015, the purchased options used to manage exposure to the S&P 500 Index on stock indexed deposits represented an asset of \$187 thousand (notional amount of \$425 thousand) and \$1.2 million (notional amount of \$3.4 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 \$181 thousand (notional amount of \$411 thousand) and \$1.1 million (notional amount of \$3.2 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. As of June 30, 2016 and December 31, 2015, the outstanding total notional amount of interest rate caps was \$124.5 million and \$109.8 million, respectively. At June 30, 2016 and December 31, 2015, the interest rate caps sold to clients represented a liability of \$36 thousand and \$32 thousand, respectively, and were included as part of derivative liabilities in the unaudited consolidated

statements of financial condition. At June 30, 2016 and December 31, 2015, the interest rate caps purchased as mirror-images represented an asset of \$36 thousand and \$32 thousand, respectively, and were included as part of derivative assets in the unaudited consolidated statements of financial condition.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 8 — ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable at June 30, 2016 and December 31, 2015 consists of the following:

|                                 | <b>June 30,<br/>2016</b> | <b>(In thousands)</b> |    | <b>December 31,<br/>2015</b> |
|---------------------------------|--------------------------|-----------------------|----|------------------------------|
| Loans, excluding acquired loans | \$                       | 16,545                | \$ | 16,020                       |
| Investments                     |                          | 3,464                 |    | 4,617                        |
|                                 | \$                       | <b>20,009</b>         | \$ | <b>20,637</b>                |

Other assets at June 30, 2016 and December 31, 2015 consist of the following:

|  | <b>June 30,<br/>2016</b> | <b>(In thousands)</b> |    | <b>December 31,<br/>2015</b> |
|--|--------------------------|-----------------------|----|------------------------------|
| Prepaid expenses                                   |                          | 16,332                |    | 11,762                       |
| Other repossessed assets                           |                          | 3,866                 |    | 6,226                        |
| Core deposit and customer relationship intangibles |                          | 6,999                 |    | 7,838                        |
| Mortgage tax credits                               |                          | 6,277                 |    | 6,277                        |
| Investment in Statutory Trust                      |                          | 1,083                 |    | 1,083                        |
| Accounts receivable and other assets               |                          | 42,255                |    | 42,786                       |
|  | \$                       | <b>76,812</b>         | \$ | <b>75,972</b>                |

Prepaid expenses amounting to \$16.3 million and \$11.8 million at June 30, 2016 and December 31, 2015, respectively, include prepaid municipal, property and income taxes aggregating to \$11.2 million and \$7.0 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, 2016 and December 31, 2015 this core deposit intangible amounted to \$4.8 million and \$5.3 million, respectively. In addition, the Company recorded a customer relationship intangible representing the value of customer relationships acquired with the acquisition of the securities broker-dealer and insurance agency in the BBVAPR Acquisition. At June 30, 2016 and December 31, 2015 this customer relationship intangible amounted to \$2.2 million and \$2.5 million, respectively.

Other repossessed assets totaled \$3.9 million at June 30, 2016 and \$6.2 million at December 31, 2015, include repossessed automobiles amounting to \$3.7 million and \$5.5 million, respectively, which are recorded at their net realizable value.

At June 30, 2016 and December 31, 2015, mortgage tax credits for the Company totaled \$6.3 million for both periods. These tax credits do not have an expiration date.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 9— DEPOSITS AND RELATED INTEREST

Total deposits, including related accrued interest payable, as of June 30, 2016 and December 31, 2015 consists of the following:

|  | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|--------------------------|------------------------------|
|  | <b>(In thousands)</b>    |                              |
| Non-interest bearing demand deposits         | \$ 917,260               | \$ 762,009                   |
| Interest-bearing savings and demand deposits | 2,165,907                | 2,208,180                    |
| Individual retirement accounts               | 269,189                  | 268,799                      |
| Retail certificates of deposit               | 525,979                  | 441,998                      |
| Institutional certificates of deposit        | 204,074                  | 253,791                      |
| <b>Total core deposits</b>                   | <b>4,082,409</b>         | <b>3,934,777</b>             |
| Brokered deposits                            | 561,645                  | 782,974                      |
| <b>Total deposits</b>                        | <b>\$ 4,644,054</b>      | <b>\$ 4,717,751</b>          |

Brokered deposits include \$495.9 million in certificates of deposits and \$65.7 million in money market accounts at June 30, 2016, and \$711.4 million in certificates of deposits and \$71.6 million in money market accounts at December 31, 2015.

The weighted average interest rate of the Company's deposits was 0.63% and 0.57% at June 30, 2016 and December 31, 2015, respectively. Interest expense for the quarters and six-month periods ended June 30, 2016 and 2015 was as follows:

|                             | <b>Quarter Ended June 30,</b> |                 | <b>Six-Month Period Ended June 30,</b> |                  |
|-----------------------------|-------------------------------|-----------------|--|------------------|
|                             | <b>2016</b>                   | <b>2015</b>     | <b>2016</b>                            | <b>2015</b>      |
|                             | <b>(In thousands)</b>         |                 | <b>(In thousands)</b>                  |                  |
| Demand and savings deposits | \$ 3,184                      | \$ 3,100        | \$ 6,026                               | \$ 6,482         |
| Certificates of deposit     | 4,183                         | 3,504           | 8,465                                  | 7,226            |
|                             | <b>\$ 7,367</b>               | <b>\$ 6,604</b> | <b>\$ 14,491</b>                       | <b>\$ 13,708</b> |

At June 30, 2016 and December 31, 2015, demand and interest-bearing deposits and certificates of deposit included deposits of the Puerto Rico Cash & Money Market Fund, Inc., which amounted to \$104.4 million and \$103.7 million, respectively, with a weighted average rate of 0.77% for both periods, and were collateralized with investment securities with a fair value of \$84.7 million and \$81.6 million, respectively.

At June 30, 2016 and December 31, 2015, time deposits in denominations of \$250 thousand or higher, excluding accrued interest and unamortized discounts, amounted to \$340.9 million and \$376.8 million, respectively. Such amounts include public fund time deposits from various Puerto Rico government municipalities, agencies, and corporations of \$9.2 million and \$7.6 million at a weighted average rate of 0.55% and 0.49% at June 30, 2016 and December 31, 2015, respectively.

At June 30, 2016 and December 31, 2015, total public fund deposits from various Puerto Rico government municipalities, agencies, and corporations amounted to \$88.4 million and \$99.0 million, respectively. These public funds were collateralized with commercial loans amounting to \$410.9 million at June 30, 2016 and December 31, 2015.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Excluding equity indexed options in the amount of \$181 thousand, which are used by the Company to manage its exposure to the S&P 500 Index, and also excluding accrued interest of \$1.8 million and unamortized deposit discount in the amount of \$150 thousand, the scheduled maturities of certificates of deposit at June 30, 2016 and December 31, 2015 are as follows:

|                              | June 30, 2016       |           | December 31, 2015 |
|------------------------------|---------------------|-----------|-------------------|
|                              | (In thousands)      |           |                   |
| Within one year:             |                     |           |                   |
| Three (3) months or less     | \$ 225,512          | \$        | 474,051           |
| Over 3 months through 1 year | 518,304             |           | 501,551           |
|                              | <b>743,816</b>      |           | <b>975,602</b>    |
| Over 1 through 2 years       | 513,092             |           | 454,906           |
| Over 2 through 3 years       | 155,666             |           | 176,406           |
| Over 3 through 4 years       | 36,059              |           | 32,396            |
| Over 4 through 5 years       | 44,340              |           | 33,715            |
|                              | <b>\$ 1,492,973</b> | <b>\$</b> | <b>1,673,025</b>  |

The table of scheduled maturities of certificates of deposits above includes brokered-deposits and individual retirement accounts.

The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans amounted to \$569 thousand as of June 30, 2016 and \$1.5 million as of December 31, 2015.

**NOTE 10 — BORROWINGS AND RELATED INTEREST***Securities Sold under Agreements to Repurchase*

At June 30, 2016, 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, 2016 and December 31, 2015, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of \$1.6 million and \$2.2 million, respectively, were as follows:



|                                       | <b>June 30,<br/>2016</b>     |  | <b>December 31,<br/>2015</b> |  |
|---------------------------------------|------------------------------|--|------------------------------|--|
|                                       | <b>Borrowing<br/>Balance</b> | <b>Fair Value of<br/>Underlying<br/>Collateral</b> | <b>Borrowing<br/>Balance</b> | <b>Fair Value of<br/>Underlying<br/>Collateral</b> |
|                                       | <b>(In thousands)</b>        |  |                              |  |
| JP Morgan Chase Bank NA               | \$ 222,500                   | \$ 231,586   | \$ 262,500                   | \$ 283,483   |
| Credit Suisse Securities<br>(USA) LLC | 402,000                      | 437,103  | 670,000                      | 737,887  |
| <b>Total</b>                          | <b>\$ 624,500</b>            | <b>\$ 668,689</b>                                  | <b>\$ 932,500</b>            | <b>\$ 1,021,370</b>                                |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table shows a summary of the Company's repurchase agreements and their terms, excluding accrued interest in the amount of \$1.6 million, at June 30, 2016:

| Year of Maturity |    | Borrowing<br>Balance<br>(In thousands) | Weighted-<br>Average<br>Coupon | Settlement Date | Maturity<br>Date |
|------------------|----|--|--------------------------------|-----------------|------------------|
| 2016             | \$ | 170,000                                | 1.500%                         | 12/6/2012       | 12/8/2016        |
| 2017             |    | 232,000                                | 4.780%                         | 3/2/2007        | 3/2/2017         |
| 2018             |    | 222,500                                | 1.420%                         | 12/10/2012      | 4/29/2018        |
|                  | \$ | <b>624,500</b>                         | <b>2.690%</b>                  |                 |                  |

The Company's repurchase agreement in the original amount of \$500 million with an original term of ten years, maturing on March 2, 2017, was modified in February 2016 to terminate, before maturity, \$268.0 million of this repurchase agreement at a cost of \$12.0 million, included as a loss on early extinguishment of debt in the unaudited statements of operations. The remaining balance of this repurchase agreement was \$232.0 million at June 30, 2016.

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, 2016 and December 31, 2015. There was no cash collateral at June 30, 2016 and December 31, 2015.

## June 30, 2016

## Market Value of Underlying Collateral

|              | Repurchase<br>Liability | Weighted<br>Average<br>Rate | FNMA and<br>FHLMC<br>Certificates<br>(Dollars in thousands) | GNMA<br>Certificates | US<br>Treasury<br>Treasury<br>Notes | Total      |
|--------------|-------------------------|-----------------------------|---|----------------------|-------------------------------------|------------|
| Over 90 days | \$ 624,500              | 2.69%                       | \$ 646,889  | \$ 1,579             | \$ 20,221                           | \$ 668,689 |

## December 31, 2015

## Market Value of Underlying Collateral

|  | Repurchase<br>Liability | Weighted<br>Average<br>Rate | FNMA and<br>FHLMC<br>Certificates | GNMA<br>Certificates | US<br>Treasury<br>Treasury<br>Notes | Total |
|--|-------------------------|-----------------------------|-----------------------------------|----------------------|-------------------------------------|-------|
|--|-------------------------|-----------------------------|-----------------------------------|----------------------|-------------------------------------|-------|

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**(Dollars in thousands)**

|                   |           |                |              |           |                  |           |              |           |               |           |                  |
|-------------------|-----------|----------------|--------------|-----------|------------------|-----------|--------------|-----------|---------------|-----------|------------------|
| Less than 90 days | \$        | 30,000         | 0.70%        | \$        | 31,961           | \$        | -            | \$        | -             | \$        | 31,961           |
| Over 90 days      |           | 902,500        | 3.18%        |           | 974,698          |           | 2,131        |           | 12,580        |           | 989,409          |
| <b>Total</b>      | <b>\$</b> | <b>932,500</b> | <b>3.10%</b> | <b>\$</b> | <b>1,006,659</b> | <b>\$</b> | <b>2,131</b> | <b>\$</b> | <b>12,580</b> | <b>\$</b> | <b>1,021,370</b> |

58

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## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*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, 2016 and December 31, 2015, these advances were secured by mortgage and commercial loans amounting to \$1.5 billion and \$1.3 billion, respectively. Also, at June 30, 2016 and December 31, 2015, the Company had an additional borrowing capacity with the FHLB-NY of \$895.0 million and \$770.6 million, respectively. At June 30, 2016 and December 31, 2015, the weighted average remaining maturity of FHLB’s advances was 5.4 months and 6.3 months, respectively. The original terms of these advances ranges between one month 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, 2016.

The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$336 thousand, at June 30, 2016:

| Year of Maturity | Borrowing<br>Balance<br>(In thousands) | Weighted-<br>Average<br>Coupon | Settlement Date | Maturity<br>Date |
|------------------|--|--------------------------------|-----------------|------------------|
| 2016             | \$ 50,000                              | 0.56%                          | 6/10/2016       | 7/11/2016        |
|                  | 100,000                                | 0.59%                          | 6/16/2016       | 7/18/2016        |
|                  | 25,000                                 | 0.60%                          | 6/24/2016       | 7/25/2016        |
|                  | 25,000                                 | 0.57%                          | 6/30/2016       | 7/29/2016        |
|                  | 37,290                                 | 0.63%                          | 6/1/2016        | 7/1/2016         |
|                  | 237,290                                |                                |                 |                  |
| 2017             | 4,150                                  | 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             | 9,704                                  | 2.59%                          | 7/19/2013       | 7/20/2020        |
|                  | <b>\$ 306,144</b>                      | <b>0.95%</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 \$103.0 million and \$102.6 million at June 30, 2016 and December 31, 2015, respectively.

Under the requirements of Puerto Rico Banking Act, the Bank must establish a redemption fund for the subordinated capital notes, which will mature on September 29, 2016, by transferring from undivided profits pre-established amounts as follows:

|                                  |    | <b>Redemption fund<br/>(In thousands)</b> |               |
|----------------------------------|----|---|---------------|
| Redemption fund at June 30, 2016 | \$ |   | 67,000        |
|                                  | \$ |   | <b>67,000</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Other borrowings*

Other borrowings, presented in the unaudited consolidated statements of financial condition amounted to \$1.8 million and \$1.7 million at June 30, 2016 and December 31, 2015, respectively, which mainly consists of unsecured fixed-rate borrowings.

**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, 2016 and December 31, 2015:

|             | June 30, 2016                                 |   | Gross Amounts Not Offset<br>in the Statement of<br>Financial Condition                                    |                          |                                |               |
|-------------|---|---|---|--------------------------|--------------------------------|---------------|
|             | Gross<br>Amount<br>of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in<br>the<br>Statement<br>of<br>Financial<br>Condition | Net<br>Amount of<br>Assets<br>Presented<br>in<br>Statement<br>of Financial<br>Condition<br>(In thousands) | Financial<br>Instruments | Cash<br>Collateral<br>Received | Net<br>Amount |
| Derivatives | \$ 1,926                                      | \$ -  | \$ 1,926  | \$ 2,009                 | \$ -                           | \$ (83)       |

December 31, 2015

**Gross Amounts Not Offset  
in the Statement of  
Financial Condition**

|             | Gross<br>Amount<br>of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in<br>the<br>Statement<br>of<br>Financial<br>Condition | Net amount<br>of<br>Assets<br>Presented<br>in<br>Statement<br>of Financial<br>Condition<br>(In thousands) | Financial<br>Instruments | Cash<br>Collateral<br>Received | Net<br>Amount |
|-------------|---|---|---|--------------------------|--------------------------------|---------------|
| Derivatives | \$ 3,025                                      | \$ -  | \$ 3,025  | \$ 2,000                 | \$ -                           | \$ 1,025      |

60

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

June 30, 2016

|  | Gross Amount of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Condition | Net Amount of Liabilities Presented in Statement of Financial Condition | Gross Amounts Not Offset in the Statement of Financial Condition |                          |                    |
|--|--|--|---|--|--------------------------|--------------------|
|  |  |  |   | Financial Instruments  | Cash Collateral Provided | Net Amount         |
|  |  |  |   |  |                          |                    |
| Derivatives                                    | \$ 5,594                               | \$ -   | \$ 5,594  | \$ -   | \$ 1,980                 | \$ 3,614           |
| Securities sold under agreements to repurchase | 624,500                                | -  | 624,500   | 668,689  | -                        | (44,189)           |
| <b>Total</b>                                   | <b>\$ 630,094</b>                      | <b>\$ -</b>  | <b>\$ 630,094</b>   | <b>\$ 668,689</b>  | <b>\$ 1,980</b>          | <b>\$ (40,575)</b> |

December 31, 2015

|  | Gross Amount of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Condition | Net Amount of Liabilities Presented in Statement of Financial Condition | Gross Amounts Not Offset in the Statement of Financial Condition |                          |                    |
|--|--|--|---|--|--------------------------|--------------------|
|  |  |  |   | Financial Instruments  | Cash Collateral Provided | Net Amount         |
|  |  |  |   |  |                          |                    |
| Derivatives                                    | \$ 7,257                               | \$ -   | \$ 7,257  | \$ -   | \$ 1,980                 | \$ 5,277           |
| Securities sold under agreements to repurchase | 932,500                                | -  | 932,500   | 1,021,370  | -                        | (88,870)           |
| <b>Total</b>                                   | <b>\$ 939,757</b>                      | <b>\$ -</b>  | <b>\$ 939,757</b>   | <b>\$ 1,021,370</b>  | <b>\$ 1,980</b>          | <b>\$ (83,593)</b> |



**NOTE 12 — RELATED PARTY TRANSACTIONS**

The Bank grants loans to its directors, executive officers and 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. The activity and balance of these loans for the quarters and six-month periods ended June 30, 2016 and 2015 was as follows:

|   | <b>Quarter Ended June 30,</b> |                  | <b>Six-Month Period Ended June 30,</b> |                  |
|---|-------------------------------|------------------|--|------------------|
|   | <b>2016</b>                   | <b>2015</b>      | <b>2016</b>                            | <b>2015</b>      |
|   | <b>(In thousands)</b>         |                  | <b>(In thousands)</b>                  |                  |
| <b>Balance at the beginning of year</b> | \$ 31,134                     | \$ 27,508        | \$ 31,475                              | \$ 27,011        |
| New loans and disbursements             | 1,596                         | 6,457            | 1,799                                  | 10,312           |
| Repayments                              | (2,034)                       | (647)            | (2,578)                                | (4,005)          |
| <b>Balance at the end of period</b>     | <b>\$ 30,696</b>              | <b>\$ 33,318</b> | <b>\$ 30,696</b>                       | <b>\$ 33,318</b> |

**OFG BANCORP**

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

**NOTE 13 — INCOME TAXES**

On May 26, 2016, Law 54 of 2016 was enacted to repeal the Value Added Tax (VAT) approved in 2015. Although this law was vetoed by the Governor, the Puerto Rico's Senate and House of Representatives were able to override the veto. As a result, the current Sales and Use Tax (SUT) remains in effect, with a rate of 11.5% on most transactions and a rate of 4% for business to business transactions and designated professional services.

At June 30, 2016 and December 31, 2015, the Company's net deferred tax asset amounted to \$143.0 million and \$145.9 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 deferred tax asset, net of the existing valuation allowances recorded at June 30, 2016 and December 31, 2015. 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 carry forward period are reduced.

At June 30, 2016 and December 31, 2015, Oriental International Bank Inc. ("OIB"), the Bank's international banking entity subsidiary, had \$126 thousand and \$141 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 quarter ended June 30, 2016 and 2015, \$8 thousand and \$12 thousand, respectively, related to this residual tax effect from OIB was reclassified from accumulated other comprehensive income (loss) into income tax provision. During the six-month period ended June 30, 2016 and 2015, \$16 thousand and \$22 thousand, respectively, related to this residual tax effect from OIB was reclassified from accumulated other comprehensive income (loss) into 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 was \$2.3 million at June 30, 2016 and \$2.2 million at December 31, 2015. The Company had accrued \$81 thousand at June 30, 2016 and \$175 thousand at December 31, 2015 for the payment of interest and penalties relating to unrecognized tax benefits.

Income tax expense for the quarters ended June 30, 2016 and 2015 was \$5.9 million and \$769 thousand, respectively. Income tax expense for the six-month periods ended June 30, 2016 and 2015 was \$11.5 million and \$1.7 million, respectively.



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 14 — REGULATORY CAPITAL REQUIREMENTS

*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, 2015 for the Company and the Bank (subject to certain phase-in periods through January 1, 2019) and that replaced their general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules. Among other matters, the new capital rules: (i) introduce a new capital measure called "Common Equity Tier 1" ("CET1") and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to prior regulations. The new capital rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the assets, and resulting in higher risk weights for a variety of asset classes.

Pursuant to the new capital rules, the minimum capital ratios requirements as of January 1, 2015 are as follows:

4.5% CET1 to risk-weighted assets;

6.0% Tier 1 capital (that is, CET1 *plus* Additional Tier 1 capital) to risk-weighted assets;

8.0% Total capital (that is, Tier 1 capital *plus* Tier 2 capital) to risk-weighted assets; and

4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the "leverage ratio").

As of June 30, 2016 and December 31, 2015, the Company and the Bank met all capital adequacy requirements to which they are subject. As of June 30, 2016 and December 31, 2015, the Bank is “well capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well capitalized,” an institution must maintain minimum CET1 risk-based, Tier 1 risk-based, total risk-based, and Tier 1 leverage ratios as set forth in the tables presented below.

The New Capital Rules also introduce a new 2.5% “capital conservation buffer”, composed entirely of CET1, on top of the three minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. Thus, when fully phased-in on January 1, 2019, the Company and the Bank will be required to maintain such an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019. At June 30, 2016 the Company and the Bank met the capital buffer requirement.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company's and the Bank's actual capital amounts and ratios as of June 30, 2016 and December 31, 2015 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><u>As of June 30, 2016</u></b>                    |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets                | \$ 849,147 | 18.00% | \$ 377,323                  | 8.00% | \$ 471,653                     | 10.00% |
| Tier 1 capital to risk-weighted assets               | \$ 788,349 | 16.71% | \$ 282,992                  | 6.00% | \$ 377,323                     | 8.00%  |
| Common equity tier 1 capital to risk-weighted assets | \$ 596,080 | 12.64% | \$ 212,244                  | 4.50% | \$ 306,575                     | 6.50%  |
| Tier 1 capital to average total assets               | \$ 788,349 | 11.92% | \$ 264,633                  | 4.00% | \$ 330,791                     | 5.00%  |
| <b><u>As of December 31, 2015</u></b>                |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets                | \$ 846,748 | 17.29% | \$ 391,723                  | 8.00% | \$ 489,654                     | 10.00% |
| Tier 1 capital to risk-weighted assets               | \$ 782,912 | 15.99% | \$ 293,792                  | 6.00% | \$ 391,723                     | 8.00%  |
| Common equity tier 1 capital to risk-weighted assets | \$ 594,482 | 12.14% | \$ 220,344                  | 4.50% | \$ 318,275                     | 6.50%  |
| Tier 1 capital to average total assets               | \$ 782,912 | 11.18% | \$ 280,009                  | 4.00% | \$ 350,011                     | 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><u>As of June 30, 2016</u></b>                    |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets                | \$ 830,002 | 17.62% | \$ 376,874                  | 8.00% | \$ 471,093                     | 10.00% |
| Tier 1 capital to risk-weighted assets               | \$ 769,424 | 16.33% | \$ 282,656                  | 6.00% | \$ 376,874                     | 8.00%  |
| Common equity tier 1 capital to risk-weighted assets | \$ 769,424 | 16.33% | \$ 211,992                  | 4.50% | \$ 306,210                     | 6.50%  |
| Tier 1 capital to average total assets               | \$ 769,424 | 11.68% | \$ 263,464                  | 4.00% | \$ 329,330                     | 5.00%  |
| <b><u>As of December 31, 2015</u></b>                |            |        |                             |       |                                |        |
| Total capital to risk-weighted assets                | \$ 815,458 | 16.70% | \$ 390,688                  | 8.00% | \$ 488,360                     | 10.00% |
| Tier 1 capital to risk-weighted assets               | \$ 751,886 | 15.40% | \$ 293,016                  | 6.00% | \$ 390,688                     | 8.00%  |
| Common equity tier 1 capital to risk-weighted assets | \$ 751,886 | 15.40% | \$ 219,762                  | 4.50% | \$ 317,434                     | 6.50%  |
| Tier 1 capital to average total assets               | \$ 751,886 | 10.80% | \$ 278,399                  | 4.00% | \$ 347,999                     | 5.00%  |

**OFG BANCORP**

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

**NOTE 15 – STOCKHOLDERS' EQUITY**

*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, 2016 and December 31, 2015 accumulated issuance costs charged against additional paid-in capital amounted to \$13.6 million and \$10.1 million for preferred and common stock, respectively.

*Legal Surplus*

The Puerto Rico Banking Act requires that a minimum of 10% of the Bank's net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid-in capital on common and preferred stock. At June 30, 2016 and December 31, 2015, the Bank's legal surplus amounted to \$73.3 million and \$70.4 million, respectively. The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders.

*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 \$7.7 million of authority remains. The shares of common stock repurchased are to be held by the Company as treasury shares. There were no repurchases during the six-month period ended June 30, 2016. During the six-month period ended June 30, 2015, the Company purchased 303,985 shares under this program for a total of \$4.2 million at an average price of \$13.90 per share.

The number of shares that may yet be purchased under the \$70 million program is estimated at 931,428 and was calculated by dividing the remaining balance of \$7.7 million by \$8.30 (closing price of the Company common stock at June 30, 2016). The Company did not purchase any shares of its common stock during the six-month period ended June 30, 2016 and 2015, other than through its publicly announced stock purchase program.

The activity in connection with common shares held in treasury by the Company for the six-month periods ended June 30, 2016 and 2015 is set forth below:

|   | <b>Six-Month Period Ended June 30</b>     |                      |                  |                      |
|---|---|----------------------|------------------|----------------------|
|   | <b>2016</b>                               |                      | <b>2015</b>      |                      |
|   | <b>Shares</b>                             | <b>Dollar Amount</b> | <b>Shares</b>    | <b>Dollar Amount</b> |
|   | <b>(In thousands, except shares data)</b> |                      |                  |                      |
| <b>Beginning of period</b>  | 8,757,960                                 | \$ 105,379           | 8,012,254        | \$ 97,070            |
| Common shares used upon lapse of restricted stock units           | (45,810)                                  | (505)                | (58,279)         | (640)                |
| Common shares repurchased as part of the stock repurchase program | -   | -                    | 303,985          | 4,238                |
| <b>End of period</b>  | <b>8,712,150</b>                          | <b>\$ 104,874</b>    | <b>8,257,960</b> | <b>\$ 100,668</b>    |



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 16 - ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income, net of income tax, as of June 30, 2016 and December 31, 2015 consisted of:

|   | June 30,<br>2016 | December 31,<br>2015 |
|---|------------------|----------------------|
|   | (In thousands)   |                      |
| Unrealized gain on securities available-for-sale which are not<br>other-than-temporarily impaired                 | \$ 19,004        | \$ 22,044            |
| Unrealized gain on securities available-for-sale which are<br>other-than-temporarily impaired                     | -                | (3,196)              |
| Income tax effect of unrealized gain on securities available-for-sale   | (919)            | (1,924)              |
| Net unrealized gain on securities available-for-sale which are not<br>other-than-temporarily impaired, net of tax | 18,085           | 16,924               |
| Unrealized loss on cash flow hedges   | (3,655)          | (4,307)              |
| Income tax effect of unrealized loss on cash flow hedges  | 1,375            | 1,380                |
| Net unrealized loss on cash flow hedges   | (2,280)          | (2,927)              |
| Accumulated other comprehensive income, net of taxes  | \$ <b>15,805</b> | \$ <b>13,997</b>     |

## OFG BANCORP

## NOTES TO 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, 2016 and 2015:

|   | Quarter Ended June 30,                                |   |                  |   |   |
|---|---|---|------------------|---|---|
|   | 2016  |   | Accumulated      | 2015  |   |
|   | Net unrealized gains on securities available-for-sale | Net unrealized loss on cash flow hedges |                  | Net unrealized gains on securities available-for-sale | Net unrealized loss on cash flow hedges |
|   | (In thousands)  |   |                  |   |   |
| <b>Beginning balance</b>  | \$ 15,089   | \$ (2,805)                              | \$ 12,284        | \$ 30,214   | \$ (5,890)                              |
| Other comprehensive income (loss) before reclassifications                | 3,060   | (949)                                   | 2,111            | (11,523)  | (18,912)                                |
| Amounts reclassified out of accumulated other comprehensive (loss) income | (64)  | 1,474                                   | 1,410            | 141   | 1,565                                   |
| Other comprehensive income (loss)   | 2,996   | 525                                     | 3,521            | (11,382)  | 1,318                                   |
| <b>Ending balance</b>   | <b>\$ 18,085</b>                                      | <b>\$ (2,280)</b>                       | <b>\$ 15,805</b> | <b>\$ 18,832</b>                                      | <b>\$ (4,537)</b>                       |
|   | Six-Month Period Ended June 30,                       |   |                  |   |   |
|   | 2016  |   | Accumulated      | 2015  |   |
|   | Net unrealized gains on securities available-for-sale | Net unrealized loss on cash flow hedges |                  | Net unrealized gains on securities available-for-sale | Net unrealized loss on cash flow hedges |
|   | (In thousands)  |   |                  |   |   |
| <b>Beginning balance</b>  | \$ 16,924   | \$ (2,927)                              | \$ 13,997        | \$ 25,764   | \$ (6,050)                              |
| Other comprehensive (loss) before reclassifications                       | (1,266)   | (2,406)                                 | (3,672)          | (7,212)   | (1,540)                                 |
| Amounts reclassified out of accumulated other comprehensive income (loss) | 2,427   | 3,053                                   | 5,480            | 280   | 3,000                                   |
| Other comprehensive income (loss)   | 1,161   | 647                                     | 1,808            | (6,932)   | 1,528                                   |
| <b>Ending balance</b>   | <b>\$ 18,085</b>                                      | <b>\$ (2,280)</b>                       | <b>\$ 15,805</b> | <b>\$ 18,832</b>                                      | <b>\$ (4,537)</b>                       |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents reclassifications out of accumulated other comprehensive income for the quarters and six-month periods ended June 30, 2016 and 2015:

|  | Amount reclassified out of accumulated other comprehensive income |                 | Affected  |
|--|---|-----------------|-----------|
|  | Quarter Ended   |                 | Cons      |
|  | June 30,  | June 30,        | Stat      |
|  | 2016  | 2015            | of Op     |
|  | (In thousands)  |                 |           |
| <b>Cash flow hedges:</b>   |   |                 |           |
| Interest-rate contracts  | \$ 1,354  | \$ 1,614        | Net inter |
| Tax effect from increase in capital gains tax rate   | 120   | (75)            | Income t  |
| <b>Available-for-sale securities:</b>  |   |                 |           |
| Residual tax effect from OIB's change in applicable tax rate                                       | 8   | 12              | Income t  |
| Tax effect from increase in capital gains tax rate   | (72)  | 129             | Income t  |
|  | <b>\$ 1,410</b>   | <b>\$ 1,680</b> |           |
|  |   |                 |           |
|  | Amount reclassified out of accumulated other comprehensive income |                 | Affected  |
|  | Six-Month   |                 | Cons      |
|  | Period Ended  | Period Ended    | Stat      |
|  | June 30,  | June 30,        | of Op     |
|  | 2016  | 2015            |           |
|  | (In thousands)  |                 |           |
| <b>Cash flow hedges:</b>   |   |                 |           |
| Interest-rate contracts  | \$ 2,804  | \$ 3,220        | Net inter |
| Tax effect from increase in capital gains tax rate   | 249   | (149)           | Income t  |
| <b>Available-for-sale securities:</b>  |   |                 |           |
| Residual tax effect from OIB's change in applicable tax rate                                       | 16  | 22              | Income t  |
| Other-than-temporary impairment losses on available for sale securities realized during the period | 2,557   | -               |           |
| Tax effect from increase in capital gains tax rate   | (146)   | 258             | Income t  |
|  | <b>\$ 5,480</b>   | <b>\$ 3,351</b> |           |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 17 – EARNINGS (LOSS) PER COMMON SHARE

The calculation of earnings (loss) per common share for the quarters and six-month periods ended June 30, 2016 and 2015 is as follows:

|  | Quarter Ended<br>June 30,<br>2016    2015<br>(In thousands,<br>except per share<br>data) |                   | Six-Month Per<br>Ended June 30,<br>2016    2015<br>(In thousands,<br>except per share<br>data) |                    |
|--|--|-------------------|--|--------------------|
| <b>Net income (loss)</b>   | \$ 14,339  | \$ (3,109)        | \$ 28,510  | \$ (6,000)         |
| Less: Dividends on preferred stock   |  |                   |  |                    |
| Non-convertible preferred stock (Series A, B, and D)                               | (1,629)  | (1,628)           | (3,256)  | (3,256)            |
| Convertible preferred stock (Series C)   | (1,837)  | (1,838)           | (3,675)  | (3,675)            |
| <b>Income (loss) available to common shareholders</b>                              | <b>\$ 10,873</b>   | <b>\$ (6,575)</b> | <b>\$ 21,579</b>   | <b>\$ (13,000)</b> |
| Effect of assumed conversion of the convertible preferred stock                    | 1,837  | 1,838             | 3,675  | 3,675              |
| <b>Income (loss) available to common shareholders assuming conversion</b>          | <b>\$ 12,710</b>   | <b>\$ (4,737)</b> | <b>\$ 25,254</b>   | <b>\$ (9,325)</b>  |
| <b>Weighted average common shares and share equivalents:</b>                       |  |                   |  |                    |
| Average common shares outstanding  | 43,914   | 44,505            | 43,906   | 44,505             |
| Effect of dilutive securities:   |  |                   |  |                    |
| Average potential common shares-options  | 43   | 110               | 37   | 110                |
| Average potential common shares-assuming conversion of convertible preferred stock | 7,138  | 7,159             | 7,138  | 7,159              |
| <b>Total weighted average common shares outstanding and equivalents</b>            | <b>51,095</b>  | <b>51,774</b>     | <b>51,081</b>  | <b>51,774</b>      |
| <b>Earnings (loss) per common share - basic</b>                                    | <b>\$ 0.25</b>   | <b>\$ (0.15)</b>  | <b>\$ 0.49</b>   | <b>\$ (0.15)</b>   |
| <b>Earnings (loss) per common share - diluted</b>                                  | <b>\$ 0.25</b>   | <b>\$ (0.15)</b>  | <b>\$ 0.49</b>   | <b>\$ (0.15)</b>   |

In computing diluted earnings (loss) per common share, the 84,000 shares of convertible preferred stock, which remain outstanding at June 30, 2016, with a conversion rate, subject to certain conditions, of 86.4225 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 (loss) per common share, the dividends declared during the quarters ended June 30, 2016 and 2015 on the convertible preferred stock were added back as income available to common shareholders.

For the quarters ended June 30, 2016 and 2015, weighted-average stock options with an anti-dilutive effect on earnings (loss) per share not included in the calculation amounted to 957,743 and 566,025, respectively. For the six-month periods ended June 30, 2016 and 2015, weighted-average stock options with an anti-dilutive effect on earnings (loss) per share not included in the calculation amounted to \$957,783 and \$457,467, respectively.

**NOTE 18 – GUARANTEES**

At June 30, 2016, the unamortized balance of the obligations undertaken in issuing the guarantees under standby letters of credit represented a liability of \$2.3 million (December 31, 2015 - \$14.7 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, 2016 and December 31, 2015, the unpaid principal balance of residential mortgage loans sold subject to credit recourse was \$21.1 million and \$22.4 million, respectively.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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, 2016 and 2015.

|                                       | Quarter Ended June 30, |               | Six-Month Period Ended June 30, |               |
|---------------------------------------|------------------------|---------------|---------------------------------|---------------|
|                                       | 2016                   | 2015          | 2016                            | 2015          |
|                                       | (In thousands)         |               | (In thousands)                  |               |
| <b>Balance at beginning of period</b> | \$ 181                 | \$ 487        | \$ 439                          | \$ 927        |
| Net (charge-offs/terminations)        |                        |               |                                 |               |
| recoveries                            | (19)                   | (198)         | (277)                           | (638)         |
| <b>Balance at end of period</b>       | <b>\$ 162</b>          | <b>\$ 289</b> | <b>\$ 162</b>                   | <b>\$ 289</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. The recourse obligation will be fully extinguished before the end of 2017.

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, 2016, the Company repurchased approximately \$83 thousand and \$288 thousand, respectively of unpaid principal balance in mortgage loans subject to the credit recourse provisions. During the quarter and six-month period ended June 30, 2015, the Company repurchased approximately \$1.2 million and \$3.4 million, respectively 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, 2016, the Company's liability for estimated credit losses related to loans sold with credit recourse amounted to \$162 thousand (December 31, 2015– \$439 thousand).

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 that 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. During the quarter and six-month period ended June 30, 2016, the Company repurchased \$817 thousand and \$2.3 million,

respectively, of unpaid principal balance in mortgage loans, excluding mortgage loans subject to credit recourse provisions referred to above. During the quarter and six-month period ended June 30, 2015, the Company repurchased \$2.7 million and \$11.7 million, respectively, of unpaid principal balance in mortgage loans, excluding mortgage loans subject to credit recourse provisions referred to above.

During the quarter and six-month period ended June 30, 2016, the Company recognized \$92 thousand and \$111 thousand, respectively, in losses from the repurchase of residential mortgage loans sold subject to credit recourse, and \$329 thousand and \$830 thousand, respectively, 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, 2015, the Company recognized \$476 thousand and \$583 thousand, respectively, in losses from the repurchase of residential mortgage loans sold subject to credit recourse, and \$742 thousand and \$1.5 million, respectively, in losses from the repurchase of residential mortgage loans as a result of breaches of the customary representations and warranties.

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

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, 2016, the Company serviced \$726.6 million 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, 2016, the outstanding balance of funds advanced by the Company under such mortgage loan servicing agreements was approximately \$339 thousand (December 31, 2015 - \$301 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.

**NOTE 19— 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, 2016 and December 31, 2015 were as follows:

| <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------------------------|------------------------------|
|--------------------------|------------------------------|



|                              |    | <b>(In thousands)</b> |    |         |
|------------------------------|----|-----------------------|----|---------|
| Commitments to extend credit | \$ | 461,054               | \$ | 456,720 |
| Commercial letters of credit |    | 1,556                 |    | 1,508   |

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, 2016 and December 31, 2015, 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 \$667 thousand at both June 30, 2016 and December 31, 2015.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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.

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, 2016 and December 31, 2015, is as follows:

|  |    | <b>June 30,<br/>2016</b> |    | <b>December 31,<br/>2015</b> |
|--|----|--------------------------|----|------------------------------|
|  |    | <b>(In thousands)</b>    |    |                              |
| Standby letters of credit and financial guarantees | \$ | 4,756                    | \$ | 14,656                       |
| Loans sold with recourse                           |    | 21,064                   |    | 22,374                       |

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, 2016 and 2015, amounted to \$2.3 million for both periods. For the six-month periods ended June 30, 2016 and 2015, rent expense amounted to \$4.4 million and \$4.7 million, respectively, and is included in the "occupancy and equipment" caption in the unaudited consolidated statements of operations. Future rental commitments under leases in effect at June 30, 2016 exclusive of taxes, insurance, and maintenance expenses payable by the Company, are summarized as follows:

| <b><u>Year Ending December 31,</u></b> |    | <b>Minimum Rent<br/>(In thousands)</b> |
|--|----|--|
| 2016                                   | \$ | 4,732                                  |
| 2017                                   |    | 6,850                                  |
| 2018                                   |    | 6,428                                  |

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|            |    |               |
|------------|----|---------------|
| 2019       |    | 6,387         |
| 2020       |    | 5,660         |
| Thereafter |    | 12,500        |
|            | \$ | <b>42,557</b> |

**OFG BANCORP**

**NOTES TO 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 20 - 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 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.

*Money market investments*

The fair value of money market investments is based on the carrying amounts reflected in the unaudited 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 Interactive Data Corporation (“IDC”), an independent, well-recognized pricing company. 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 June 30, 2016 and December 31, 2015, the Company did not have investment securities classified as Level 3.

***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.

**OFG BANCORP**

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

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.

***Impaired Loans***

Impaired loans are carried at the present value of expected future cash flows using the loan's existing rate in a discounted cash flow calculation, or the fair value of the collateral if the loan is collateral-dependent. Expected cash flows are based on internal inputs reflecting expected default rates on contractual cash flows. This method of estimating fair value does not incorporate the exit-price concept of fair value described in Accounting Standards Codification ("ASC") 820-10 and would generally result in a higher value than the exit-price approach. For loans measured using the estimated fair value of collateral less costs to sell, fair value is generally determined 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 less disposition costs. 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 automobiles. 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 CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Assets and liabilities measured at fair value on a recurring and non-recurring basis are summarized below:

|  | June 30, 2016   |                         |                   | Total             |
|--|-----------------|-------------------------|-------------------|-------------------|
|  | Level 1         | Fair Value Measurements |                   |                   |
|  |                 | Level 2                 | Level 3           |                   |
|  | (In thousands)  |                         |                   |                   |
| Recurring fair value measurements:       |                 |                         |                   |                   |
| Investment securities available-for-sale | \$ -            | \$ 664,302              | \$ -              | \$ 664,302        |
| Trading securities                       | -               | 348                     | -                 | 348               |
| Money market investments                 | 5,740           | -                       | -                 | 5,740             |
| Derivative assets                        | -               | 1,739                   | 187               | 1,926             |
| Servicing assets                         | -               | -                       | 7,932             | 7,932             |
| Derivative liabilities                   | -               | (5,413)                 | (181)             | (5,594)           |
|  | <b>\$ 5,740</b> | <b>\$ 660,976</b>       | <b>\$ 7,938</b>   | <b>\$ 674,654</b> |
| Non-recurring fair value measurements:   |                 |                         |                   |                   |
| Impaired commercial loans                | \$ -            | \$ -                    | \$ 219,393        | \$ 219,393        |
| Foreclosed real estate                   | -               | -                       | 51,220            | 51,220            |
| Other repossessed assets                 | -               | -                       | 3,866             | 3,866             |
|  | <b>\$ -</b>     | <b>\$ -</b>             | <b>\$ 274,479</b> | <b>\$ 274,479</b> |

|  | December 31, 2015 |                         |                   | Total             |
|--|-------------------|-------------------------|-------------------|-------------------|
|  | Level 1           | Fair Value Measurements |                   |                   |
|  |                   | Level 2                 | Level 3           |                   |
|  | (In thousands)    |                         |                   |                   |
| Recurring fair value measurements:       |                   |                         |                   |                   |
| Investment securities available-for-sale | \$ -              | \$ 974,609              | \$ -              | \$ 974,609        |
| Trading securities                       | -                 | 288                     | -                 | 288               |
| Money market investments                 | 4,699             | -                       | -                 | 4,699             |
| Derivative assets                        | -                 | 1,855                   | 1,170             | 3,025             |
| Servicing assets                         | -                 | -                       | 7,455             | 7,455             |
| Derivative liabilities                   | -                 | (6,162)                 | (1,095)           | (7,257)           |
|  | <b>\$ 4,699</b>   | <b>\$ 970,590</b>       | <b>\$ 7,530</b>   | <b>\$ 982,819</b> |
| Non-recurring fair value measurements:   |                   |                         |                   |                   |
| Impaired commercial loans                | \$ -              | \$ -                    | \$ 235,767        | \$ 235,767        |
| Foreclosed real estate                   | -                 | -                       | 58,176            | 58,176            |
| Other repossessed assets                 | -                 | -                       | 6,226             | 6,226             |
|  | <b>\$ -</b>       | <b>\$ -</b>             | <b>\$ 300,169</b> | <b>\$ 300,169</b> |



## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters and six-month periods ended June 30, 2016 and 2015:

| Level 3 Instruments Only                  | Quarter Ended June 30, 2016                          |                     |   |          |
|---|--|---------------------|---|----------|
|   | Derivative<br>asset<br>(S&P<br>Purchased<br>Options) | Servicing<br>assets | Derivative<br>liability<br>(S&P<br>Embedded<br>Options) | Total    |
| <b>Balance at beginning of period</b>     | \$ 772   | \$ 7,819            | \$ (746)  | \$ 7,845 |
| Gains (losses) included in earnings       | (585)  | -                   | 557   | (28)     |
| New instruments acquired                  | -  | 717                 | -   | 717      |
| Principal repayments                      | -  | (121)               | -   | (121)    |
| Amortization                              | -  | -                   | 8   | 8        |
| Changes in fair value of servicing assets | -  | (483)               | -   | (483)    |
| <b>Balance at end of period</b>           | \$ 187   | \$ 7,932            | \$ (181)  | \$ 7,938 |

| Level 3 Instruments Only                  | Six-Month Period Ended June 30, 2016                 |                     |   |          |
|---|--|---------------------|---|----------|
|   | Derivative<br>asset<br>(S&P<br>Purchased<br>Options) | Servicing<br>assets | Derivative<br>liability<br>(S&P<br>Embedded<br>Options) | Total    |
| <b>Balance at beginning of period</b>     | \$ 1,171   | \$ 7,455            | \$ (1,095)  | \$ 7,531 |
| Gains (losses) included in earnings       | (984)  | -                   | 886   | (98)     |
| New instruments acquired                  | -  | 1,275               | -   | 1,275    |
| Principal repayments                      | -  | (225)               | -   | (225)    |
| Amortization                              | -  | -                   | 28  | 28       |
| Changes in fair value of servicing assets | -  | (573)               | -   | (573)    |
| <b>Balance at end of period</b>           | \$ 187   | \$ 7,932            | \$ (181)  | \$ 7,938 |

| Level 3 Instruments Only                        | Quarter Ended June 30, 2015                          |                     |   |           |
|---|--|---------------------|---|-----------|
|   | Derivative<br>asset<br>(S&P<br>Purchased<br>Options) | Servicing<br>assets | Derivative<br>liability<br>(S&P<br>Embedded<br>Options) | Total     |
| <b>Balance at beginning of period</b>           | \$ 3,734   | \$ 12,164           | \$ (3,617)  | \$ 12,281 |
| (Losses) included in earnings                   | (1,596)  | -                   | 1,517   | (79)      |
| Sale of mortgage servicing rights held-for-sale | -  | (6,985)             | -   | (6,985)   |
| Changes due to payments on loans                | -  | (313)               | -   | (313)     |
| New instruments acquired                        | -  | 1,529               | -   | 1,529     |

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|  |                 |                 |                   |                 |
|--|-----------------|-----------------|-------------------|-----------------|
| Changes in fair value related to price of MSRs held for sale | -               | (835)           | -                 | (835)           |
| Amortization   | -               | -               | 56                | 56              |
| Changes in fair value of servicing assets                    | -               | 231             | -                 | 231             |
| <b>Balance at end of period</b>                              | <b>\$ 2,138</b> | <b>\$ 5,791</b> | <b>\$ (2,044)</b> | <b>\$ 5,885</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

|   | Six-Month Period Ended June 30, 2015                 |                     |   |           |
|---|--|---------------------|---|-----------|
|   | Derivative<br>asset<br>(S&P<br>Purchased<br>Options) | Servicing<br>assets | Derivative<br>liability<br>(S&P<br>Embedded<br>Options) | Total     |
| <b>Level 3 Instruments Only</b>                               |  |                     |   |           |
| Balance at beginning of period                                | \$ 5,555   | \$ 13,992           | \$ (5,477)  | \$ 14,070 |
| (Losses) gains included in earnings                           | (3,417)  | -                   | 3,299   | (118)     |
| Sale of mortgage servicing rights held-for-sale               | -  | (6,985)             | -   | (6,985)   |
| Changes due to payments on loans                              | -  | (732)               | -   | (732)     |
| New instruments acquired                                      | -  | 2,060               | -   | 2,060     |
| Amortization  | -  | -                   | 134   | 134       |
| Changes in fair value related to price of MSR's held for sale | -  | (2,716)             | -   | (2,716)   |
| Changes in fair value of servicing assets                     | -  | 172                 | -   | 172       |
| Balance at end of period                                      | \$ 2,138   | \$ 5,791            | \$ (2,044)  | \$ 5,885  |

During the quarters and six-month periods ended June 30, 2016 and 2015, there were purchases and sales of assets and liabilities measured at fair value on a recurring basis. There were no transfers into or out of Level 1 and Level 2 fair value measurements during such periods.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The table below presents quantitative information for all assets and liabilities measured at fair value on a recurring and non-recurring basis using significant unobservable inputs (Level 3) at June 30, 2016:

|                               |                                      |                            | <b>June 30, 2016</b>   |                                   |
|-------------------------------|--------------------------------------|----------------------------|--|-----------------------------------|
|                               | <b>Fair Value<br/>(In thousands)</b> | <b>Valuation Technique</b> | <b>Unobservable Input</b>  | <b>Range</b>                      |
| Derivative assets (S&P        |                                      |                            |  |                                   |
| Purchased Options)            | \$ 187                               | Option pricing model       | Implied option volatility<br>Counterparty credit risk                              | 41.87%                            |
|                               |                                      |                            | (based on 5-year credit default swap ("CDS") spread)                               | 79.96%-89.03%                     |
| Servicing assets              | \$ 7,932                             | Cash flow valuation        | Constant prepayment rate<br>Discount rate  | 4.41% - 11.40%<br>10.00% - 12.00% |
| Derivative liability (S&P     |                                      |                            |  |                                   |
| Embedded Options)             | \$ (181)                             | Option pricing model       | Implied option volatility<br>Counterparty credit risk (based on 5-year CDS spread) | 41.87%<br>79.96%-89.03%           |
| Collateral dependant          |                                      | Fair value of property     |  |                                   |
| impaired loans                | \$ 28,558                            | or collateral              | Appraised value less disposition costs   | 29.20% - 43.20%                   |
| Puerto Rico Electric Power    |                                      |                            |  |                                   |
| Authority line of credit, net | \$ 183,020                           | Cash flow valuation        | Discount rate  | 7.25%                             |
| Other non-collateral          | \$ 7,814                             | Cash flow valuation        | Discount rate  | 4.25%-10.50%                      |

dependant  
impaired loans

|                                |           |                           |  |                 |
|--------------------------------|-----------|---------------------------|--|-----------------|
|                                |           | Fair value of<br>property |  |                 |
| Foreclosed<br>real estate      | \$ 51,220 | or<br>collateral          | Appraised value less disposition costs | 29.20% - 43.20% |
|                                |           | Fair value of<br>property |  |                 |
| Other<br>repossessed<br>assets | \$ 3,866  | or<br>collateral          | Appraised value less disposition costs | 29.20% - 43.20% |

**OFG BANCORP**

**NOTES TO 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 CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The estimated fair value and carrying value of the Company's financial instruments at June 30, 2016 and December 31, 2015 is as follows:

|  | June 30,<br>2016 |                   | December 31,<br>2015 |                   |
|--|------------------|-------------------|----------------------|-------------------|
|  | Fair<br>Value    | Carrying<br>Value | Fair<br>Value        | Carrying<br>Value |
| (In thousands)                                 |                  |                   |                      |                   |
| <b>Level 1</b>                                 |                  |                   |                      |                   |
| <b>Financial Assets:</b>                       |                  |                   |                      |                   |
| Cash and cash equivalents                      | \$ 517,048       | \$ 517,048        | \$ 536,709           | \$ 536,709        |
| Restricted cash                                | 3,030            | 3,030             | 3,349                | 3,349             |
| <b>Level 2</b>                                 |                  |                   |                      |                   |
| <b>Financial Assets:</b>                       |                  |                   |                      |                   |
| Trading securities                             | 348              | 348               | 288                  | 288               |
| Investment securities available-for-sale       | 664,302          | 664,302           | 974,609              | 974,609           |
| Investment securities held-to-maturity         | 643,530          | 635,399           | 614,679              | 620,189           |
| Federal Home Loan Bank (FHLB) stock            | 19,838           | 19,838            | 20,783               | 20,783            |
| Other investments                              | 3                | 3                 | 3                    | 3                 |
| Derivative assets                              | 1,739            | 1,739             | 1,855                | 1,855             |
| <b>Financial Liabilities:</b>                  |                  |                   |                      |                   |
| Derivative liabilities                         | 5,413            | 5,413             | 6,162                | 6,162             |
| <b>Level 3</b>                                 |                  |                   |                      |                   |
| <b>Financial Assets:</b>                       |                  |                   |                      |                   |
| Total loans (including loans held-for-sale)    | 4,163,769        | 4,373,617         | 4,101,219            | 4,434,213         |
| Derivative assets                              | 187              | 187               | 1,170                | 1,170             |
| FDIC indemnification asset                     | 11,064           | 18,426            | 17,786               | 22,599            |
| Accrued interest receivable                    | 20,009           | 20,009            | 20,637               | 20,637            |
| Servicing assets                               | 7,932            | 7,932             | 7,455                | 7,455             |
| Accounts receivable and other assets           | 42,243           | 42,243            | 42,786               | 42,786            |
| <b>Financial Liabilities:</b>                  |                  |                   |                      |                   |
| Deposits                                       | 4,633,864        | 4,643,873         | 4,705,878            | 4,715,764         |
| Securities sold under agreements to repurchase | 630,933          | 626,109           | 955,859              | 934,691           |
| Advances from FHLB                             | 308,583          | 306,480           | 335,812              | 332,476           |
| Other borrowings                               | 2,599            | 1,753             | 2,593                | 1,734             |
| Subordinated capital notes                     | 98,944           | 102,983           | 94,940               | 102,633           |
| Accrued expenses and other liabilities         | 88,930           | 88,930            | 92,935               | 92,935            |
| Derivative liabilities embedded in deposits    | 181              | 181               | 1,095                | 1,095             |



**OFG BANCORP**

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

The following methods and assumptions were used to estimate the fair values of significant financial instruments at June 30, 2016 and December 31, 2015:

- Cash and cash equivalents (including money market investments and time deposits with other banks), restricted cash, accrued interest receivable, accounts receivable and other assets and 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 and other investments, is based on quoted market prices, when available or prices provided from contracted pricing providers, 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 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 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 asset 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 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. Non-performing loans have been valued at the carrying amounts.
- 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.
- The fair value of long-term borrowings, which include securities sold under agreements to repurchase, advances from FHLB-NY, other borrowings, 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.

**OFG BANCORP**

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

**NOTE 21 – 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 OPC. 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 retirement 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 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, 2016 and 2015:

## Quarter Ended June 30, 2016

|                                     | Wealth              |                  |                     | Total               |                     | Consolidated        |
|-------------------------------------|---------------------|------------------|---------------------|---------------------|---------------------|---------------------|
|                                     | Banking             | Management       | Treasury            | Major Segments      | Eliminations        |                     |
|                                     | (In thousands)      |                  |                     |                     |                     |                     |
| Interest income                     | \$ 79,675           | \$ 16            | \$ 8,217            | \$ 87,908           | \$ -                | \$ 87,908           |
| Interest expense                    | (7,300)             | -                | (7,296)             | (14,596)            | -                   | (14,596)            |
| Net interest income                 | 72,375              | 16               | 921                 | 73,312              | -                   | 73,312              |
| Provision for loan and lease losses | (14,445)            | -                | -                   | (14,445)            | -                   | (14,445)            |
| Non-interest income                 | 8,214               | 6,910            | 31                  | 15,155              | -                   | 15,155              |
| Non-interest expenses               | (47,098)            | (4,908)          | (1,820)             | (53,826)            | -                   | (53,825)            |
| Intersegment revenue                | 389                 | -                | 49                  | 438                 | (438)               | -                   |
| Intersegment expenses               | (49)                | (286)            | (103)               | (438)               | 438                 | -                   |
| <b>Income before income taxes</b>   | <b>\$ 19,386</b>    | <b>\$ 1,732</b>  | <b>\$ (922)</b>     | <b>\$ 20,196</b>    | <b>\$ -</b>         | <b>\$ 20,197</b>    |
| <b>Total assets</b>                 | <b>\$ 5,829,987</b> | <b>\$ 19,054</b> | <b>\$ 1,800,838</b> | <b>\$ 7,649,879</b> | <b>\$ (937,283)</b> | <b>\$ 6,712,596</b> |

## Quarter Ended June 30, 2015

|  | Wealth              |                  |                     | Total               |                     | Consolidated        |
|--|---------------------|------------------|---------------------|---------------------|---------------------|---------------------|
|  | Banking             | Management       | Treasury            | Major Segments      | Eliminations        |                     |
|  | (In thousands)      |                  |                     |                     |                     |                     |
| Interest income                          | \$ 90,504           | \$ 24            | \$ 8,885            | \$ 99,413           | \$ -                | \$ 99,413           |
| Interest expense                         | (7,110)             | -                | (10,011)            | (17,121)            | -                   | (17,121)            |
| Net interest income                      | 83,394              | 24               | (1,126)             | 82,292              | -                   | 82,292              |
| Provision for loan and lease losses      | (15,539)            | -                | -                   | (15,539)            | -                   | (15,539)            |
| Non-interest (loss) income               | (11,713)            | 6,893            | 164                 | (4,656)             | -                   | (4,656)             |
| Non-interest expenses                    | (56,844)            | (6,733)          | (860)               | (64,437)            | -                   | (64,437)            |
| Intersegment revenue                     | 163                 | -                | 61                  | 224                 | (224)               | -                   |
| Intersegment expenses                    | (61)                | (87)             | (76)                | (224)               | 224                 | -                   |
| <b>(Loss) income before income taxes</b> | <b>\$ (600)</b>     | <b>\$ 97</b>     | <b>\$ (1,837)</b>   | <b>\$ (2,340)</b>   | <b>\$ -</b>         | <b>\$ (2,340)</b>   |
| <b>Total assets</b>                      | <b>\$ 6,153,663</b> | <b>\$ 21,157</b> | <b>\$ 2,136,293</b> | <b>\$ 8,311,113</b> | <b>\$ (912,788)</b> | <b>\$ 7,398,325</b> |

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## Six-Month Period Ended June 30, 2016

|  | Wealth           |                 | Total Major       |                  | Consolidated |
|--|------------------|-----------------|-------------------|------------------|--------------|
|  | Banking          | Management      | Treasury          | Segments         | Eliminations |
|  | (In thousands)   |                 |                   |                  |              |
| Interest income                          | \$ 160,827       | \$ 34           | \$ 18,353         | \$ 179,214       | \$ -         |
| Interest expense                         | (14,107)         | -               | (16,820)          | (30,927)         | -            |
| Net interest income                      | 146,720          | 34              | 1,533             | 148,287          | -            |
| Provision for loan and lease losses      | (28,234)         | -               | -                 | (28,234)         | -            |
| Non-interest income (loss)               | 16,009           | 12,930          | (281)             | 28,658           | -            |
| Non-interest expenses                    | (97,786)         | (7,853)         | (3,043)           | (108,682)        | -            |
| Intersegment revenue                     | 787              | -               | 149               | 936              | (936)        |
| Intersegment expenses                    | (149)            | (577)           | (210)             | (936)            | 936          |
| <b>Income (loss) before income taxes</b> | <b>\$ 37,347</b> | <b>\$ 4,534</b> | <b>\$ (1,852)</b> | <b>\$ 40,029</b> | <b>\$ -</b>  |

## Six-Month Period Ended June 30, 2015

|  | Wealth            |                 | Total Major       |                   | Consolidated |
|--|-------------------|-----------------|-------------------|-------------------|--------------|
|  | Banking           | Management      | Treasury          | Segments          | Eliminations |
|  | (In thousands)    |                 |                   |                   |              |
| Interest income                          | \$ 187,986        | \$ 47           | \$ 18,381         | \$ 206,414        | \$ -         |
| Interest expense                         | (14,564)          | -               | (19,923)          | (34,487)          | -            |
| Net interest income                      | 173,422           | 47              | (1,542)           | 171,927           | -            |
| Provision for loan and lease losses      | (57,732)          | -               | -                 | (57,732)          | -            |
| Non-interest income (loss)               | (13,962)          | 13,903          | 2,284             | 2,225             | -            |
| Non-interest expenses                    | (106,156)         | (11,524)        | (3,089)           | (120,769)         | -            |
| Intersegment revenue                     | 707               | -               | 160               | 866               | (866)        |
| Intersegment expenses                    | (159)             | (518)           | (189)             | (866)             | 866          |
| <b>(Loss) income before income taxes</b> | <b>\$ (3,880)</b> | <b>\$ 1,908</b> | <b>\$ (2,376)</b> | <b>\$ (4,349)</b> | <b>\$ -</b>  |

## **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 Form 10-K for the year ended December 31, 2015 (the “2015 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 48 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 2015 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 2015 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:

- Loans and lease receivables
- 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 Committee of our Board of Directors. Effective June 30, 2016, pursuant to supervisory direction, the Company changed the purchase credit impaired policy for all loans accounted for under ASC 310-30. Under the revised policy, the Company writes-off the loan's recorded investment and derecognizes the associated allowance for loan and lease losses for loans that exit the pools. The revised policy implementation is performed prospectively due to the immaterial impact for retrospective adoption. Prior to June 30, 2016, the pool's carrying value and allowance was determined by discount expected cash flows at the pool's effective yield. The allowance for loan and lease losses was maintained until all of the loans in the pool were paid off or charged-off. The transition to this revised policy on June 30, 2016 resulted in the de-recognition of loans recorded investment balance and associated allowance for loans that had exited the pools, with no impact to provision for loan and lease losses. Other than this change, there have been no material changes in the methods used to formulate these critical accounting estimates from those discussed in our 2015 Form 10-K.

**OVERVIEW OF FINANCIAL PERFORMANCE****SELECTED FINANCIAL DATA**

|  | Quarter Ended June 30, |                   |               | Six-Month Period Ended June 30, |                    |                |
|--|------------------------|-------------------|---------------|---------------------------------|--------------------|----------------|
|  | 2016                   | 2015              | Variance %    | 2016                            | 2015               | Variance %     |
| <b>EARNINGS DATA:</b>  |                        |                   |               |                                 |                    |                |
| (In thousands, except per share data)                                |                        |                   |               |                                 |                    |                |
| Interest income  | \$ 87,908              | \$ 99,413         | -11.6%        | \$ 179,214                      | \$ 206,414         | -13.2%         |
| Interest expense   | 14,596                 | 17,121            | -14.7%        | 30,927                          | 34,487             | -10.3%         |
| <b>Net interest income</b>   | <b>73,312</b>          | <b>82,292</b>     | <b>-10.9%</b> | <b>148,287</b>                  | <b>171,927</b>     | <b>-13.8%</b>  |
| Provision for loan and lease losses                                  | 14,445                 | 15,539            | -7.0%         | 28,234                          | 57,732             | -51.1%         |
| <b>Net interest income after provision for loan and lease losses</b> | <b>58,867</b>          | <b>66,753</b>     | <b>-11.8%</b> | <b>120,053</b>                  | <b>114,195</b>     | <b>5.1%</b>    |
| Non-interest income (loss)   | 15,155                 | (4,656)           | <b>425.5%</b> | 28,658                          | 2,225              | 1188.0%        |
| Non-interest expenses  | 53,825                 | 64,437            | -16.5%        | 108,682                         | 120,769            | -10.0%         |
| <b>Income (loss) before taxes</b>                                    | <b>20,197</b>          | <b>(2,340)</b>    | <b>963.1%</b> | <b>40,029</b>                   | <b>(4,349)</b>     | <b>1020.4%</b> |
| Income tax expense   | 5,858                  | 769               | 661.8%        | 11,519                          | 1,748              | 559.0%         |
| <b>Net income (loss)</b>   | <b>14,339</b>          | <b>(3,109)</b>    | <b>561.2%</b> | <b>28,510</b>                   | <b>(6,097)</b>     | <b>567.6%</b>  |
| Less: dividends on preferred stock                                   | (3,466)                | (3,466)           | 0.0%          | (6,931)                         | (6,931)            | 0.0%           |
| <b>Income (loss) available to common shareholders</b>                | <b>\$ 10,873</b>       | <b>\$ (6,575)</b> | <b>265.4%</b> | <b>\$ 21,579</b>                | <b>\$ (13,028)</b> | <b>265.6%</b>  |
| <b>PER SHARE DATA:</b>   |                        |                   |               |                                 |                    |                |
| <b>Basic</b>   | <b>\$ 0.25</b>         | <b>\$ (0.15)</b>  | <b>267.6%</b> | <b>\$ 0.49</b>                  | <b>\$ (0.29)</b>   | <b>268.1%</b>  |
| <b>Diluted</b>   | <b>\$ 0.25</b>         | <b>\$ (0.15)</b>  | <b>267.6%</b> | <b>\$ 0.49</b>                  | <b>\$ (0.29)</b>   | <b>268.1%</b>  |
| Average common shares outstanding                                    | 43,914                 | 44,505            | -1.3%         | 43,906                          | 44,569             | -1.5%          |
| Average common shares outstanding and equivalents                    | 51,095                 | 51,774            | -1.3%         | 51,081                          | 51,876             | -1.5%          |
| Cash dividends declared per common share                             | \$ 0.06                | \$ 0.10           | -40.3%        | \$ 0.12                         | \$ 0.20            | -40.3%         |
| Cash dividends declared on common shares                             | \$ 2,639               | \$ 4,457          | -40.8%        | \$ 5,272                        | \$ 8,920           | -40.9%         |
| <b>PERFORMANCE RATIOS:</b>   |                        |                   |               |                                 |                    |                |
| Return on average assets (ROA)                                       | 0.85%                  | -0.17%            | 598.7%        | 0.83%                           | -0.17%             | 588.2%         |
| Return on average tangible common equity                             | 6.70%                  | -3.93%            | 270.4%        | 6.69%                           | -3.84%             | 274.1%         |
| Return on average common equity (ROE)                                | 5.86%                  | -3.44%            | 270.2%        | 5.85%                           | -3.37%             | 273.5%         |
| Equity-to-assets ratio   | 13.64%                 | 12.32%            | 10.7%         | 13.64%                          | 12.32%             | 10.7%          |
| Efficiency ratio   | 58.76%                 | 63.39%            | -7.3%         | 59.16%                          | 57.37%             | 3.1%           |
| Interest rate spread   | 4.55%                  | 4.68%             | -2.8%         | 4.60%                           | 4.91%              | -6.3%          |
| Interest rate margin   | 4.65%                  | 4.92%             | -5.5%         | 4.68%                           | 5.14%              | -8.9%          |



## SELECTED FINANCIAL DATA - (Continued)

|  | June 30,<br>2016    | December 31,<br>2015 | Variance<br>% |
|--|---------------------|----------------------|---------------|
| <b>PERIOD END BALANCES AND CAPITAL RATIOS:</b> |                     |                      |               |
| (In thousands, except per share data)          |                     |                      |               |
| <b>Investments and loans</b>                   |                     |                      |               |
| Investment securities                          | \$ 1,319,890        | \$ 1,615,872         | -18.3%        |
| Loans and leases, net                          | 4,373,617           | 4,434,213            | -1.4%         |
| <b>Total investments and loans</b>             | <b>\$ 5,693,507</b> | <b>\$ 6,050,085</b>  | <b>-5.9%</b>  |
| <b>Deposits and borrowings</b>                 |                     |                      |               |
| Deposits                                       | \$ 4,644,054        | \$ 4,717,751         | -1.6%         |
| Securities sold under agreements to repurchase | 626,109             | 934,691              | -33.0%        |
| Other borrowings                               | 411,216             | 436,843              | -5.9%         |
| <b>Total deposits and borrowings</b>           | <b>\$ 5,681,379</b> | <b>\$ 6,089,285</b>  | <b>-6.7%</b>  |
| <b>Stockholders' equity</b>                    |                     |                      |               |
| Preferred stock                                | \$ 176,000          | \$ 176,000           | 0.0%          |
| Common stock                                   | 52,626              | 52,626               | 0.0%          |
| Additional paid-in capital                     | 540,705             | 540,512              | 0.0%          |
| Legal surplus                                  | 73,265              | 70,435               | 4.0%          |
| Retained earnings                              | 162,363             | 148,886              | 9.1%          |
| Treasury stock, at cost                        | (104,874)           | (105,379)            | 0.5%          |
| Accumulated other comprehensive income         | 15,805              | 13,997               | 12.9%         |
| <b>Total stockholders' equity</b>              | <b>\$ 915,890</b>   | <b>\$ 897,077</b>    | <b>2.1%</b>   |
| <b>Per share data</b>                          |                     |                      |               |
| <b>Book value per common share</b>             | <b>\$ 17.08</b>     | <b>\$ 16.67</b>      | <b>2.5%</b>   |
| <b>Tangible book value per common share</b>    | <b>\$ 14.96</b>     | <b>\$ 14.53</b>      | <b>3.0%</b>   |
| <b>Market price at end of period</b>           | <b>\$ 8.30</b>      | <b>\$ 7.32</b>       | <b>13.4%</b>  |
| <b>Capital ratios</b>                          |                     |                      |               |
| <b>Leverage capital</b>                        | <b>11.92%</b>       | <b>11.18%</b>        | <b>6.6%</b>   |
| <b>Common equity Tier 1 capital</b>            | <b>12.64%</b>       | <b>12.14%</b>        | <b>4.1%</b>   |
| <b>Tier 1 risk-based capital</b>               | <b>16.71%</b>       | <b>15.99%</b>        | <b>4.5%</b>   |
| <b>Total risk-based capital</b>                | <b>18.00%</b>       | <b>17.29%</b>        | <b>4.1%</b>   |
| <b>Financial assets managed</b>                |                     |                      |               |
| Trust assets managed                           | \$ 2,779,612        | \$ 2,691,423         | 3.3%          |
| Broker-dealer assets gathered                  | \$ 2,387,445        | \$ 2,374,709         | 0.5%          |

**FINANCIAL HIGHLIGHTS OF THE SECOND QUARTER OF 2016**

- **Net income available to shareholders was in line with the preceding quarter and surpassed the year ago quarter.** The Company generated \$10.9 million, or \$0.25 per share fully diluted, compared to \$10.7 million, or \$0.24, in the preceding quarter. In the year ago quarter, the Company reported a net loss of \$6.6 million, or (\$0.15) per share, primarily due to non-recurring charges.
- **Oriental Bank's overall performance continued strong.** New loan generation at \$237.8 million grew 5.1% from the preceding quarter, with increased activity in auto, mortgage, and consumer loans. Banking and wealth management fee revenues increased 6.8% from the preceding quarter.
- **Credit quality continued its positive trajectory.** Net charge-offs (excluding acquired loans) declined to 1.21% from 1.30% in the first quarter. Early and total delinquency rates dropped from the previous and year-ago quarters. Non-performing loan rates fell to the lowest level in the last five quarters.
- **Costs remained under control.** The efficiency ratio improved to 58.76%, the best level in the last five quarters.
- **Total Puerto Rico government related exposure continued to decline.** Balances fell approximately 1.0%, to \$405.3 million during the second quarter. In addition, Puerto Rico Electric Power Authority (PREPA) continued to make significant progress toward final implementation of its Restructuring Support Agreement by the end of 2016.
- **Net Interest Margin (NIM) remained relatively level,** at 4.65% compared to 4.92% in the year-ago quarter.
- **Capital continued to build.** Tangible book value per common share increased to \$14.96 from \$14.53. Tangible common equity (TCE) ratio increased to 9.92% from 9.10% in December 31, 2015.

## 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, 2016 and 2015:

**TABLE 1 - QUARTERLY ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE QUARTERS ENDED JUNE 30, 2016 AND 2015**

|  | Interest      |               | Average rate  |               | Average balance  |                  |
|--|---------------|---------------|---------------|---------------|------------------|------------------|
|  | June 2016     | June 2015     | June 2016     | June 2015     | June 2016        | June 2015        |
| (Dollars in thousands)                             |               |               |               |               |                  |                  |
| <b>A - NORMAL SPREAD</b>                           |               |               |               |               |                  |                  |
| <b>Interest-earning assets:</b>                    |               |               |               |               |                  |                  |
| <b>Investments:</b>                                |               |               |               |               |                  |                  |
| Investment securities                              | \$ 7,621      | \$ 8,587      | 2.33%         | 2.33%         | \$ 1,311,468     | \$ 1,476,867     |
| Interest bearing cash and money market investments | 612           | 322           | 0.48%         | 0.27%         | 512,916          | 483,507          |
| <b>Total investments</b>                           | <b>8,233</b>  | <b>8,909</b>  | <b>1.81%</b>  | <b>1.84%</b>  | <b>1,824,384</b> | <b>1,960,374</b> |
| <b>Non-acquired loans</b>                          |               |               |               |               |                  |                  |
| Mortgage   | 9,851         | 9,698         | 5.31%         | 4.97%         | 743,516          | 782,753          |
| Commercial   | 15,824        | 14,375        | 4.43%         | 4.32%         | 1,433,944        | 1,333,276        |
| Consumer   | 6,548         | 4,953         | 10.68%        | 10.32%        | 246,003          | 192,572          |
| Auto and leasing                                   | 16,885        | 15,213        | 9.59%         | 9.86%         | 706,107          | 618,746          |
| <b>Total non-acquired loans</b>                    | <b>49,108</b> | <b>44,239</b> | <b>6.29%</b>  | <b>6.06%</b>  | <b>3,129,570</b> | <b>2,927,347</b> |
| <b>Acquired loans:</b>                             |               |               |               |               |                  |                  |
| <b>Acquired BBVAPR</b>                             |               |               |               |               |                  |                  |
| Mortgage   | 8,294         | 8,813         | 5.52%         | 5.57%         | 602,184          | 634,794          |
| Commercial   | 6,572         | 11,770        | 7.69%         | 9.49%         | 342,752          | 497,422          |
| Consumer   | 3,173         | 3,445         | 18.19%        | 16.91%        | 69,949           | 81,713           |
| Auto   | 5,605         | 9,479         | 10.44%        | 10.23%        | 215,321          | 371,494          |
| <b>Total acquired BBVAPR loans</b>                 | <b>23,644</b> | <b>33,507</b> | <b>7.71%</b>  | <b>8.48%</b>  | <b>1,230,206</b> | <b>1,585,423</b> |
| <b>Acquired Eurobank</b>                           | <b>6,923</b>  | <b>12,758</b> | <b>19.29%</b> | <b>21.74%</b> | <b>144,001</b>   | <b>235,375</b>   |
| <b>Total loans</b>                                 | <b>79,675</b> | <b>90,504</b> | <b>7.10%</b>  | <b>7.65%</b>  | <b>4,503,777</b> | <b>4,748,145</b> |
| <b>Total interest earning assets</b>               | <b>87,908</b> | <b>99,413</b> | <b>5.57%</b>  | <b>5.94%</b>  | <b>6,328,161</b> | <b>6,708,519</b> |
| <b>Interest-bearing liabilities:</b>               |               |               |               |               |                  |                  |
| <b>Deposits:</b>                                   |               |               |               |               |                  |                  |
| NOW Accounts                                       | \$ 1,518      | \$ 1,073      | 0.51%         | 0.38%         | \$ 1,195,895     | \$ 1,144,931     |
| Savings and money market                           | 1,308         | 1,662         | 0.48%         | 0.51%         | 1,103,808        | 1,300,001        |
| Individual retirement accounts                     | 464           | 600           | 0.69%         | 0.85%         | 269,417          | 283,587          |
| Retail certificates of deposits                    | 1,474         | 1,326         | 1.26%         | 1.31%         | 468,750          | 405,302          |
| <b>Total core deposits</b>                         | <b>4,764</b>  | <b>4,661</b>  | <b>0.63%</b>  | <b>0.60%</b>  | <b>3,037,870</b> | <b>3,133,821</b> |
| Institutional deposits                             | 620           | 698           | 1.02%         | 1.00%         | 243,592          | 280,930          |
| Brokered deposits                                  | 1,816         | 1,085         | 1.19%         | 0.76%         | 612,137          | 571,950          |
| <b>Total wholesale deposits</b>                    | <b>2,436</b>  | <b>1,783</b>  | <b>1.14%</b>  | <b>0.84%</b>  | <b>855,729</b>   | <b>852,880</b>   |

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|   |                  |                  |              |              |                   |                   |
|---|------------------|------------------|--------------|--------------|-------------------|-------------------|
|   | <b>7,200</b>     | <b>6,444</b>     | <b>0.74%</b> | <b>0.65%</b> | <b>3,893,599</b>  | <b>3,986,701</b>  |
| Non-interest bearing deposits                         | -                | -                | 0.00%        | 0.00%        | 810,177           | \$ 773,479        |
| Deposits fair value premium amortization              | (91)             | (132)            | 0.00%        | 0.00%        | -                 | -                 |
| Core deposit intangible amortization                  | 258              | 292              | 0.00%        | 0.00%        | -                 | -                 |
| <b>Total deposits</b>                                 | <b>7,367</b>     | <b>6,604</b>     | <b>0.63%</b> | <b>0.56%</b> | <b>4,703,776</b>  | <b>4,760,180</b>  |
| <b>Borrowings:</b>                                    |                  |                  |              |              |                   |                   |
| Securities sold under agreements to repurchase        | 4,258            | 7,394            | 2.72%        | 2.91%        | 627,693           | 1,020,077         |
| Advances from FHLB and other borrowings               | 2,098            | 2,248            | 2.65%        | 2.62%        | 317,191           | 344,088           |
| Subordinated capital notes                            | 873              | 875              | 3.40%        | 3.44%        | 102,869           | 101,938           |
| <b>Total borrowings</b>                               | <b>7,229</b>     | <b>10,517</b>    | <b>2.77%</b> | <b>2.88%</b> | <b>1,047,753</b>  | <b>1,466,103</b>  |
| <b>Total interest bearing liabilities</b>             | <b>14,596</b>    | <b>17,121</b>    | <b>1.02%</b> | <b>1.10%</b> | <b>5,751,529</b>  | <b>6,226,283</b>  |
| <b>Net interest income / spread</b>                   | <b>\$ 73,312</b> | <b>\$ 82,292</b> | <b>4.55%</b> | <b>4.84%</b> |                   |                   |
| <b>Interest rate margin</b>                           |                  |                  | <b>4.65%</b> | <b>4.92%</b> |                   |                   |
| <b>Excess of average interest-earning assets over</b> |                  |                  |              |              |                   |                   |
| <b>average interest-bearing liabilities</b>           |                  |                  |              |              | <b>\$ 576,632</b> | <b>\$ 482,236</b> |
| <b>Average interest-earning assets to average</b>     |                  |                  |              |              |                   |                   |
| <b>interest-bearing liabilities ratio</b>             |                  |                  |              |              | <b>110.03%</b>    | <b>107.75%</b>    |

**B - CHANGES IN NET INTEREST INCOME DUE TO:**

|                               | Volume            | Rate              | Total             |
|-------------------------------|-------------------|-------------------|-------------------|
|                               | (In thousands)    |                   |                   |
| <b>Interest Income:</b>       |                   |                   |                   |
| Investments                   | \$ (618)          | \$ (58)           | \$ (676)          |
| Loans                         | (9,404)           | (1,424)           | (10,828)          |
| <b>Total interest income</b>  | <b>(10,022)</b>   | <b>(1,482)</b>    | <b>(11,504)</b>   |
| <b>Interest Expense:</b>      |                   |                   |                   |
| Deposits                      | (78)              | 840               | 762               |
| Repurchase agreements         | (2,844)           | (292)             | (3,136)           |
| Other borrowings              | (182)             | 30                | (152)             |
| <b>Total interest expense</b> | <b>(3,104)</b>    | <b>578</b>        | <b>(2,526)</b>    |
| <b>Net Interest Income</b>    | <b>\$ (6,918)</b> | <b>\$ (2,060)</b> | <b>\$ (8,978)</b> |

|  | Interest         |                  | Average rate |              | Average balance     |                     |
|--|------------------|------------------|--------------|--------------|---------------------|---------------------|
|  | June             | June             | June         | June         | June                | June                |
|  | 2016             | 2015             | 2016         | 2015         | 2016                | 2015                |
| <b>(Dollars in thousands)</b>                      |                  |                  |              |              |                     |                     |
| <b>C - TAX EQUIVALENT SPREAD</b>                   |                  |                  |              |              |                     |                     |
| <b>(GAAP to Non-GAAP)</b>                          |                  |                  |              |              |                     |                     |
| <b>Interest-earning assets (GAAP)</b>              | <b>\$ 87,908</b> | <b>\$ 99,413</b> | <b>5.57%</b> | <b>5.94%</b> | <b>\$ 6,328,161</b> | <b>\$ 6,708,519</b> |
| Tax equivalent adjustment                          | 1,422            | 3,811            | 0.09%        | 0.23%        | -                   | -                   |
| <b>Interest-earning assets - tax equivalent</b>    | <b>89,330</b>    | <b>103,224</b>   | <b>5.66%</b> | <b>6.18%</b> | <b>6,328,161</b>    | <b>6,708,519</b>    |
| Interest-bearing liabilities (GAAP)                | 14,596           | 17,121           | 1.02%        | 1.10%        | 5,751,529           | 6,226,283           |
| <b>Tax equivalent net interest income / spread</b> | <b>74,734</b>    | <b>86,103</b>    | <b>4.64%</b> | <b>5.08%</b> | <b>576,632</b>      | <b>482,236</b>      |
| <b>Tax equivalent interest rate margin</b>         |                  |                  | <b>4.74%</b> | <b>5.15%</b> |                     |                     |

**TABLE 1 - YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2016 AND 2015**

|  | Interest       |                | Average rate  |               | Average balance  |                  |
|--|----------------|----------------|---------------|---------------|------------------|------------------|
|  | June 2016      | June 2015      | June 2016     | June 2015     | June 2016        | June 2015        |
| (Dollars in thousands)                             |                |                |               |               |                  |                  |
| <b>A - NORMAL SPREAD</b>                           |                |                |               |               |                  |                  |
| <b>Interest-earning assets:</b>                    |                |                |               |               |                  |                  |
| <b>Investments:</b>                                |                |                |               |               |                  |                  |
| Investment securities                              | \$ 17,129      | \$ 17,782      | 2.49%         | 2.54%         | \$ 1,380,798     | \$ 1,411,107     |
| Interest bearing cash and money market investments | 1,258          | 645            | 0.50%         | 0.25%         | 507,817          | 523,649          |
| <b>Total investments</b>                           | <b>18,387</b>  | <b>18,427</b>  | <b>1.95%</b>  | <b>1.92%</b>  | <b>1,888,615</b> | <b>1,934,756</b> |
| <b>Non-acquired loans</b>                          |                |                |               |               |                  |                  |
| Mortgage   | 19,456         | 19,908         | 5.20%         | 5.11%         | 749,904          | 785,029          |
| Commercial   | 31,238         | 31,329         | 4.38%         | 4.85%         | 1,429,638        | 1,301,367        |
| Consumer   | 12,734         | 9,538          | 10.63%        | 10.28%        | 240,251          | 187,049          |
| Auto and leasing                                   | 33,595         | 29,747         | 9.69%         | 9.89%         | 695,071          | 606,819          |
| <b>Total non-acquired loans</b>                    | <b>97,023</b>  | <b>90,522</b>  | <b>6.25%</b>  | <b>6.34%</b>  | <b>3,114,864</b> | <b>2,880,264</b> |
| <b>Acquired loans:</b>                             |                |                |               |               |                  |                  |
| <b>Acquired BBVAPR</b>                             |                |                |               |               |                  |                  |
| Mortgage   | 16,601         | 17,800         | 5.57%         | 5.59%         | 597,212          | 642,063          |
| Commercial   | 14,268         | 26,342         | 8.73%         | 10.34%        | 327,810          | 513,950          |
| Consumer   | 6,276          | 6,634          | 18.20%        | 15.64%        | 69,164           | 85,541           |
| Auto   | 12,175         | 18,426         | 11.52%        | 8.65%         | 211,986          | 429,619          |
| <b>Total acquired BBVAPR loans</b>                 | <b>49,320</b>  | <b>69,202</b>  | <b>8.20%</b>  | <b>8.35%</b>  | <b>1,206,172</b> | <b>1,671,173</b> |
| <b>Acquired Eurobank</b>                           | <b>14,484</b>  | <b>28,263</b>  | <b>20.37%</b> | <b>22.35%</b> | <b>142,578</b>   | <b>255,053</b>   |
| <b>Total loans</b>                                 | <b>160,827</b> | <b>187,987</b> | <b>7.23%</b>  | <b>7.89%</b>  | <b>4,463,613</b> | <b>4,806,490</b> |
| <b>Total interest earning assets</b>               | <b>179,214</b> | <b>206,414</b> | <b>5.66%</b>  | <b>6.17%</b>  | <b>6,352,228</b> | <b>6,741,246</b> |
| <b>Interest-bearing liabilities:</b>               |                |                |               |               |                  |                  |
| <b>Deposits:</b>                                   |                |                |               |               |                  |                  |
| NOW Accounts                                       | 2,600          | 2,354          | 0.44%         | 0.39%         | 1,173,975        | 1,202,621        |
| Savings and money market                           | 2,706          | 3,396          | 0.49%         | 0.52%         | 1,109,680        | 1,307,141        |
| Individual retirement accounts                     | 966            | 1,371          | 0.72%         | 0.95%         | 268,238          | 289,877          |
| Retail certificates of deposits                    | 2,813          | 2,733          | 1.27%         | 1.32%         | 443,371          | 416,608          |
| <b>Total core deposits</b>                         | <b>9,085</b>   | <b>9,854</b>   | <b>0.61%</b>  | <b>0.61%</b>  | <b>2,995,264</b> | <b>3,216,247</b> |
| Institutional deposits                             | 1,274          | 1,497          | 1.00%         | 1.11%         | 256,699          | 272,991          |
| Brokered deposits                                  | 3,804          | 2,251          | 1.13%         | 0.77%         | 673,231          | 586,986          |
| <b>Total wholesale deposits</b>                    | <b>5,078</b>   | <b>3,748</b>   | <b>1.10%</b>  | <b>0.87%</b>  | <b>929,930</b>   | <b>859,977</b>   |
|  | 14,163         | 13,602         | 0.72%         | 0.67%         | 3,925,194        | 4,076,224        |
| Non-interest bearing deposits                      | -              | -              | 0.00%         | 0.00%         | 792,564          | 762,122          |
| Deposits fair value premium amortization           | (189)          | (479)          | 0.00%         | 0.00%         | -                | -                |
| Core deposit intangible amortization               | 517            | 585            | 0.00%         | 0.00%         | -                | -                |
| <b>Total deposits</b>                              | <b>14,491</b>  | <b>13,708</b>  | <b>0.62%</b>  | <b>0.57%</b>  | <b>4,717,758</b> | <b>4,838,346</b> |
| <b>Borrowings:</b>                                 |                |                |               |               |                  |                  |
| Securities sold under agreements to repurchase     | 10,358         | 14,558         | 2.91%         | 3.00%         | 713,653          | 979,950          |
| Advances from FHLB and other borrowings            | 4,337          | 4,483          | 2.66%         | 2.65%         | 327,278          | 340,709          |

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|   |                   |                   |              |              |                   |                   |
|---|-------------------|-------------------|--------------|--------------|-------------------|-------------------|
| Subordinated capital notes                        | 1,741             | 1,738             | 3.40%        | 3.44%        | 102,782           | 101,808           |
| <b>Total borrowings</b>                           | <b>16,436</b>     | <b>20,779</b>     | <b>2.88%</b> | <b>2.95%</b> | <b>1,143,713</b>  | <b>1,422,467</b>  |
| <b>Total interest bearing liabilities</b>         | <b>30,927</b>     | <b>34,487</b>     | <b>1.06%</b> | <b>1.11%</b> | <b>5,861,471</b>  | <b>6,260,813</b>  |
| <b>Net interest income / spread</b>               | <b>\$ 148,287</b> | <b>\$ 171,927</b> | <b>4.60%</b> | <b>5.06%</b> |                   |                   |
| <b>Interest rate margin</b>                       |                   |                   | <b>4.68%</b> | <b>5.14%</b> |                   |                   |
| <b>Excess of average interest-earning assets</b>  |                   |                   |              |              | <b>\$ 490,758</b> | <b>\$ 480,434</b> |
| <b>over average interest-bearing liabilities</b>  |                   |                   |              |              |                   |                   |
| <b>Average interest-earning assets to average</b> |                   |                   |              |              |                   |                   |
| <b>interest-bearing liabilities ratio</b>         |                   |                   |              |              | <b>108.37%</b>    | <b>107.67%</b>    |

**B - CHANGES IN NET INTEREST INCOME DUE TO:**

|                               | Volume             | Rate              | Total              |
|-------------------------------|--------------------|-------------------|--------------------|
|                               | (In thousands)     |                   |                    |
| <b>Interest Income:</b>       |                    |                   |                    |
| Investments                   | \$ (439)           | \$ 399            | \$ (40)            |
| Loans                         | (20,548)           | (6,610)           | (27,158)           |
| <b>Total interest income</b>  | <b>(20,987)</b>    | <b>(6,211)</b>    | <b>(27,198)</b>    |
| <b>Interest Expense:</b>      |                    |                   |                    |
| Deposits                      | (342)              | 1,125             | 783                |
| Repurchase agreements         | (3,956)            | (246)             | (4,202)            |
| Other borrowings              | (175)              | 35                | (140)              |
| <b>Total interest expense</b> | <b>(4,473)</b>     | <b>914</b>        | <b>(3,559)</b>     |
| <b>Net Interest Income</b>    | <b>\$ (16,514)</b> | <b>\$ (7,125)</b> | <b>\$ (23,639)</b> |

|  | Interest          |                   | Average rate |              | Average balance     |                     |
|--|-------------------|-------------------|--------------|--------------|---------------------|---------------------|
|  | June              | June              | June         | June         | June                | June                |
|  | 2016              | 2015              | 2016         | 2015         | 2016                | 2015                |
| <b>C - TAX EQUIVALENT SPREAD</b>                   |                   |                   |              |              |                     |                     |
| <b>(Non-GAAP to GAAP)</b>                          |                   |                   |              |              |                     |                     |
| <b>Interest-earning assets (GAAP)</b>              | <b>\$ 179,214</b> | <b>\$ 206,414</b> | <b>5.66%</b> | <b>6.17%</b> | <b>\$ 6,352,229</b> | <b>\$ 6,741,247</b> |
| Tax equivalent adjustment                          | 2,588             | 20,756            | 0.08%        | 0.62%        | -                   | -                   |
| <b>Interest-earning assets - tax equivalent</b>    | <b>181,802</b>    | <b>227,170</b>    | <b>5.74%</b> | <b>6.80%</b> | <b>6,352,229</b>    | <b>6,741,247</b>    |
| Interest-bearing liabilities (GAAP)                | 30,927            | 34,487            | 1.06%        | 1.11%        | 5,861,471           | 6,260,813           |
| <b>Tax equivalent net interest income / spread</b> | <b>150,875</b>    | <b>192,683</b>    | <b>4.68%</b> | <b>5.69%</b> | <b>490,758</b>      | <b>480,434</b>      |
| <b>Tax equivalent interest rate margin</b>         |                   |                   | <b>4.76%</b> | <b>5.76%</b> |                     |                     |



## Net Interest Income

Net interest income is a function of the difference between rates earned on the Company's interest-earning assets and rates paid on its interest-bearing liabilities (interest rate spread) and the relative amounts of its interest earning assets and interest-bearing liabilities (interest rate margin). The Company constantly monitors the composition and re-pricing of its assets and liabilities to maintain its net interest income at adequate levels.

### *Comparison of quarters ended June 30, 2016 and 2015*

Table 1 above shows the 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 ended June 30, 2016 and 2015.

Net interest income of \$73.3 million decreased 10.9% compared with \$82.3 million reported in the second quarter of 2015, primarily reflecting a decrease of 12.0% in interest income from loans.

Interest rate spread decreased 29 basis points from 4.84% to 4.55%. This decrease is mainly due to the net effect of a 37 basis points decrease in the average yield of interest-earning assets from 5.94% to 5.57%.

Interest income decreased to \$87.9 million from \$99.4 million in the second quarter of 2016. Such decrease reflects decreases of \$10.0 million and \$1.5 million in the volume and interest rate, respectively, of interest-earning assets. Interest income from investments decreased 7.6% to \$8.2 million, reflecting decreases in volume and interest rate of \$618 thousand and \$58 thousand, respectively. Interest income from loans decreased 12.0% to \$79.7 million, reflecting a decrease in volume and interest rate of \$9.4 million and \$1.4 million, respectively, primarily due to lower acquired loan balances and yields. Our loan portfolio is transitioning as originated loans with normal yields grow at a slower pace than higher-yielding acquired loans decrease due to repayments and maturities.

Originated loans interest income increased 11.0% to \$49.1 million as average balances grew 6.9% and yields increased 23 basis points to 6.29%. Acquired BBVAPR loans interest income declined 29.4% to \$23.7 million as average balances declined 22.4% and yields decreased 76 basis points to 7.71%. Acquired Eurobank loans interest income fell 45.9% to \$6.9 million as average balances declined 38.8% and yields decreased 253 basis points to 19.29%.

The average balance of total interest-earning assets was \$6.328 billion, a decrease of 5.7% from the same period in 2015. The decrease in average balance of interest-earning assets was mainly attributable to a decrease of 5.1% in average loans, and a decrease of 6.9% in average investments. The decrease in average loans is mostly related to the bulk sale on September 28, 2015, of a portion of covered non-performing commercial loans amounting to \$197.1 million unpaid principal balance or UPB (\$100.0 million carrying amount), the de-risking of the government exposures, and to the repayment and maturities of acquired loans.

Interest expense decreased 14.8% to \$14.6 million, primarily because of a \$3.1 million decrease in the volume of interest-bearing liabilities, partially offset by an increase of \$578 thousand in interest rate. The decrease in interest-bearing liabilities is mostly due to the decrease in repurchase agreements volume of \$2.8 million. The decrease in repurchase agreement volume reflects a partial unwinding of repurchase agreements during the first quarter of 2016 amounting to \$268.0 million, which carried a cost of 4.78%. The cost of deposits before fair value amortization and core deposit intangible amortization increased 9 basis points to 0.74% for the second quarter of 2016, compared to 0.65% for the second quarter of 2015. The cost of borrowings decreased 11 basis points to 2.77% from 2.88%.

*Comparison of six-month periods ended June 30, 2016 and 2015*

Table 1 above also shows the 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 six-month periods ended June 30, 2016 and 2015. Net interest income of \$148.3 million decreased 13.8% compared with \$171.9 million reported during the same period in 2015, reflecting a decrease of 14.4% in interest income from loans.

Interest rate spread decreased 46 basis points from 5.06% to 4.60%. This decrease is mainly due to the net effect of a 51 basis point decrease in the average yield of interest-earning assets from 6.17% to 5.66%.

Interest income decreased to \$179.2 million from \$206.4 million in the same period in 2015. Such decrease reflects decreases of \$21.0 million and \$6.2 million in the volume and interest rate, respectively, of interest-earning assets. Interest income from loans decreased 14.4% to \$160.8 million, reflecting a decrease in volume and interest rate of \$20.5 million and \$6.6 million, respectively, primarily due to lower acquired loan balances and yields. Our loan portfolio is transitioning as originated loans with normal yields grow at a slower pace than higher-yielding acquired loans decrease due to repayments and maturities.

Originated loans interest income increased 7.2% to \$97.0 million as average balances grew 8.1% and yields decreased 9 basis points to 6.25%. During the first quarter of 2015, the revolving line of credit to PREPA was classified as non-accrual. Starting with the second quarter of 2015, quarterly interest payments of \$3.6 million have been applied to principal.

Acquired BBVAPR loans interest income declined 28.7% to \$49.3 million as average balances declined 27.8% and yields decreased 15 basis points to 8.20%. Acquired Eurobank loans interest income fell 48.8% to \$14.5 million as average balances declined 44.1% and yields decreased 201 basis points to 20.37%. Interest income from investments remained at \$18.4 million, reflecting a decrease in volume of \$439 thousand, partially offset by an increase of \$399 thousand in interest rate. The average balance of total interest-earning assets was \$6.352 billion, a decrease of 5.8% from the same period in 2015. The decrease in average balance of interest-earning assets was mainly attributable to a decrease of 5.1% in average loans. The decrease in average loans is mostly related to the bulk sale on September 28, 2015, of a portion of covered non-performing commercial loans amounting to \$197.1 million unpaid principal balance or UPB (\$100.0 million carrying amount).

Interest expense decreased 10.3% to \$30.9 million, primarily because of a \$4.5 million decrease in the volume of interest-bearing liabilities and an increase of \$914 thousand in deposit interest rate. The decrease in interest-bearing liabilities is mostly due to the decrease in repurchase agreements volume of \$4.0 million and a decrease in deposit

volume of \$342 thousand which was offset by an increase in deposit interest rate of \$1.1 million. The decrease in repurchase agreement volume reflects a partial unwinding of repurchase agreements during the first quarter of 2016 amounting to \$268.0 million, which carried a cost of 4.78%. The cost of deposits before fair value amortization and core deposit intangible amortization slightly increased 5 basis point to 0.72%, compared to 0.67% for the same period in 2015. The cost of borrowings decreased 7 basis points to 2.88% from 2.95%.

**TABLE 2 - NON-INTEREST  
INCOME SUMMARY**

|  | Quarter Ended June 30, |                   |               | Six-Month Period<br>Ended June 30, |                 |                |
|--|------------------------|-------------------|---------------|------------------------------------|-----------------|----------------|
|  | 2016                   | 2015              | Variance      | 2016                               | 2015            | Variance       |
|  | (Dollars in thousands) |                   |               |                                    |                 |                |
| Banking service revenue                                | \$ 10,219              | \$ 10,212         | 0.1%          | \$ 20,337                          | \$ 20,417       | -0.4%          |
| Wealth management revenue                              | 7,041                  | 7,285             | -3.3%         | 13,193                             | 14,440          | -8.6%          |
| Mortgage banking activities                            | 1,024                  | 1,862             | -45.0%        | 1,879                              | 3,725           | -49.6%         |
| <b>Total banking and financial<br/>service revenue</b> | <b>18,284</b>          | <b>19,359</b>     | <b>-5.6%</b>  | <b>35,409</b>                      | <b>38,582</b>   | <b>-8.2%</b>   |
| FDIC shared-loss expense, net                          | (3,420)                | (23,245)          | 85.3%         | (7,449)                            | (36,329)        | 79.5%          |
| Net gain (loss) on:                                    |                        |                   |               |                                    |                 |                |
| Sale of securities available for sale                  | 211                    | -                 | 100.0%        | 12,207                             | 2,572           | 374.6%         |
| Derivatives  | (10)                   | 77                | -113.0%       | (13)                               | (13)            | 0.0%           |
| Early extinguishment of debt                           | -                      | -                 | 0.0%          | (12,000)                           | -               | -100.0%        |
| Other non-interest income (loss)                       | 90                     | (847)             | 110.6%        | 504                                | (2,587)         | 119.5%         |
|  | (3,129)                | (24,015)          | 87.0%         | (6,751)                            | (36,357)        | 81.4%          |
| <b>Total non-interest income (loss), net \$</b>        | <b>15,155</b>          | <b>\$ (4,656)</b> | <b>425.5%</b> | <b>\$ 28,658</b>                   | <b>\$ 2,225</b> | <b>1188.0%</b> |

**Non-Interest Income, net**

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, trading and other transactions.

**Comparison of quarters ended June 30, 2016 and 2015**

As shown in Table 2 above, the Company recorded non-interest income, net, in the amount of \$15.2 million, compared to a \$4.7 million non-interest loss for the same period in 2015, an increase of \$19.8 million.

Banking service revenue, which consists primarily of fees generated by deposit accounts, electronic banking services, and customer services, remained at \$10.2 million, as compared to the same period in 2015. Electronic banking fees increased from higher transactions in debit cards and point-of-sale (POS) as portfolio and merchant amounts increased, offset by lower overdraft fees, mostly in commercial checking accounts, and a decrease in international service fees.

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased 3.3% to \$7.0 million, compared to \$7.3 million for the same period in 2015. Such decrease reflects a reduction in some securities brokerage activities and a reduction in fees from the IRA

portfolio. Client trading volumes in our broker-dealer subsidiary continued to fall due to general investor uncertainty in the Puerto Rico market.

Income generated from mortgage banking activities decreased 45.0% to \$1.0 million, compared to \$1.9 million for the same period in 2015. The decrease in mortgage banking activities was mostly due to a decrease in servicing income of \$1.1 million, as the Company sold part of its mortgage servicing asset during the second quarter of 2015. In addition, mortgage banking activities were affected by foregone gains on sales as a result of the Company retaining securitized GNMA pools, more than offset by a decrease in losses from repurchased loans.

The net FDIC shared-loss expense decreased to \$3.4 million as compared to \$23.2 million for the second quarter of 2015, primarily from the expiration of the FDIC commercial loss share coverage at June 30, 2015. The decrease is also related to the ongoing evaluation of expected cash flows of the covered loan portfolio and from changes in the fair value of the true-up payment obligation (also known as a clawback liability).

Other non-interest income increased \$937 thousand, as the second quarter of 2015 included the recognition of an \$835 thousand loss in the valuation of the mortgage servicing asset sold during the period.

*Comparison of six-month periods ended June 30, 2016 and 2015*

The Company recorded non-interest income, net in the amount of \$28.7 million, compared to \$2.2 million for the same period in 2015, an increase of 1,188.0%, or \$26.4 million.

Banking service revenue, which consists primarily of fees generated by deposit accounts, electronic banking services, and customer services, slightly decreased 0.4% to \$20.3 million from \$20.4 million for the same period in 2015.

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased 8.6% to \$13.2 million, compared to \$14.4 million for the same period in 2015. Such decrease reflects a reduction in some securities brokerage activities and a reduction in fees from the IRA portfolio.

Income generated from mortgage banking activities decreased 49.6% to \$1.9 million, compared to \$3.7 million for the same period in 2015. The decrease in mortgage banking activities was mostly due to a decrease in servicing income of \$1.6 million, as the Company sold part of its mortgage servicing asset during the second quarter of 2015. In addition, mortgage banking activities were affected by foregone gains on sales, which decreased \$1.4 million, as a result of the Company retaining securitized GNMA pools, partially offset by a decrease of \$1.1 million in losses from repurchased loans.

The net FDIC shared-loss expense decreased to \$7.4 million as compared to \$36.3 million for the same period in 2015, primarily from the expiration of the FDIC commercial loss share coverage at June 30, 2015. The decrease is also related to the ongoing evaluation of expected cash flows of the covered loan portfolio and from changes in the fair value of the true-up payment obligation (also known as a clawback liability).

During the six-month period ended June 30, 2016, the Company capitalized on favorable market conditions to partially unwind a high-rate repurchase agreement amounting to \$268.0 million at a cost of \$12 million, included as a loss on early extinguishment of debt in the unaudited statements of operations. In addition, the Company sold \$277.2 million in mortgage backed securities and \$11.1 million in Puerto Rico government bonds. As a result, the Company recorded a net gain on sale of securities of \$12.2 million, compared to \$2.6 million for the same period in 2015.

Other non-interest income increased \$3.1 million, as the same period of 2015 included the recognition of a \$2.7 million loss in the sale of the mortgage servicing asset.

**TABLE 3 - NON-INTEREST EXPENSES  
SUMMARY**

|  | Quarter Ended<br>June 30, |                  |               | Six-Month Period<br>Ended June 30, |                   |               |
|--|---------------------------|------------------|---------------|------------------------------------|-------------------|---------------|
|  | 2016                      | 2015             | Variance<br>% | 2016                               | 2015              | Variance<br>% |
|  | (Dollars in thousands)    |                  |               |                                    |                   |               |
| Compensation and employee benefits                         | \$ 18,531                 | \$ 19,260        | -3.8%         | \$ 38,815                          | \$ 39,440         | -1.6%         |
| Professional and service fees                              | 3,511                     | 4,143            | -15.3%        | 7,138                              | 8,324             | -14.2%        |
| Occupancy and equipment                                    | 8,107                     | 8,883            | -8.7%         | 15,929                             | 17,519            | -9.1%         |
| Insurance  | 3,155                     | 2,251            | 40.2%         | 6,305                              | 4,204             | 50.0%         |
| Electronic banking charges                                 | 4,947                     | 5,851            | -15.5%        | 10,536                             | 11,218            | -6.1%         |
| Information technology expenses                            | 1,606                     | 1,543            | 4.1%          | 3,262                              | 2,997             | 8.8%          |
| Advertising, business promotion, and strategic initiatives | 1,343                     | 1,558            | -13.8%        | 2,786                              | 3,186             | -12.6%        |
| Foreclosure, repossession and other real estate expenses   | 5,164                     | 10,337           | -50.0%        | 7,971                              | 15,783            | -49.5%        |
| Loan servicing and clearing expenses                       | 1,926                     | 2,594            | -25.8%        | 4,007                              | 4,947             | -19.0%        |
| Taxes, other than payroll and income taxes                 | 2,330                     | 2,703            | -13.8%        | 5,001                              | 4,182             | 19.6%         |
| Communication  | 581                       | 770              | -24.5%        | 1,400                              | 1,460             | -4.1%         |
| Printing, postage, stationery and supplies                 | 600                       | 582              | 3.1%          | 1,325                              | 1,219             | 8.7%          |
| Director and investor relations                            | 301                       | 289              | 4.2%          | 579                                | 583               | -0.7%         |
| Other operating expenses                                   | 1,723                     | 3,673            | -53.1%        | 3,628                              | 5,707             | -36.4%        |
| <b>Total non-interest expenses</b>                         | <b>\$ 53,825</b>          | <b>\$ 64,437</b> | <b>-16.5%</b> | <b>\$ 108,682</b>                  | <b>\$ 120,769</b> | <b>-10.0%</b> |
| <b>Relevant ratios and data:</b>                           |                           |                  |               |                                    |                   |               |
| Efficiency ratio   | <b>58.76%</b>             | <b>47.89%</b>    |               | <b>59.16%</b>                      | <b>57.37%</b>     |               |
| Compensation and benefits to                               |                           |                  |               |                                    |                   |               |
| non-interest expense                                       | <b>34.43%</b>             | <b>29.89%</b>    |               | <b>35.71%</b>                      | <b>32.66%</b>     |               |
| Compensation to average total assets owned                 | <b>1.09%</b>              | <b>1.05%</b>     |               | <b>1.13%</b>                       | <b>1.07%</b>      |               |
| Average number of employees                                | <b>1,451</b>              | <b>1,509</b>     |               | <b>1,460</b>                       | <b>1,509</b>      |               |
| Average compensation per employee                          | <b>\$ 12.8</b>            | <b>\$ 12.8</b>   |               | <b>\$ 26.6</b>                     | <b>\$ 26.1</b>    |               |
| Average loan balance per average employee                  | <b>\$ 3,104</b>           | <b>\$ 3,147</b>  |               | <b>\$ 3,057</b>                    | <b>\$ 3,185</b>   |               |



## Non-Interest Expenses

### *Comparison of quarters ended June 30, 2016 and 2015*

Non-interest expense for the second quarter of 2016 was \$53.8 million, representing a decrease of 16.5% compared to \$64.4 million in the same quarter of the previous year.

Foreclosure, repossession and other real estate expenses decreased 50.0% to \$5.2 million, as compared to \$10.3 million in the same period for the previous year, primarily as a result of the bulk sale of non-performing assets in the third quarter of 2015. The second quarter of 2015 included a \$2.9 million increase in other real estate owned and other mortgage properties markdowns, as part of 2015 de-risking efforts. In addition, the second quarter of 2015 included a loss of \$1.3 million on the sale of repossessed assets, contrasting with 2016 which included a gain of \$512 thousand, mainly due to efficiencies in the selling process.

Electronic banking charges decreased \$904 thousand to \$4.9 million mostly due the termination of a profit sharing agreement with a vendor which resulted in a reduction of \$300 thousand of the aforementioned expenses, and also affected by a reduction of \$418 thousand in debit card billing fees mainly due to a decrease in service charge from Master Card.

Occupancy and equipment decreased 8.7%, or \$776 thousand, to \$8.1 million, reflecting a reduction of \$678 thousand in depreciation of leasehold improvements, as a result of the closing of seven branches during the year 2015.

Compensation and employee benefits decreased 3.8%, or \$729 thousand, to \$18.5 million, mostly due to the decrease in average employees.

Other operating expenses for the second quarter of 2015 included a \$2.1 million payment required by the broker-dealer's regulator.

The decreases in the foregoing non-interest expenses were partially offset by increase in insurance expense of 40.2% to \$3.2 million, as compared to \$2.3 million in the same period of 2015, mainly due to an increase in the FDIC Savings Association Insurance Fund ("SAIF") premium.

The efficiency ratio was 58.76% compared to 47.89% for the same period in 2015. The efficiency ratio measures how much of the Company's revenues 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, 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 (losses) that are excluded from the efficiency ratio computation for the quarter ended June 30, 2016 amounted to losses of \$3.1 million, compared to losses of \$24.0 million for the quarter ended June 30, 2015.

### *Comparison of six-month periods ended June 30, 2016 and 2015*

Non-interest expense for the six-month period ended June 30, 2016 was \$108.7 million, representing a decrease of 10.0% compared to \$120.8 million in the same period of the previous year.

Foreclosure, repossession and other real estate expenses decreased 49.5% to \$8.0 million, as compared to \$15.8 million in the same period for the previous year, primarily as a result of the bulk sale of non-performing assets in the third quarter of 2015. The six-month period ended June 30, 2015 included a \$3.0 million increase in other real estate owned and other mortgage properties markdowns, as part of 2015 de-risking efforts. In addition, the six-month period ended June 30, 2015 included a loss of \$3.4 million on the sale of repossessed assets, contrasting with 2016 which included a gain of \$1.2 million, mainly due to efficiencies in the selling process.

Occupancy and equipment decreased 9.1% to \$15.9 million, reflecting decreases in rent and depreciation expenses from the closing of seven branches during the year 2015.

Professional and service fees decreased 14.2%, or \$1.2 million, to \$7.1 million, mostly due to lower legal expenses from strategic initiatives to reduce costs, lower collection services due to in-house collection efforts, and lower consulting fees due to non-recurring expenses in 2015.

Other operating expenses for the six-month period ended June 30, 2015 included a \$2.1 million payment required by the broker-dealer's regulator.

The decreases in the foregoing non-interest expenses were partially offset by increases in insurance expense and taxes, other than payroll and income taxes.

Insurance expense increased 50.0% to \$6.3 million, as compared to \$4.2 million in the same period of 2015, mainly due to an increase in the SAIF premium.

Taxes, other than payroll and income taxes increased 19.6% to \$5.0 million from \$4.2 million for the same period in 2015. The six-month period ended June 30, 2015 included a \$1.2 million adjustment from the local gross receipt tax that was repealed for taxable years commencing after December 31, 2014, which reduced the expense in such period.

The efficiency ratio was 59.16% compared to 57.37% for the same period in 2015. The efficiency ratio measures how much of the Company's revenues 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, 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 for the six-month period ended June 30, 2016 amounted to losses of \$6.8 million, compared to losses of \$36.4 million for the six-month period ended June 30, 2015.

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

#### ***Comparison of quarters ended June 30, 2016 and 2015***

Provision for loan and lease losses decreased 7.0%, or \$1.1 million, to \$14.4 million. 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 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.

Provision for originated and other loan and lease losses decreased 9.1%, or \$901 thousand, to \$9.1 million from \$10.0 million when compared with the same period in 2015. Commercial provision decreased \$2.4 million to a recapture of \$457 thousand, compared to \$1.9 million provision for the same quarter in 2015. Mortgage provision decreased \$188 thousand to \$1.1 million, compared to \$1.3 million for the same quarter in 2015. Decreases were partially offset by an increase in auto and leasing provision of \$1.9 million to \$5.4 million, from \$3.5 million for the same quarter of 2015. Consumer provision increased \$57 thousand to \$3.0 million, compared with the same period in 2015.

Total charge-offs on originated and other loans increased 10.9% to \$13.1 million, as compared to \$11.8 million for the same quarter in 2015. Consumer charge-offs increased \$502 thousand to \$2.8 million. Mortgage charge-offs remained at \$1.4 million for both quarters. Auto and leasing charge-offs increased \$438 thousand to \$8.1 million. Commercial charge-offs increased \$336 thousand to \$833 thousand. Total recoveries on originated and other loans decreased from \$4.1 million to \$3.6 million. As a result, the recoveries to charge-offs ratio decreased from 34.68% to 27.74%. Net credit losses increased \$1.8 million to \$9.5 million, representing 1.21% of average originated and other loans

outstanding versus 1.06% for the same quarter in 2015, annualized.

Provision for acquired loan and lease losses decreased 3.5%, or \$193 thousand, to \$5.4 million from \$5.6 million when compared with the same period in 2015. Provision for acquired BBVAPR loan and lease losses decreased \$1.3 million to \$4.4 million from \$5.7 million, when compared to the same period in 2015. Provision for acquired Eurobank loan and lease losses increased \$1.1 million from a recapture of \$105 thousand to a provision of \$1.0 million.

***Comparison of six-month periods ended June 30, 2016 and 2015***

Provision for loan and lease losses decreased 51.1%, or \$29.5 million, to \$28.2 million as a result of a \$24.0 million provision for loan and lease losses related to the PREPA line of credit recorded during the first quarter of 2015.

Based on an analysis of the credit quality and the composition of the Company's loan portfolio, management determined that the provision for the period 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.

Provision for originated and other loan and lease losses decreased 55.1%, or \$24.2 million, to \$19.7 million from \$43.9 million when compared with the same period in 2015. During the first quarter of 2015, the Company changed to non-accrual status the PREPA line of credit and recorded a \$24.0 million provision for loan and lease losses related thereto. During the fourth quarter of 2015, the Company recorded an additional \$29.3 million provision for loan and lease losses on PREPA. Management determined that no additional provision was required on the PREPA line of credit during the six-month period ended June 30, 2016.

Total charge-offs on originated and other loans increased 10.1% to \$26.5 million, as compared to \$24.0 million for the same period in 2015. Consumer charge-offs increased \$1.2 million to \$5.1 million. Mortgage charge-offs increased \$266 thousand to \$3.0 million. Auto and leasing charge-offs increased \$664 thousand to \$16.5 million. Commercial charge-offs increased \$355 thousand to \$1.8 million. Total recoveries on originated and other loans decreased from \$7.7 million to \$7.0 million. As a result, the recoveries to charge-offs ratio decreased from 32.14% to 26.26%. Net credit losses increased \$3.2 million to \$19.5 million, representing 1.25% of average originated and other loans outstanding versus 1.13% for the same period in 2015, annualized.

Provision for acquired loan and lease losses decreased 38.5%, or \$5.3 million, to \$8.5 million from \$13.9 million when compared with the same period in 2015. Provision for acquired BBVAPR loan and lease losses decreased \$2.5 million to \$6.7 million from \$9.2 million, when compared to the same period in 2015. Provision for acquired Eurobank loan and lease losses decreased \$2.9 million from \$4.7 million to \$1.8 million. Such decrease reflects an additional provision of \$3.5 million in the first quarter of 2015 related to the commercial shared-loss coverage with the FDIC that ended on June 30, 2015.

**Income Taxes**

***Comparison of quarters ended June 30, 2016 and 2015***

Income tax expense was \$5.9 million, compared to \$769 thousand for the same period in 2015. Income tax expense reflects the net income before income taxes of \$20.2 million for the second quarter of 2016, compared to a net loss before income taxes of \$2.3 million for the year-ago quarter.

*Comparison of six-month periods ended June 30, 2016 and 2015*

Income tax expense was \$11.5 million, compared to \$1.7 million for the same period in 2015. Income tax expense reflects the net income before income taxes of \$40.0 million for the six-month period of 2016, compared to a net loss before income taxes of \$4.4 million for the year-ago period.

## Business Segments

The Company segregates its businesses into the following major reportable segments: 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. Following are the results of operations and the selected financial information by operating segment for the quarters and six-month periods ended June 30, 2016 and 2015.

### Quarter Ended June 30, 2016

|                                     | Wealth              |                  |                     | Total               | Eliminations        | Consolidated        |
|-------------------------------------|---------------------|------------------|---------------------|---------------------|---------------------|---------------------|
|                                     | Banking             | Management       | Treasury            | Major Segments      |                     | Total               |
|                                     | (In thousands)      |                  |                     |                     |                     |                     |
| Interest income                     | \$ 79,675           | \$ 16            | \$ 8,217            | \$ 87,908           | \$ -                | \$ 87,908           |
| Interest expense                    | (7,300)             | -                | (7,296)             | (14,596)            | -                   | (14,596)            |
| Net interest income                 | 72,375              | 16               | 921                 | 73,312              | -                   | 73,312              |
| Provision for loan and lease losses | (14,445)            | -                | -                   | (14,445)            | -                   | (14,445)            |
| Non-interest income                 | 8,214               | 6,910            | 31                  | 15,155              | -                   | 15,155              |
| Non-interest expenses               | (47,098)            | (4,908)          | (1,820)             | (53,826)            | -                   | (53,825)            |
| Intersegment revenue                | 389                 | -                | 49                  | 438                 | (438)               | -                   |
| Intersegment expenses               | (49)                | (286)            | (103)               | (438)               | 438                 | -                   |
| <b>Income before income taxes</b>   | <b>\$ 19,386</b>    | <b>\$ 1,732</b>  | <b>\$ (922)</b>     | <b>\$ 20,196</b>    | <b>\$ -</b>         | <b>\$ 20,197</b>    |
| <b>Total assets</b>                 | <b>\$ 5,829,987</b> | <b>\$ 19,054</b> | <b>\$ 1,800,838</b> | <b>\$ 7,649,879</b> | <b>\$ (937,283)</b> | <b>\$ 6,712,596</b> |

### Quarter Ended June 30, 2015

|  | Wealth              |                  |                     | Total               | Eliminations        | Consolidated        |
|--|---------------------|------------------|---------------------|---------------------|---------------------|---------------------|
|  | Banking             | Management       | Treasury            | Major Segments      |                     | Total               |
|  | (In thousands)      |                  |                     |                     |                     |                     |
| Interest income                          | \$ 90,504           | \$ 24            | \$ 8,885            | \$ 99,413           | \$ -                | \$ 99,413           |
| Interest expense                         | (7,110)             | -                | (10,011)            | (17,121)            | -                   | (17,121)            |
| Net interest income                      | 83,394              | 24               | (1,126)             | 82,292              | -                   | 82,292              |
| Provision for loan and lease losses      | (15,539)            | -                | -                   | (15,539)            | -                   | (15,539)            |
| Non-interest (loss) income               | (11,713)            | 6,893            | 164                 | (4,656)             | -                   | (4,656)             |
| Non-interest expenses                    | (56,844)            | (6,733)          | (860)               | (64,437)            | -                   | (64,437)            |
| Intersegment revenue                     | 163                 | -                | 61                  | 224                 | (224)               | -                   |
| Intersegment expenses                    | (61)                | (87)             | (76)                | (224)               | 224                 | -                   |
| <b>(Loss) income before income taxes</b> | <b>\$ (600)</b>     | <b>\$ 97</b>     | <b>\$ (1,837)</b>   | <b>\$ (2,340)</b>   | <b>\$ -</b>         | <b>\$ (2,340)</b>   |
| <b>Total assets</b>                      | <b>\$ 6,153,663</b> | <b>\$ 21,157</b> | <b>\$ 2,136,293</b> | <b>\$ 8,311,113</b> | <b>\$ (912,788)</b> | <b>\$ 7,398,325</b> |





## Six-Month Period Ended June 30, 2016

|  | Wealth           |                 | Total             |                  | Consolidated |                  |
|--|------------------|-----------------|-------------------|------------------|--------------|------------------|
|  | Banking          | Management      | Treasury          | Major Segments   | Eliminations | Total            |
|  | (In thousands)   |                 |                   |                  |              |                  |
| Interest income                          | \$ 160,827       | \$ 34           | \$ 18,353         | \$ 179,214       | \$ -         | \$ 179,214       |
| Interest expense                         | (14,107)         | -               | (16,820)          | (30,927)         | -            | (30,927)         |
| Net interest income                      | 146,720          | 34              | 1,533             | 148,287          | -            | 148,287          |
| Provision for loan and lease losses      | (28,234)         | -               | -                 | (28,234)         | -            | (28,234)         |
| Non-interest income (loss)               | 16,009           | 12,930          | (281)             | 28,658           | -            | 28,658           |
| Non-interest expenses                    | (97,786)         | (7,853)         | (3,043)           | (108,682)        | -            | (108,682)        |
| Intersegment revenue                     | 787              | -               | 149               | 936              | (936)        | -                |
| Intersegment expenses                    | (149)            | (577)           | (210)             | (936)            | 936          | -                |
| <b>Income (loss) before income taxes</b> | <b>\$ 37,347</b> | <b>\$ 4,534</b> | <b>\$ (1,852)</b> | <b>\$ 40,029</b> | <b>\$ -</b>  | <b>\$ 40,029</b> |

## Six-Month Period Ended June 30, 2015

|  | Wealth            |                 | Total             |                   | Consolidated |                   |
|--|-------------------|-----------------|-------------------|-------------------|--------------|-------------------|
|  | Banking           | Management      | Treasury          | Major Segments    | Eliminations | Total             |
|  | (In thousands)    |                 |                   |                   |              |                   |
| Interest income                          | \$ 187,986        | \$ 47           | \$ 18,381         | \$ 206,414        | \$ -         | \$ 206,414        |
| Interest expense                         | (14,564)          | -               | (19,923)          | (34,487)          | -            | (34,487)          |
| Net interest income                      | 173,422           | 47              | (1,542)           | 171,927           | -            | 171,927           |
| Provision for loan and lease losses      | (57,732)          | -               | -                 | (57,732)          | -            | (57,732)          |
| Non-interest income (loss)               | (13,962)          | 13,903          | 2,284             | 2,225             | -            | 2,225             |
| Non-interest expenses                    | (106,156)         | (11,524)        | (3,089)           | (120,769)         | -            | (120,769)         |
| Intersegment revenue                     | 707               | -               | 160               | 866               | (866)        | -                 |
| Intersegment expenses                    | (159)             | (518)           | (189)             | (866)             | 866          | -                 |
| <b>(Loss) income before income taxes</b> | <b>\$ (3,880)</b> | <b>\$ 1,908</b> | <b>\$ (2,376)</b> | <b>\$ (4,349)</b> | <b>\$ -</b>  | <b>\$ (4,349)</b> |

*Comparison of quarters ended June 30, 2016 and 2015***Banking**

Net interest income of the Company's Banking segment decreased \$11.0 million for 2016, or 13.2%, reflecting a decrease in interest income from loans of \$10.8 million, or 12.0%, to \$79.7 million. Such decrease is comprised of \$9.4 million and \$1.4 million in volume and interest rate, respectively, of loans, primarily due to lower acquired loan balances and yields. Our loan portfolio is transitioning as originated loans with normal yields grow at a slower pace than higher-yielding acquired loans decrease due to repayments and maturities.

Originated loan interest income increased 11.0% to \$49.1 million as average balances grew 6.9% and yields increased 23 basis points to 6.29%. Acquired BBVAPR loans interest income declined 29.4% to \$23.7 million as average balances declined 22.4% and yields decreased 76 basis points to 7.71%. Acquired Eurobank loans interest income fell 45.9% to \$6.9 million as average balances declined 38.8% and yields decreased 253 basis points to 19.29%. The average balance of loans was \$4.504 billion, a decrease of 5.1% from the same period in 2015, mostly related to the bulk sale on September 28, 2015, of a portion of covered non-performing commercial loans amounting to \$197.1 million unpaid principal balance or UPB (\$100.0 million carrying amount), the de-risking of the government exposures, and to the repayment and maturities of acquired loans.

Provision for loan and lease losses decreased 7.0% to \$14.4 million. Provision for originated and other loan and lease losses decreased 9.1%, or \$901 thousand, to \$9.1 million from \$10.0 million when compared with the same period in 2015. Commercial provision decreased \$2.4 million to a recapture of \$457 thousand, compared to \$1.9 million provision for the same quarter in 2015. Mortgage provision decreased \$188 thousand to \$1.1 million, compared to \$1.3 million for the same quarter in 2015. Decreases were partially offset by an increase in auto and leasing provision of \$1.9 million to \$5.4 million, from \$3.5 million for the same quarter of 2015. Consumer provision increased \$57 thousand to \$3.0 million, compared with the same period in 2015. Provision for acquired loan and lease losses decreased 3.5%, or \$193 thousand, to \$5.4 million from \$5.6 million when compared with the same period in 2015. Provision for acquired BBVAPR loan and lease losses decreased \$1.3 million to \$4.4 million from \$5.7 million, when compared to the same period in 2015. Provision for acquired Eurobank loan and lease losses increased \$1.1 million from a recapture of \$105 thousand to a provision of \$1.0 million.

Non-interest income, net, is affected by the level of mortgage banking activities and 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. Non-interest income increased \$19.9 million to \$8.2 million, from a loss of \$11.7 million during the same quarter in 2015, mostly due to the decrease in FDIC shared-loss expense. The net FDIC shared-loss expense decreased to \$3.4 million as compared to \$23.2 million for the second quarter of 2015, primarily from the expiration of the FDIC commercial loss share coverage at June 30, 2015.

Non-interest expense of \$47.1 million decreased 17.1% when compared to the second quarter of 2015, primarily reflecting a decrease in foreclosure, repossession and other real estate expenses of 50.0% to \$5.2 million, as compared to \$10.3 million in the same period for the previous year. The second quarter of 2015 included a \$2.9 million increase in other real estate owned and other mortgage properties markdowns, as part of 2015 de-risking efforts. In addition, the second quarter of 2015 included a loss of \$1.3 million on the sale of repossessed assets, contrasting with 2016 which included a gain of \$512 thousand, mainly due to efficiencies in the selling process. In addition, electronic banking charges decreased \$904 thousand to \$4.9 million mostly due the termination of a profit sharing agreement with a vendor which resulted in a reduction of \$300 thousand of the aforementioned expenses, and also affected by a reduction of \$418 thousand in debit card billing fees mainly due to a decrease in service charge from Master Card.

## **Wealth Management**

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, remained at \$6.9 million for both quarters.

Non-interest expenses decreased by 27.1% to \$4.9 million, due to a payment of \$2.1 million required by the broker-dealer's regulator during the second quarter of 2015.

## **Treasury**

Treasury revenue, which consists of the Company's asset/liability management activities, such as purchase and sale of investment securities, interest rate risk management, derivatives, and borrowings, increased to a loss of \$920 thousand, compared to a loss of \$1.8 million in the second quarter of 2015. This increase is mostly due to a decrease of 27.1%, or \$2.7 million, in interest expense on borrowings, partially offset by a decrease of \$666 thousand, or 7.5%, in interest income from investment securities and by an increase of \$1.0 million in non-interest expenses, due to an increase in the SAIF premium to brokered deposits.

The decrease in interest income from investments reflects decreases in volume and interest rate of \$618 thousand and \$58 thousand, respectively. The decrease in interest expense on borrowings is mostly due to the decrease in repurchase agreements volume of \$2.8 million. Both were affected by a partial unwinding of a high-rate repurchase agreements amounting to \$268.0 million, which carried a cost of 4.78%, and a sale of \$272.1 million mortgage backed securities and \$11.1 million Puerto Rico government bonds during the first quarter of 2016.

## ***Comparison of six-month periods ended June 30, 2016 and 2015***

### **Banking**

Net interest income of the Company's Banking segment decreased \$26.7 million for 2016, or 15.4%, reflecting a decrease in interest income from loans of \$27.2 million, or 14.4%, to \$160.8 million. Such decrease reflects decreases of \$20.5 million and a \$6.6 million in volume and interest rate, respectively, of loans, primarily due to lower acquired loan balances and yields. Our loan portfolio is transitioning as originated loans with normal yields grow at a slower pace than higher-yielding acquired loans fall due to repayments and maturities.

Originated loans interest income increased 7.2% to \$97.0 million as average balances grew 8.1% and yields decreased 9 basis points to 6.25%. Acquired BBVAPR loans interest income declined 28.7% to \$49.3 million as average balances declined 27.8% and yields decreased 15 basis points to 8.20%. Acquired Eurobank loans interest income fell 48.8% to \$14.5 million as average balances declined 44.1% and yields decreased 201 basis points to 20.37%. The average balance of loans was \$4.464 billion, a decrease of 7.1% from the same period in 2015, mostly related to the bulk sale on September 28, 2015, of a portion of covered non-performing commercial loans amounting to \$197.1 million unpaid principal balance or UPB (\$100.0 million carrying amount), the de-risking of the government exposures, and to the repayment and maturities of acquired loans.

Provision for loan and lease losses decreased 51.1%, or \$29.5 million, to \$28.2 million. Provision for originated and other loan and lease losses decreased 55.1%, or \$24.2 million, to \$19.7 million when compared with the same period in 2015. During the first quarter of 2015, the Company changed to non-accrual status the PREPA line of credit and recorded a \$24.0 million provision for loan and lease losses related thereto. Provision for acquired loan and lease losses decreased 38.5%, or \$5.3 million, to \$8.5 million from \$13.9 million when compared with the same period in 2015. Provision for acquired BBVAPR loan and lease losses decreased \$2.5 million to \$6.7 million from \$9.2 million, when compared to the same period in 2015. Provision for acquired Eurobank loan and lease losses decreased \$2.9 million from \$4.7 million to \$1.8 million. Such decrease reflects an additional provision of \$3.5 million in the first quarter of 2015 related to the commercial shared-loss coverage with the FDIC that ended on June 30, 2015.

Non-interest income, net, is affected by the level of mortgage banking activities and 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. Non-interest income increased \$30.0 million to \$16.0 million, from a loss of \$14.0 million during the same period in 2015, mostly due to the decrease in FDIC shared-loss expense. The net FDIC shared-loss expense decreased to \$7.4 million as compared to \$36.3 million for the second quarter of 2015, primarily from the expiration of the FDIC commercial loss share coverage at June 30, 2015.

Non-interest expense of \$97.8 million decreased 7.9% when compared to the same period in 2015, primarily reflecting a decrease in foreclosure, repossession and other real estate expenses of 49.5% to \$8.0 million, as compared to \$15.8 million in the same period for the previous year. The second quarter of 2015 included a \$3.0 million increase in other real estate owned and other mortgage properties markdowns, as part of 2015 de-risking efforts. In addition, the second quarter of 2015 included a loss of \$3.4 million on the sale of repossessed assets, contrasting with 2016 which included a gain of \$1.2 million, mainly due to efficiencies in the selling process. In addition, professional and service fees decreased 14.2%, or \$1.2 million, to \$7.1 million, mostly due to lower legal expenses from strategic initiatives to reduce costs, lower collection services due to in-house collection efforts, and lower consulting fees due to non-recurrent expenses in 2015. These decreases were partially offset by an increase in insurance expense of 26.0% to \$5.3 million, as compared to \$4.2 million in the same period of 2015, mainly due to an increase in the SAIF premium.

### **Wealth Management**

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased 7% to \$12.9 million. Such decrease reflects a reduction in some securities brokerage activities and a reduction in fees from the IRA portfolio.

Non-interest expenses decreased by 31.9% to \$7.9 million, due to a payment of \$2.1 million required by the broker-dealer's regulator during the second quarter of 2015.

### **Treasury**

Treasury revenue, which consists of the Company's asset/liability management activities, such as purchase and sale of investment securities, interest rate risk management, derivatives, and borrowings, increased to a loss of \$1.9 million, compared to a loss of \$2.4 million in the second quarter of 2015. This increase is mostly due to a decrease of 15.6%, or \$3.1 million, in interest expense on borrowings. These decreases were partially offset by a decrease of \$2.6 million in non-interest income.

The decrease in interest expense on borrowings is mostly due to the decrease in repurchase agreements volume of \$4.0 million, affected by a partial unwinding of a high-rate repurchase agreements amounting to \$268.0 million, which carried a cost of 4.78% during the first quarter of 2016.

During the six-month period ended June 30, 2015, the Company sold \$63.5 million mortgage-backed securities and recorded a net gain on sale of securities of \$2.6 million. During the six-month period ended June 30, 2016, the

Company capitalized on favorable market conditions to partially unwind a high-rate repurchase agreement amounting to \$268.0 million, at a cost of \$12.0 million, and sell \$272.1 million in mortgage backed securities and \$11.1 million in Puerto Rico government bonds, at a net gain on sale of securities of \$12.0 million.

## **ANALYSIS OF FINANCIAL CONDITION**

### **Assets Owned**

At June 30, 2016, the Company's total assets amounted to \$6.713 billion representing a decrease of 5.4% when compared to \$7.099 billion at December 31, 2015. This reduction is mainly due to a decrease in the investment portfolio. The investment portfolio decreased \$296.0 million from \$1.616 billion at December 31, 2015 to \$1.320 billion, mainly from the sale of \$277.2 million in mortgage backed securities and \$11.1 million in Puerto Rico government bonds during the first half of 2016. As a result, at June 30, 2016, loans represented 77% of total interest-earning assets while investments represented 23%, compared to 73% and 27%, respectively, at December 31, 2015.

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, and auto loans. At June 30, 2016, the Company's loan portfolio decreased by 1.4% to \$4.374 billion compared to \$4.434 billion at December 31, 2015, primarily due to lower acquired loan balances. Our loan portfolio is transitioning as originated loans grow at a slower pace than acquired loans decrease, due to repayments and maturities. At June 30, 2016, the originated loan portfolio increased \$86.1 million, or 2.8%, the acquired BBVAPR loan portfolio decreased \$143.9 million, or 11.2%, and the acquired Eurobank loan portfolio decreased \$7.3 million, or 5.0%, from December 31, 2015.

### **Financial Assets Managed**

The Company's financial assets 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 individual retirement accounts ("IRA"s) and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while the retirement plan administration subsidiary, OPC, manages private retirement plans. At June 30, 2016, total assets managed by the Company's trust division and OPC amounted to \$2.780 billion, compared to \$2.691 billion at December 31, 2015. 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, 2016, total assets gathered by Oriental Financial Services from its customer investment accounts increased to \$2.387 billion, compared to \$2.375 billion at December 31, 2015. Changes in trust and broker-dealer related assets primarily reflect changes in portfolio balances and differences in market values.





## Goodwill

Goodwill recorded in connection with the BBVAPR Acquisition and the FDIC-assisted Eurobank acquisition is not amortized to expense, but is tested at least annually for impairment. A quantitative annual impairment test is not required if, based on a qualitative analysis, the Company determines that the existence of events and circumstances indicate that it is more likely than not that goodwill is not impaired. The Company completes its annual goodwill impairment test as of October 31 of each year. The Company tests for impairment by first allocating its goodwill and other assets and liabilities, as necessary, to defined reporting units. A fair value is then determined for each reporting unit. If the fair values of the reporting units exceed their book values, no write-down of the recorded goodwill is necessary. If the fair values are less than the book values, an additional valuation procedure is necessary to assess the proper carrying value of the goodwill.

Reporting unit valuation is inherently subjective, with a number of factors based on assumptions and management judgments or estimates. Actual values may differ significantly from such estimates. Among these are future growth rates for the reporting units, selection of comparable market transactions, discount rates and earnings capitalization rates. Changes in assumptions and results due to economic conditions, industry factors, and reporting unit performance and cash flow projections could result in different assessments of the fair values of reporting units and could result in impairment charges. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount, an interim impairment test is required.

Relevant events and circumstances for evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount may include macroeconomic conditions (such as a further deterioration of the Puerto Rico economy or the liquidity for Puerto Rico securities or loans secured by assets in Puerto Rico), adverse changes in legal factors or in the business climate, adverse actions by a regulator, unanticipated competition, the loss of key employees, or similar events. The Company's loan portfolio, which is the largest component of its interest-earning assets, is concentrated in Puerto Rico and is directly affected by adverse local economic and fiscal conditions. Such conditions have generally affected the market demand for non-conforming loans secured by assets in Puerto Rico and, therefore, affect the valuation of the Company's assets.

As of June 30, 2016, the Company had \$86.1 million of goodwill allocated as follows: \$84.1 million to the Banking unit and \$2.0 million to the Wealth Management unit. During the last quarter of 2015, based on its annual goodwill impairment test, the Company determined that the Banking unit failed step one of the two-step impairment test and that Wealth Management unit passed such step. As a result of step one, the Banking unit's adjusted net book value exceed its fair value by approximately \$263.1 million, or 29.6%. Accordingly, the Company proceeded to perform step two of the analysis. Based on the results of step two, the Company determined that the carrying value of the goodwill allocated to the Banking unit was not impaired as of the valuation date. During the six-month period ended June 30, 2016, the Company performed an assessment of events or circumstances that could trigger reductions in the book value of the goodwill. Based on this assessment, no events were identified that triggered changes in the book value of goodwill at June 30, 2016.



TABLE 4 - ASSETS SUMMARY AND COMPOSITION

|  | June 30,<br>2016       | December 31,<br>2015 | Variance<br>% |
|--|------------------------|----------------------|---------------|
|  | (Dollars in thousands) |                      |               |
| <b>Investments:</b>                                  |                        |                      |               |
| FNMA and FHLMC certificates                          | \$ 1,027,355           | \$ 1,354,802         | -24.2%        |
| Obligations of US government-sponsored agencies      | 4,502                  | 5,093                | -11.6%        |
| US Treasury securities                               | 25,015                 | 25,032               | -0.1%         |
| CMOs issued by US government-sponsored agencies      | 120,475                | 135,073              | -10.8%        |
| GNMA certificates                                    | 114,278                | 58,495               | 95.4%         |
| Puerto Rico government and public instrumentalities  | 5,848                  | 13,731               | -57.4%        |
| FHLB stock   | 19,838                 | 20,783               | -4.5%         |
| Other debt securities                                | 2,228                  | 2,572                | -13.4%        |
| Other investments                                    | 351                    | 291                  | 20.6%         |
| <b>Total investments</b>                             | <b>1,319,890</b>       | <b>1,615,872</b>     | <b>-18.3%</b> |
| <b>Loans</b>   | <b>4,373,617</b>       | <b>4,434,213</b>     | <b>-1.4%</b>  |
| <b>Total securities and loans</b>                    | <b>5,693,507</b>       | <b>6,050,085</b>     | <b>-5.9%</b>  |
| <b>Other assets:</b>                                 |                        |                      |               |
| Cash and due from banks (including restricted cash)  | 514,338                | 535,359              | -3.9%         |
| Money market investments                             | 5,740                  | 4,699                | 22.2%         |
| FDIC indemnification asset                           | 18,426                 | 22,599               | -18.5%        |
| Foreclosed real estate                               | 51,220                 | 58,176               | -12.0%        |
| Accrued interest receivable                          | 20,009                 | 20,637               | -3.0%         |
| Deferred tax asset, net                              | 143,048                | 145,901              | -2.0%         |
| Premises and equipment, net                          | 72,585                 | 74,590               | -2.7%         |
| Servicing assets                                     | 7,932                  | 7,455                | 6.4%          |
| Derivative assets                                    | 1,926                  | 3,025                | -36.3%        |
| Goodwill   | 86,069                 | 86,069               | 0.0%          |
| Other assets and customers' liability on acceptances | 97,796                 | 90,554               | 8.0%          |
| <b>Total other assets</b>                            | <b>1,019,089</b>       | <b>1,049,064</b>     | <b>-2.9%</b>  |
| <b>Total assets</b>                                  | <b>\$ 6,712,596</b>    | <b>\$ 7,099,149</b>  | <b>-5.4%</b>  |
| <b>Investments portfolio composition:</b>            |                        |                      |               |
| FNMA and FHLMC certificates                          | 77.9%                  | 83.9%                |               |
| Obligations of US government-sponsored agencies      | 0.3%                   | 0.3%                 |               |
| US Treasury securities                               | 1.9%                   | 1.5%                 |               |
| CMOs issued by US government-sponsored agencies      | 9.1%                   | 8.4%                 |               |
| GNMA certificates                                    | 8.7%                   | 3.6%                 |               |
| Puerto Rico government and public instrumentalities  | 0.4%                   | 0.8%                 |               |
| FHLB stock   | 1.5%                   | 1.3%                 |               |
| Other debt securities and other investments          | 0.2%                   | 0.2%                 |               |
|  | <b>100.0%</b>          | <b>100.0%</b>        |               |

**TABLE 5 — LOANS RECEIVABLE COMPOSITION**

|   | <b>June 30, 2016</b>  |
|---|-----------------------|
|   | <b>(In thousands)</b> |
| <b>Originated and other loans and leases held for investment:</b>   |                       |
| Mortgage  | \$ 741,917            |
| Commercial  | 1,476,613             |
| Consumer  | 265,269               |
| Auto and leasing  | 712,268               |
|   | <b>3,196,067</b>      |
| Allowance for loan and lease losses on originated and other loans and leases  | (112,812)             |
|   | <b>3,083,255</b>      |
| Deferred loan costs, net  | 4,619                 |
| <b>Total originated and other loans held for investment, net</b>  | <b>3,087,874</b>      |
| <b>Acquired loans:</b>  |                       |
| <b>Acquired BBVAPR loans:</b>   |                       |
| <b>Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b>                       |                       |
| Commercial  | 4,559                 |
| Consumer  | 35,194                |
| Auto  | 77,118                |
|   | <b>116,871</b>        |
| Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-20                             | (4,487)               |
|   | <b>112,384</b>        |
| <b>Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy) (a)</b> |                       |
| Mortgage  | 591,029               |
| Commercial  | 246,188               |
| Construction  | 76,917                |
| Consumer  | 7,331                 |
| Auto  | 117,038               |
|   | <b>1,038,503</b>      |
| Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-30 (b)                         | (22,801)              |
|   | <b>1,015,702</b>      |
| <b>Total acquired BBVAPR loans, net</b>   | <b>1,128,086</b>      |
| <b>Acquired Eurobank loans: (a)</b>   |                       |
| Loans secured by 1-4 family residential properties  | 76,777                |
| Commercial and construction   | 83,377                |
| Consumer  | 1,410                 |
|   | <b>161,564</b>        |
| Allowance for loan and lease losses on Eurobank loans (b)   | (22,116)              |
| <b>Total acquired Eurobank loans, net</b>   | <b>139,448</b>        |
| <b>Total acquired loans, net</b>  | <b>1,267,534</b>      |
| <b>Total held for investment, net</b>   | <b>4,355,408</b>      |
| <b>Mortgage loans held for sale</b>   | <b>18,209</b>         |
| <b>Total loans, net</b>   | <b>\$ 4,373,617</b>   |

- (a) Current period amounts have been re-measured using the revised derecognition policy for purchased credit impaired loans.
- (b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on J revision in the derecognition policy for these loans.

The Company's loan portfolio is composed of two segments, loans initially accounted for under the amortized cost method (referred as "originated and other" loans) and loans acquired (referred as "acquired" loans). Acquired loans are further segregated between acquired BBVAPR loans and acquired Eurobank loans. Acquired Eurobank loans were purchased subject to loss-sharing agreements with the FDIC. The FDIC loss-sharing coverage, related to acquired Eurobank commercial loans expired on June 30, 2015. Notwithstanding the expiration of loss-share coverage of commercial loans, on July 2, 2015, the Company entered into an agreement with the FDIC pursuant to which the FDIC concurred with a potential sale of a pool of loss-share assets covered under the commercial loss-share agreement. Pursuant to such agreement, the FDIC agreed to pay up to \$20 million in loss-share coverage with respect to the aggregate loss resulting from any portfolio sale within 120 days of the agreement. This sale was completed on September 28, 2015. The coverage for the single-family residential loans will expire on June 30, 2020. At June 30, 2016, the remaining covered loans amounting to \$57.1 million, net carrying amount, are included as part of acquired Eurobank loans under the name "loans secured by 1-4 family residential properties." At December 31, 2015, covered loans amounted to \$59.6 million, net carrying amount, and also included under the name "loans secured by 1-4 family residential properties." Covered loans are no longer a material amount. Therefore, the Company changed its loan disclosures during 2015.

As shown in Table 5 above, total loans, net, amounted to \$4.374 billion at June 30, 2016 and \$4.434 billion at December 31, 2015. The Company's originated and other loans held-for-investment portfolio composition and trends were as follows:

- Mortgage loan portfolio amounted to \$741.9 million (23.2% of the gross originated loan portfolio) compared to \$757.8 million (24.4% of the gross originated loan portfolio) at December 31, 2015. Mortgage loan production totaled \$57.6 million and \$106.0 million for the quarter and six-month period ended June 30, 2016, which represents a decrease of 11.1% and 16.3%, from \$64.8 million and \$126.5 million, respectively. Mortgage loans included delinquent loans in the GNMA buy-back option program amounting to \$8.4 million and \$7.9 million at June 30, 2016 and December 31, 2015, 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 \$1.477 billion (46.2% of the gross originated loan portfolio) compared to \$1.442 billion (46.3% of the gross originated loan portfolio) at December 31, 2015. Commercial loan production decreased 45.0% and 29.4% to \$66.3 million and \$145.5 million for the quarter and six-month period ended June 30, 2016, from \$120.5 million and \$206.2 million for the same periods in 2015.
- Consumer loan portfolio amounted to \$265.3 million (8.3% of the gross originated loan portfolio) compared to \$243.0 million (7.8% of the gross originated loan portfolio) at December 31, 2015. Consumer loan production decreased 0.7% and increased 11.9% to \$39.6 million and \$73.8 million for the quarter and six-month period ended June 30, 2016, respectively, from \$39.8 million and \$66.0 million for the same periods in 2015.

- Auto and leasing portfolio amounted to \$712.3 million (22.3% of the gross originated loan portfolio) compared to \$669.2 million (21.5% of the gross originated loan portfolio) at December 31, 2015. Auto and leasing production increased by 20.9% and 8.8% to \$74.4 million and \$138.7 million for the quarter and six-month period ended June 30, 2016, respectively, compared to \$61.5 million and \$127.5 million for the same periods in 2015.



**TABLE 6 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS**

|  | <b>June 30, 2016</b>                           |                  |                 |                            |                  |                 |                                 |                  |                 |
|--|--|------------------|-----------------|----------------------------|------------------|-----------------|---------------------------------|------------------|-----------------|
|  | <b>Higher-Risk Residential Mortgage Loans*</b> |                  |                 |                            |                  |                 |                                 |                  |                 |
|  | <b>Junior Lien Mortgages</b>                   |                  |                 | <b>Interest Only Loans</b> |                  |                 | <b>High Loan-to-Value Ratio</b> |                  |                 |
|  | <b>Carrying</b>                                |                  |                 | <b>Carrying</b>            |                  |                 | <b>Mortgages</b>                |                  |                 |
|  | <b>Value</b>                                   | <b>Allowance</b> | <b>Coverage</b> | <b>Value</b>               | <b>Allowance</b> | <b>Coverage</b> | <b>LTV 90% and over</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><u>Delinquency:</u></b>                       |  |                  |                 |                            |                  |                 |                                 |                  |                 |
| 0 - 89 days                                      | \$ 11,044                                      | \$ 231           | 2.09%           | \$ 12,154                  | \$ 735           | 6.05%           | \$ 86,238                       | \$ 1,794         | 2.08%           |
| 90 - 119 days                                    | 140  | 7                | 5.00%           | 564                        | 40               | 7.09%           | 1,655                           | 111              | 6.71%           |
| 120 - 179 days                                   | 35   | -                | 0.00%           | 396                        | 37               | 9.34%           | 904                             | 70               | 7.74%           |
| 180 - 364 days                                   | 88   | -                | 0.00%           | 1,359                      | 125              | 9.20%           | 3,011                           | 138              | 4.58%           |
| 365+ days  | 527  | 113              | 21.44%          | 1,297                      | 350              | 26.99%          | 9,697                           | 758              | 7.82%           |
| Total  | \$ 11,834                                      | \$ 351           | 2.97%           | \$ 15,770                  | \$ 1,287         | 8.16%           | \$ 101,505                      | \$ 2,871         | 2.83%           |
| Percentage of total loans<br>excluding           |  |                  |                 |                            |                  |                 |                                 |                  |                 |
| acquired loans accounted for<br>under ASC 310-30 |  |                  | 0.36%           |                            |                  | 0.48%           |                                 |                  | 3.06%           |
| <b><u>Refinanced or Modified Loans:</u></b>      |  |                  |                 |                            |                  |                 |                                 |                  |                 |
| Amount   | \$ 2,067                                       | \$ 202           | 9.77%           | \$ 195                     | \$ 17            | 8.72%           | \$ 20,116                       | \$ 1,449         | 7.20%           |
| Percentage of Higher-Risk Loan                   |  |                  | 17.47%          |                            |                  | 1.24%           |                                 |                  | 19.82%          |
| Category   |  |                  |                 |                            |                  |                 |                                 |                  |                 |
| <b><u>Loan-to-Value Ratio:</u></b>               |  |                  |                 |                            |                  |                 |                                 |                  |                 |
| Under 70%  | \$ 7,474                                       | \$ 213           | 2.85%           | \$ 934                     | \$ 56            | 6.00%           | \$ -                            | \$ -             | -               |
| 70% - 79%  | 2,327  | 102              | 4.38%           | 2,404                      | 166              | 6.91%           | -                               | -                | -               |
| 80% - 89%  | 126  | 13               | 10.32%          | 4,937                      | 421              | 8.53%           | -                               | -                | -               |
| 90% and over                                     | 1,907  | 24               | 1.26%           | 7,495                      | 644              | 8.59%           | 101,505                         | 2,871            | 2.83%           |
|  | \$ 11,834                                      | \$ 352           | 2.97%           | \$ 15,770                  | \$ 1,287         | 8.16%           | \$ 101,505                      | \$ 2,871         | 2.83%           |

\* Loans may be included in more than one higher-risk loan category and excludes acquired residential mortgage loans.

The following table includes the Company's lending and investment exposure to the Puerto Rico government, including its agencies, instrumentalities, municipalities and public corporations:

**TABLE 7 - PUERTO RICO GOVERNMENT RELATED LOANS AND SECURITIES**

| Loans and Securities: | Carrying Value    | June 30, 2016 Maturity             |                  |                   | Comments   |
|-----------------------|-------------------|------------------------------------|------------------|-------------------|--|
|                       |                   | Less than 1 Year<br>(In thousands) | 1 to 3 Years     | More than 3 Years |  |
| Central government    | \$ 10,926         | \$ -                               | \$ -             | \$ 10,926         | Repayment sources include abandoned and unclaimed funds escheated to the Commonwealth                              |
| Public corporations   | 183,396           | 183,396                            | -                | -                 | Includes \$183.0 million PREPA loan, which has \$53.3 million allowance for loan and lease losses                  |
| Municipalities        | 204,270           | 187                                | 48,184           | 155,899           | Repayment from property taxes<br>Remaining position is PRHTA security issued for P3 Project Teodoro Moscoso Bridge |
| Investment securities | 6,720             | -                                  | 6,720            | -                 | operated by private companies that have the payment obligation   |
| <b>Total</b>          | <b>\$ 405,312</b> | <b>\$ 183,583</b>                  | <b>\$ 54,904</b> | <b>\$ 166,825</b> |  |

Some highlights follow regarding the data included above:

- Loans to municipalities are backed by their unlimited taxing power or real and personal property taxes.
- 45% of loans and securities balances mature in 12-months or less.
- Deposits from municipalities, central government and other government entities totaled \$88.4 million at June 30, 2016.

## 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. At June 30, 2016, the Company's allowance for loan and lease losses amounted to \$162.2 million, a \$71.9 million decrease from \$234.1 million at December 31, 2015, mainly related to the de-recognition of a portion of the allowance for credit impaired loans due to a revision in policy.

Effective June 30, 2016, pursuant to supervisory direction, the Company revised the purchase credit impaired policy for all loans accounted for under ASC 310-30. Under the revised policy, the Company writes-off the loan's recorded investment and derecognizes the associated allowance for loan and lease losses for loans that exit the pools. The revised policy implementation is performed prospectively due to the immaterial impact for retrospective adoption. Prior to June 30, 2016, the pool's carrying value and allowance was determined by discount expected cash flows at the pool's effective yield. The allowance for loan and lease losses was maintained until all of the loans in the pool were paid off or charged-off. The transition to this revised policy on June 30, 2016 resulted in the de-recognition of loans recorded investment balance and associated allowance for loans and lease losses that had exited the pools with no impact to provision for loan and lease 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.

At June 30, 2016, \$112.8 million of the allowance corresponded to originated and other loans held for investment, or 3.53% of total originated and other loans held for investment, compared to \$112.6 million, or 3.62% of total originated and other loans held for investment, at December 31, 2015. The allowance slightly increased as a result of a \$19.7 million provision for loan and lease losses and \$7.0 million of recoveries, which were partially offset by charge-offs of \$26.5 million during the six-month period ended June 30, 2016. The allowance for residential mortgage loans increased by 1.0% (or \$185 thousand), when compared with the balances recorded at December 31, 2015. The allowance for consumer loans and auto and leases increased by 5.1% (or \$574 thousand) and 5.5% (or \$998 thousand), respectively, when compared with the balances recorded at December 31, 2015. The allowance for commercial loans decreased 2.5% (or 1.7 million), when compared with the balances recorded at December 31, 2015.

Allowance for loan and lease losses recorded for acquired BBVAPR loans accounted for under the provisions of ASC 310-20 at June 30, 2016 was \$4.5 million compared to \$5.5 million at December 31, 2015, a 19.0% decrease. The allowance decreased as a result of \$3.2 million in charge-offs, which were partially offset by a \$844 thousand

provision for loan and lease losses and \$1.3 million of recoveries during the six-month period ended June 30, 2016. The allowance for commercial loans decreased by 19.2% (or \$5 thousand), when compared with the balance recorded at December 31, 2015. The allowance for consumer loans decreased by 12.5% (or \$427 thousand) and auto loans decreased by 29.9% (or \$623 thousand), respectively, when compared with the balances recorded at December 31, 2015, due to the normal amortization of credit discount of these acquired loans.

Allowance for loan and lease losses recorded for acquired BBVAPR loans accounted for under ASC-310-30 at June 30, 2016 was \$22.8 million as compared to \$25.8 million at December 31, 2015. The allowance decreased as a result of \$8.5 million in allowance de-recognition from revised purchased credit impaired loan policy and by loan pools fully charged-off of \$282 thousand, partially offset by a \$5.8 million provision for loan and lease losses during the six-month period ended June 30, 2016.

Allowance for loan and lease losses recorded for acquired Eurobank loans at June 30, 2016 was \$22.1 million as compared to \$90.2 million at December 31, 2015. The allowance decreased as a result of \$72.2 million in allowance de-recognition from revised purchased credit impaired loan policy and by \$134 thousand in loan pools fully charged-off, partially offset by a \$1.8 million provision for loan and lease losses and by \$2.4 million for the FDIC shared-loss portion of provision for covered loan and lease losses. The allowance for loan and lease losses on acquired Eurobank loans is accounted for under the provisions of ASC 310-30. 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, 2016 and December 31, 2015, the Company had \$285.3 million and \$300.1 million, respectively, of non-accrual loans, including acquired BBVAPR loans accounted for under ASC 310-20 (loans with revolving feature and/or acquired at a premium). At June 30, 2016 and December 31, 2015, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-performing assets amounted to \$97.2 million and \$93.6 million, respectively.

Oriental Bank is part of a four bank syndicate that provided a \$550 million revolving line of credit to finance the purchase of fuel for PREPA's day-to-day power generation activities. Our participation in the line of credit has an unpaid principal balance of \$183.0 million as of June 30, 2016. As part of the bank syndicate, the Bank entered into a Restructuring Support Agreement on November 5, 2015 with PREPA and certain other creditors. The Restructuring Support Agreement provides for the restructuring of the fuel line of credit subject to the accomplishment of several milestones, including some milestones that depend on the actions of third parties to the agreement, such as the negotiation of agreements with other creditors and legislative action. The Company expects the restructuring to be completed by the end of 2016. The Company conducted an impairment analysis considering the probability of collection of principal and interest, which included a financial model to project the future liquidity status of PREPA under various scenarios and its capacity to service its financial obligations, and concluded that PREPA had sufficient cash flows for the repayment of the line of credit. Despite the Company's analysis showing PREPA's capacity to repay the line of credit, the Company classifies this participation in the substandard risk category and non-accrual status and has a \$53.3 million allowance for loan and lease losses recorded for this line of credit. Since April 1, 2015, interest payments have been applied to principal.

Delinquent residential mortgage loans insured or guaranteed under applicable FHA and VA programs are classified as non-performing loans when they become 90 days or more past due, but are not placed in non-accrual status until they become 18 months or more past due, since they are insured loans. Therefore, these loans are included as non-performing loans but excluded from non-accrual loans.

Acquired loans 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 these loans when it is probable that all cash flows expected at acquisition will not be collected.

At June 30, 2016, the Company's non-performing assets decreased by 6.0% to \$345.8 million (6.22% of total assets, excluding acquired loans with deteriorated credit quality) from \$367.8 million (6.31% of total assets, excluding acquired loans with deteriorated credit quality) at December 31, 2015. The Company does not expect non-performing loans to result in significantly higher losses. At June 30, 2016, the allowance for originated loan and lease losses to non-performing loans coverage ratio was 38.85% (37.15% at December 31, 2015).

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, 2016, the Company's originated non-performing mortgage loans totaled \$72.9 million (24.9% of the Company's non-performing loans), a 6.3% decrease from \$77.9 million (25.5% of the Company's non-performing loans) at December 31, 2015. Non-performing loans in this category are 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, 2016, the Company's originated non-performing commercial loans amounted to \$207.8 million (71.0% of the Company's non-performing loans), a 3.5% decrease from \$215.3 million at December 31, 2015 (70.5% of the Company's non-performing loans). Most of this portfolio is collateralized by commercial real estate properties. At June 30, 2016 and December 31, 2015, the PREPA line of credit had an outstanding principal balance of \$183.0 million and \$190.3 million, respectively.

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, 2016, the Company's originated non-performing consumer loans totaled \$2.3 million (0.8% of the Company's non-performing loans), a 43.4% increase from \$1.6 million (0.5% of the Company's non-performing loans) at December 31, 2015.

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, 2016, the Company's originated non-performing auto loans and leases amounted to \$7.3 million (2.5% of the Company's total non-performing loans), a decrease of 12.8% from \$8.4 million at December 31, 2015 (2.8% of the Company's total non-performing loans).

- Acquired BBVAPR 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, 2016, the Company's acquired non-performing commercial lines of credit accounted for under ASC 310-20 amounted to \$770 thousand (0.3% of the Company's non-performing loans), a 12.5% decrease from \$880 thousand at December 31, 2015 (0.3% 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, 2016, the Company's acquired non-performing consumer lines of credit and credit cards accounted for under ASC 310-20 totaled \$764 thousand (0.3% of the Company's non-performing loans), a 42.8% increase from \$535 thousand at December 31, 2015 (0.2% 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, 2016, the Company's acquired non-performing auto loans accounted for under ASC 310-20 totaled \$562 thousand (0.2% of the Company's non-performing loans), a 32.4% decrease from \$831 thousand at December 31, 2015 (0.2% of the Company's non-performing loans).



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, PRHFA, ("Puerto Rico Housing Finance Authority"), 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.

In order to apply for any of the loan modification programs, if the borrower is active in Chapter 13 bankruptcy, they must request an authorization from the bankruptcy trustee to allow for the loan modification. Borrowers with discharged Chapter 7 bankruptcies may also apply. Loans in these programs are evaluated by designated underwriters for troubled-debt restructuring classification if the Company grants a concession for legal or economic reasons due to the debtor's financial difficulties.

**TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES BREAKDOWN**

|  | June 30,<br>2016       | December 31,<br>2015 | Variance<br>% |
|--|------------------------|----------------------|---------------|
|  | (Dollars in thousands) |                      |               |
| <b><u>Originated and other loans held for investment</u></b>       |                        |                      |               |
| <b>Allowance balance:</b>  |                        |                      |               |
| Mortgage   | \$ 18,537              | \$ 18,352            | 1.0%          |
| Commercial   | 63,144                 | 64,791               | -2.5%         |
| Consumer   | 11,771                 | 11,197               | 5.1%          |
| Auto and leasing   | 19,259                 | 18,261               | 5.5%          |
| Unallocated allowance  | 101                    | 25                   | 304.0%        |
| <b>Total allowance balance</b>                                     | <b>\$ 112,812</b>      | <b>\$ 112,626</b>    | <b>0.2%</b>   |
| <b>Allowance composition:</b>                                      |                        |                      |               |
| Mortgage   | 16.4%                  | 16.3%                | 0.6%          |
| Commercial   | 56.0%                  | 57.5%                | -2.6%         |
| Consumer   | 10.4%                  | 9.9%                 | 5.1%          |
| Auto and leasing   | 17.1%                  | 16.2%                | 5.6%          |
| Unallocated allowance  | 0.1%                   | 0.1%                 | 0.0%          |
|  | <b>100.0%</b>          | <b>100.0%</b>        |               |
| <b>Allowance coverage ratio at end of period applicable to:</b>    |                        |                      |               |
| Mortgage   | 2.50%                  | 2.42%                | 3.3%          |
| Commercial   | 4.28%                  | 4.49%                | -4.7%         |
| Consumer   | 4.44%                  | 4.61%                | -3.7%         |
| Auto and leasing   | 2.70%                  | 2.73%                | -1.1%         |
| <b>Total allowance to total originated loans</b>                   | <b>3.53%</b>           | <b>3.62%</b>         | <b>-2.5%</b>  |
| <b>Allowance coverage ratio to non-performing loans:</b>           |                        |                      |               |
| Mortgage   | 25.41%                 | 23.57%               | 7.8%          |
| Commercial   | 30.39%                 | 30.10%               | 1.0%          |
| Consumer   | 503.25%                | 686.51%              | -26.7%        |
| Auto and leasing   | 262.49%                | 216.93%              | 21.0%         |
| <b>Total</b>   | <b>38.85%</b>          | <b>37.15%</b>        | <b>4.6%</b>   |
| <b><u>Acquired BBVAPR loans accounted for under ASC 310-20</u></b> |                        |                      |               |
| <b>Allowance balance:</b>  |                        |                      |               |
| Commercial   | \$ 21                  | \$ 26                | -19.2%        |
| Consumer   | 3,002                  | 3,429                | -12.5%        |
| Auto   | 1,464                  | 2,087                | -29.9%        |
| <b>Total allowance balance</b>                                     | <b>\$ 4,487</b>        | <b>\$ 5,542</b>      | <b>-19.0%</b> |
| <b>Allowance composition:</b>                                      |                        |                      |               |
| Commercial   | 0.5%                   | 0.5%                 | 0.0%          |
| Consumer   | 66.9%                  | 61.9%                | 8.1%          |
| Auto   | 32.6%                  | 37.6%                | -13.3%        |
|  | <b>100.0%</b>          | <b>100.0%</b>        |               |
| <b>Allowance coverage ratio at end of period applicable to:</b>    |                        |                      |               |
| Commercial   | 0.46%                  | 0.35%                | 31.4%         |
| Consumer   | 8.53%                  | 8.93%                | -4.5%         |
| Auto   | 1.90%                  | 1.95%                | -2.6%         |
| <b>Total allowance to total acquired loans</b>                     | <b>3.84%</b>           | <b>3.63%</b>         | <b>5.8%</b>   |

**Allowance coverage ratio to non-performing loans:**

|              |                |                |               |
|--------------|----------------|----------------|---------------|
| Commercial   | 2.73%          | 2.95%          | -7.5%         |
| Consumer     | 392.93%        | 640.93%        | -38.7%        |
| Auto         | 260.50%        | 251.14%        | 3.7%          |
| <b>Total</b> | <b>214.07%</b> | <b>246.75%</b> | <b>-13.2%</b> |

**TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES BREAKDOWN (CONTINUED)**

|  | <b>June 30</b>                |           | <b>December 31,</b> |                   |
|--|-------------------------------|-----------|---------------------|-------------------|
|  | <b>2016</b>                   |           | <b>2015</b>         | <b>Variance %</b> |
|  | <b>(Dollars in thousands)</b> |           |                     |                   |
| <b><u>Acquired BBVAPR loans accounted for under ASC 310-30</u></b>   |                               |           |                     |                   |
| <b>Allowance balance:</b>  |                               |           |                     |                   |
| Mortgage   | \$ 1,585                      | \$        | 1,762               | -10.0%            |
| Commercial   | 15,863                        |           | 21,161              | -25.0%            |
| Auto   | 5,353                         |           | 2,862               | 87.0%             |
| <b>Total allowance balance (a)</b>                                   | <b>\$ 22,801</b>              | <b>\$</b> | <b>25,785</b>       | <b>-11.6%</b>     |
| <b>Allowance composition:</b>  |                               |           |                     |                   |
| Mortgage   | 7.0%                          |           | 6.8%                | 2.9%              |
| Commercial   | 69.6%                         |           | 82.1%               | -15.2%            |
| Auto   | 23.4%                         |           | 11.1%               | 110.8%            |
|  | <b>100.0%</b>                 |           | <b>100.0%</b>       |                   |
| <b><u>Acquired Eurobank loans accounted for under ASC 310-30</u></b> |                               |           |                     |                   |
| <b>Allowance balance:</b>  |                               |           |                     |                   |
| Mortgage   | \$ 11,016                     | \$        | 22,570              | -51.2%            |
| Commercial   | 11,096                        |           | 67,365              | -83.5%            |
| Consumer   | 4                             |           | 243                 | -98.4%            |
| <b>Total allowance balance (a)</b>                                   | <b>\$ 22,116</b>              | <b>\$</b> | <b>90,178</b>       | <b>-75.5%</b>     |
| <b>Allowance composition:</b>  |                               |           |                     |                   |
| Mortgage   | 49.8%                         |           | 25.0%               | 99.2%             |
| Commercial   | 50.2%                         |           | 74.7%               | -32.8%            |
| Consumer   | 0.0%                          |           | 0.3%                | -100.0%           |
|  | <b>100.0%</b>                 |           | <b>100.0%</b>       |                   |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

**TABLE 9 — ALLOWANCE FOR LOAN AND LEASE LOSSES SUMMARY**

|   | Quarter Ended June 30, |                  |               | Six-Month Period Ended June 30, |                  |               |
|---|------------------------|------------------|---------------|---------------------------------|------------------|---------------|
|   | 2016                   | 2015             | Variance      | 2016                            | 2015             | Variance      |
|   | (Dollars in thousands) |                  |               | (Dollars in thousands)          |                  |               |
| <b><u>Originated and other loans:</u></b>       |                        |                  |               |                                 |                  |               |
| <b>Balance at beginning of period</b>           | \$ 113,238             | \$ 76,759        | 47.5%         | \$ 112,626                      | \$ 51,439        | 119.0%        |
| Provision for loan and lease losses             | 9,052                  | 9,953            | -9.1%         | 19,712                          | 43,864           | -55.1%        |
| Charge-offs                                     | (13,118)               | (11,824)         | 10.9%         | (26,480)                        | (24,042)         | 10.1%         |
| Recoveries                                      | 3,640                  | 4,101            | -11.2%        | 6,954                           | 7,728            | -10.0%        |
| <b>Balance at end of period</b>                 | <b>\$ 112,812</b>      | <b>\$ 78,989</b> | <b>42.8%</b>  | <b>\$ 112,812</b>               | <b>\$ 78,989</b> | <b>42.8%</b>  |
| <b><u>Acquired loans:</u></b>                   |                        |                  |               |                                 |                  |               |
| <b><u>BBVAPR loans</u></b>                      |                        |                  |               |                                 |                  |               |
| <b>Acquired loans accounted for</b>             |                        |                  |               |                                 |                  |               |
| <b>under ASC 310-20:</b>                        |                        |                  |               |                                 |                  |               |
| <b>Balance at beginning of period</b>           | \$ 4,993               | \$ 5,450         | -8.4%         | \$ 5,542                        | \$ 4,597         | 20.6%         |
| Provision for loan and lease losses             | 548                    | 1,498            | -63.4%        | 844                             | 4,286            | -80.3%        |
| Charge-offs                                     | (1,596)                | (2,357)          | -32.3%        | (3,152)                         | (5,006)          | -37.0%        |
| Recoveries                                      | 542                    | 938              | -42.2%        | 1,253                           | 1,652            | -24.2%        |
| <b>Balance at end of period</b>                 | <b>\$ 4,487</b>        | <b>\$ 5,529</b>  | <b>-18.8%</b> | <b>\$ 4,487</b>                 | <b>\$ 5,529</b>  | <b>-18.8%</b> |
| <b>Acquired loans accounted for</b>             |                        |                  |               |                                 |                  |               |
| <b>under ASC 310-30:</b>                        |                        |                  |               |                                 |                  |               |
| <b>Balance at beginning of period</b>           | \$ 27,747              | \$ 14,166        | 95.9%         | \$ 25,785                       | \$ 13,481        | 91.3%         |
| Provision for loan and lease losses             | 3,814                  | 4,193            | -9.0%         | 5,842                           | 4,878            | 19.8%         |
| Loan pools fully charged off                    | (216)                  | -                | -100.0%       | (282)                           | -                | -100.0%       |
| Allowance de-recognition (a)                    | (8,544)                | -                | -100.0%       | (8,544)                         | -                | 0.0%          |
| <b>Balance at end of period</b>                 | <b>\$ 22,801</b>       | <b>\$ 18,359</b> | <b>24.2%</b>  | <b>\$ 22,801</b>                | <b>\$ 18,359</b> | <b>24.2%</b>  |
| <b><u>Eurobank loans</u></b>                    |                        |                  |               |                                 |                  |               |
| <b>Balance at beginning of period</b>           | \$ 92,293              | \$ 70,651        | 30.6%         | \$ 90,178                       | \$ 64,245        | 40.4%         |
| Provision (recapture) for loan and lease losses | 1,031                  | (105)            | -1081.9%      | 1,836                           | 4,704            | -61.0%        |
| FDIC shared-loss portion on                     |                        |                  |               |                                 |                  |               |
| provision for covered loan                      |                        |                  |               |                                 |                  |               |
| and lease losses                                | 951                    | 906              | 5.0%          | 2,395                           | 2,503            | -4.3%         |
| Loan pools fully charged off                    | -                      | -                | 0.0%          | (134)                           | -                | -100.0%       |
| Allowance de-recognition (a)                    | (72,159)               | -                | -100.0%       | (72,159)                        | -                | -100.0%       |
| <b>Balance at end of period</b>                 | <b>\$ 22,116</b>       | <b>\$ 71,452</b> | <b>-69.0%</b> | <b>\$ 22,116</b>                | <b>\$ 71,452</b> | <b>-69.0%</b> |

**Allowance for loans and lease losses on originated**

**and other loans to:**

|                                 |        |        |       |        |        |       |
|---------------------------------|--------|--------|-------|--------|--------|-------|
| Total originated loans          | 3.53%  | 2.67%  | 32.2% | 3.53%  | 2.67%  | 32.2% |
| Non-performing originated loans | 38.85% | 25.59% | 51.8% | 38.85% | 25.59% | 51.8% |

**Allowance for loans and lease losses on acquired**

**loans accounted for under**

**ASC 310-20 to:**

|                                |         |         |       |         |         |       |
|--------------------------------|---------|---------|-------|---------|---------|-------|
| Total acquired loans accounted |         |         |       |         |         |       |
| for under ASC 310-20           | 3.84%   | 2.87%   | 33.8% | 3.84%   | 2.87%   | 33.8% |
| Non-performing acquired loans  | 214.07% | 162.67% | 31.6% | 214.07% | 162.67% | 31.6% |
| accounted for under ASC 310-20 |         |         |       |         |         |       |

(a) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was derecognized on June 30, 2016 due to the revision in the derecognition policy for these loans.

**TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30**

|   | Quarter Ended June 30, |                     |               | Six-Month Period Ended June 30, |                     |               |
|---|------------------------|---------------------|---------------|---------------------------------|---------------------|---------------|
|   | 2016                   | 2015                | Variance<br>% | 2016                            | 2015                | Variance<br>% |
| (Dollar in thousands)                         |                        |                     |               |                                 |                     |               |
| <b>Originated and other loans and leases:</b> |                        |                     |               |                                 |                     |               |
| <b>Mortgage</b>                               |                        |                     |               |                                 |                     |               |
| Charge-offs                                   | \$ (1,374)             | \$ (1,356)          | 1.3%          | \$ (3,036)                      | \$ (2,770)          | 9.6%          |
| Recoveries                                    | 36                     | 67                  | -46.3%        | 181                             | 67                  | 170.1%        |
| <b>Total</b>                                  | <b>(1,338)</b>         | <b>(1,289)</b>      | <b>3.8%</b>   | <b>(2,855)</b>                  | <b>(2,703)</b>      | <b>5.6%</b>   |
| <b>Commercial</b>                             |                        |                     |               |                                 |                     |               |
| Charge-offs                                   | (833)                  | (497)               | 67.6%         | (1,844)                         | (1,489)             | 23.8%         |
| Recoveries                                    | 228                    | 219                 | 4.1%          | 316                             | 309                 | 2.3%          |
| <b>Total</b>                                  | <b>(605)</b>           | <b>(278)</b>        | <b>117.6%</b> | <b>(1,528)</b>                  | <b>(1,180)</b>      | <b>29.5%</b>  |
| <b>Consumer</b>                               |                        |                     |               |                                 |                     |               |
| Charge-offs                                   | (2,811)                | (2,309)             | 21.7%         | (5,138)                         | \$ (3,985)          | 28.9%         |
| Recoveries                                    | 133                    | 390                 | -65.9%        | 235                             | 543                 | -56.7%        |
| <b>Total</b>                                  | <b>(2,678)</b>         | <b>(1,919)</b>      | <b>39.6%</b>  | <b>(4,903)</b>                  | <b>(3,442)</b>      | <b>42.4%</b>  |
| <b>Auto</b>                                   |                        |                     |               |                                 |                     |               |
| Charge-offs                                   | (8,100)                | (7,662)             | 5.7%          | (16,462)                        | \$ (15,798)         | 4.2%          |
| Recoveries                                    | 3,243                  | 3,425               | -5.3%         | 6,222                           | 6,809               | -8.6%         |
| <b>Total</b>                                  | <b>(4,857)</b>         | <b>(4,237)</b>      | <b>14.6%</b>  | <b>(10,240)</b>                 | <b>(8,989)</b>      | <b>13.9%</b>  |
| <b>Net credit losses</b>                      |                        |                     |               |                                 |                     |               |
| Total charge-offs                             | (13,118)               | (11,824)            | 10.9%         | (26,480)                        | (24,042)            | 10.1%         |
| Total recoveries                              | 3,640                  | 4,101               | -11.2%        | 6,954                           | 7,728               | -10.0%        |
| <b>Total</b>                                  | <b>\$ (9,478)</b>      | <b>\$ (7,723)</b>   | <b>22.7%</b>  | <b>\$ (19,526)</b>              | <b>\$ (16,314)</b>  | <b>19.7%</b>  |
| <b>Net credit losses to average</b>           |                        |                     |               |                                 |                     |               |
| <b>loans outstanding:</b>                     |                        |                     |               |                                 |                     |               |
| Mortgage                                      | 0.72%                  | 0.66%               | 9.1%          | 0.76%                           | 0.69%               | 10.1%         |
| Commercial                                    | 0.17%                  | 0.08%               | 112.5%        | 0.21%                           | 0.18%               | 16.7%         |
| Consumer                                      | 4.35%                  | 3.99%               | 9.0%          | 4.08%                           | 3.68%               | 10.9%         |
| Auto  | 2.75%                  | 2.74%               | 0.4%          | 2.95%                           | 2.96%               | -0.3%         |
| <b>Total</b>                                  | <b>1.21%</b>           | <b>1.06%</b>        | <b>14.2%</b>  | <b>1.25%</b>                    | <b>1.13%</b>        | <b>10.6%</b>  |
| <b>Recoveries to charge-offs</b>              | <b>27.75%</b>          | <b>34.68%</b>       | <b>-20.0%</b> | <b>26.26%</b>                   | <b>32.14%</b>       | <b>-18.3%</b> |
| <b>Average originated loans:</b>              |                        |                     |               |                                 |                     |               |
| Mortgage                                      | \$ 743,516             | \$ 782,753          | -5.0%         | \$ 749,904                      | \$ 785,029          | -4.5%         |
| Commercial                                    | 1,433,944              | 1,333,276           | 7.6%          | 1,429,638                       | 1,301,367           | 9.9%          |
| Consumer                                      | 246,003                | 192,572             | 27.7%         | 240,251                         | 187,049             | 28.4%         |
| Auto  | 706,107                | 618,746             | 14.1%         | 695,071                         | 606,819             | 14.5%         |
| <b>Total</b>                                  | <b>\$ 3,129,570</b>    | <b>\$ 2,927,347</b> | <b>6.9%</b>   | <b>\$ 3,114,864</b>             | <b>\$ 2,880,264</b> | <b>8.1%</b>   |

**TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30 (CONTINUED)**

|   | Quarter Ended June 30 |                   |               | Six-Month Period Ended June 30 |                   |                |
|---|-----------------------|-------------------|---------------|--------------------------------|-------------------|----------------|
|   | 2016                  | 2015              | Variance      | 2016                           | 2015              | Variance       |
|   |                       |                   | %             |                                |                   | %              |
| (Dollars in thousands)                                |                       |                   |               |                                |                   |                |
| <b>Acquired loans accounted for under ASC 310-20:</b> |                       |                   |               |                                |                   |                |
| <b>Commercial</b>                                     |                       |                   |               |                                |                   |                |
| Charge-offs   | \$ (12)               | \$ (16)           | -25.0%        | \$ (19)                        | \$ (16)           | 18.8%          |
| Recoveries  | 8                     | 7                 | 14.3%         | 40                             | 17                | 135.3%         |
| <b>Total</b>  | <b>(4)</b>            | <b>(9)</b>        | <b>-55.6%</b> | <b>21</b>                      | <b>1</b>          | <b>2000.0%</b> |
| <b>Consumer</b>                                       |                       |                   |               |                                |                   |                |
| Charge-offs   | (1,013)               | (1,303)           | -22.3%        | (1,825)                        | (2,686)           | -32.1%         |
| Recoveries  | 88                    | 429               | -79.5%        | 169                            | 563               | -70.0%         |
| <b>Total</b>  | <b>(925)</b>          | <b>(874)</b>      | <b>5.8%</b>   | <b>(1,656)</b>                 | <b>(2,123)</b>    | <b>-22.0%</b>  |
| <b>Auto</b>   |                       |                   |               |                                |                   |                |
| Charge-offs   | (571)                 | (1,038)           | -45.0%        | (1,308)                        | (2,304)           | -43.2%         |
| Recoveries  | 446                   | 502               | -11.2%        | 1,044                          | 1,072             | -2.6%          |
| <b>Total</b>  | <b>(125)</b>          | <b>(536)</b>      | <b>-76.7%</b> | <b>(264)</b>                   | <b>(1,232)</b>    | <b>-78.6%</b>  |
| <b>Net credit losses</b>                              |                       |                   |               |                                |                   |                |
| Total charge-offs                                     | (1,596)               | (2,357)           | -32.3%        | (3,152)                        | (5,006)           | -37.0%         |
| Total recoveries                                      | 542                   | 938               | -42.2%        | 1,253                          | 1,652             | -24.2%         |
| <b>Total</b>  | <b>\$ (1,054)</b>     | <b>\$ (1,419)</b> | <b>-25.7%</b> | <b>\$ (1,899)</b>              | <b>\$ (3,354)</b> | <b>-43.4%</b>  |
| <b>Net credit losses to average</b>                   |                       |                   |               |                                |                   |                |
| <b>loans outstanding:</b>                             |                       |                   |               |                                |                   |                |
| Commercial  | 2.77%                 | 5.10%             | -45.7%        | -7.13%                         | -0.19%            | 3652.6%        |
| Consumer  | 6.19%                 | 5.70%             | 8.7%          | 5.51%                          | 6.80%             | -19.0%         |
| Auto  | 0.63%                 | 1.26%             | -50.3%        | 0.62%                          | 1.14%             | -46.2%         |
| <b>Total</b>  | <b>3.01%</b>          | <b>2.45%</b>      | <b>23.0%</b>  | <b>2.59%</b>                   | <b>2.41%</b>      | <b>7.8%</b>    |
| <b>Recoveries to charge-offs</b>                      | <b>33.96%</b>         | <b>39.80%</b>     | <b>-14.7%</b> | <b>39.75%</b>                  | <b>33.00%</b>     | <b>20.5%</b>   |
| <b>Average loans accounted for under ASC 310-20:</b>  |                       |                   |               |                                |                   |                |
| Commercial  | \$ 577                | \$ 706            | -18.3%        | \$ 589                         | \$ 1,039          | -43.3%         |
| Consumer  | 59,785                | 61,382            | -2.6%         | 60,087                         | 62,425            | -3.7%          |
| Auto  | 79,603                | 169,644           | -53.1%        | 85,815                         | 215,454           | -60.2%         |
| <b>Total</b>  | <b>\$ 139,965</b>     | <b>\$ 231,732</b> | <b>-39.6%</b> | <b>\$ 146,491</b>              | <b>\$ 278,918</b> | <b>-47.5%</b>  |



**TABLE 11 — NON-PERFORMING ASSETS**

|   | <b>June 30,<br/>2016</b>      | <b>December 31,<br/>2015</b> | <b>Variance<br/>(%)</b> |
|---|-------------------------------|------------------------------|-------------------------|
|   | <b>(Dollars in thousands)</b> |                              |                         |
| <b>Non-performing assets:</b>   |                               |                              |                         |
| Non-accruing loans  |                               |                              |                         |
| Troubled-Debt Restructuring loans   | \$ 208,978                    | \$ 217,691                   | -4.0%                   |
| Other loans   | 76,321                        | 82,429                       | -7.4%                   |
| Accruing loans  |                               |                              |                         |
| Troubled-Debt Restructuring loans   | 5,640                         | 4,240                        | 33.0%                   |
| Other loans   | 1,548                         | 1,091                        | 41.9%                   |
| Total non-performing loans  | \$ 292,487                    | \$ 305,451                   | -4.2%                   |
| Foreclosed real estate not covered under the<br>shared-loss agreements with the FDIC  | 49,484                        | 56,304                       | -12.1%                  |
| Other repossessed assets  | 3,866                         | 6,034                        | -35.9%                  |
|   | <b>\$ 345,837</b>             | <b>\$ 367,789</b>            | <b>-6.0%</b>            |
| <b>Non-performing assets to total assets, excluding<br/>covered assets and acquired loans with<br/>deteriorated credit quality (including those by<br/>analogy)</b> | <b>6.22%</b>                  | <b>6.31%</b>                 | <b>-1.4%</b>            |
| <b>Non-performing assets to total capital</b>   | <b>37.76%</b>                 | <b>41.00%</b>                | <b>-7.9%</b>            |

|  | <b>Quarter Ended June<br/>30, 2016</b> |             | <b>Six-Month Period Ended<br/>June 30, 2016</b> |             |
|--|--|-------------|---|-------------|
|  | <b>2016</b>                            | <b>2015</b> | <b>2016</b>                                     | <b>2015</b> |
|  | <b>(In thousands)</b>                  |             | <b>(In thousands)</b>                           |             |
| <b>Interest that would have been recorded in the period if the<br/>loans had not been classified as non-accruing loans</b> | \$ 984                                 | \$ 890      | \$ 1,821  | \$ 1,597    |

TABLE 12 — NON-PERFORMING LOANS

|  | <b>June 30<br/>2016</b>       | <b>December 31,<br/>2015</b> | <b>Variance<br/>%</b> |
|--|-------------------------------|------------------------------|-----------------------|
|  | <b>(Dollars in thousands)</b> |                              |                       |
| <b>Non-performing loans:</b>   |                               |                              |                       |
| <b>Originated and other loans held for investment</b>  |                               |                              |                       |
| Mortgage   | \$ 72,947                     | \$ 77,875                    | -6.3%                 |
| Commercial   | 207,768                       | 215,281                      | -3.5%                 |
| Consumer   | 2,339                         | 1,631                        | 43.4%                 |
| Auto and leasing   | 7,337                         | 8,418                        | -12.8%                |
|  | 290,391                       | 303,205                      | -4.2%                 |
| <b>Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b> |                               |                              |                       |
| Commercial   | 770                           | 880                          | -12.5%                |
| Consumer   | 764                           | 535                          | 42.8%                 |
| Auto   | 562                           | 831                          | -32.4%                |
|  | 2,096                         | 2,246                        | -6.7%                 |
| <b>Total</b>   | <b>\$ 292,487</b>             | <b>\$ 305,451</b>            | <b>-4.2%</b>          |
| <b>Non-performing loans composition percentages:</b>   |                               |                              |                       |
| <b>Originated loans</b>  |                               |                              |                       |
| Mortgage   | 24.9%                         | 25.5%                        |                       |
| Commercial   | 71.0%                         | 70.5%                        |                       |
| Consumer   | 0.8%                          | 0.5%                         |                       |
| Auto and leasing   | 2.5%                          | 2.8%                         |                       |
| <b>Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b> |                               |                              |                       |
| Commercial   | 0.3%                          | 0.3%                         |                       |
| Consumer   | 0.3%                          | 0.2%                         |                       |
| Auto   | 0.2%                          | 0.2%                         |                       |
| <b>Total</b>   | <b>100.0%</b>                 | <b>100.0%</b>                |                       |
| <b>Non-performing loans to:</b>  |                               |                              |                       |
| Total loans, excluding loans accounted for   |                               |                              |                       |
| under ASC 310-30 (including those by analogy)  | <b>8.83%</b>                  | <b>9.36%</b>                 | <b>-5.7%</b>          |
| Total assets, excluding loans accounted for  |                               |                              |                       |
| under ASC 310-30 (including those by analogy)  | <b>5.26%</b>                  | <b>5.24%</b>                 | <b>0.4%</b>           |
| Total capital  |                               |                              |                       |
| under ASC 310-30 (including those by analogy)  | <b>31.93%</b>                 | <b>34.05%</b>                | <b>-6.2%</b>          |
| <b>Non-performing loans with partial charge-offs to:</b>   |                               |                              |                       |
| Total loans, excluding loans accounted for   |                               |                              |                       |
| under ASC 310-30 (including those by analogy)  | <b>0.72%</b>                  | <b>1.15%</b>                 | <b>-37.4%</b>         |
| Non-performing loans   | <b>8.19%</b>                  | <b>12.25%</b>                | <b>-33.1%</b>         |
| <b>Other non-performing loans ratios:</b>  |                               |                              |                       |
| Charge-off rate on non-performing loans to non-performing loans  | <b>63.73%</b>                 | <b>61.15%</b>                | <b>4.2%</b>           |

on which charge-offs have been taken  
Allowance for loan and lease losses to non-performing

|   |               |               |             |
|---|---------------|---------------|-------------|
| loans on which no charge-offs have been taken | <b>46.01%</b> | <b>44.09%</b> | <b>4.4%</b> |
|---|---------------|---------------|-------------|

**FDIC Indemnification Asset**

The Company recorded the FDIC indemnification asset, measured separately from the covered loans, as part of the Eurobank FDIC-assisted transaction. Based on the accounting guidance in ASC Topic 805, at each reporting date subsequent to the initial recording of the indemnification asset, the Company measures the indemnification asset on the same basis as the covered loans and assesses its collectability. The amount to be ultimately collected for the indemnification asset is dependent upon the performance of the underlying covered assets, the passage of time, claims submitted to the FDIC and the Corporation's compliance with the terms of the loss sharing agreements. Refer to Note 6 to the unaudited consolidated financial statements for additional information on the FDIC loss share agreements.

The FDIC loss share coverage for the commercial loans and other non-single family loans was in effect until June 30, 2015. The coverage for the single family residential loans will expire on June 30, 2020. Accordingly, the Company amortized the remaining portion of the FDIC indemnification asset attributable to non-single family loans at the close of the second quarter of 2015. At June 30, 2016, the FDIC indemnification asset only reflects the balance for single family residential mortgage loans.

**TABLE 13 - ACTIVITY OF FDIC INDEMNIFICATION ASSET**

|  | Quarter Ended June 30, |                  | Six-Month Period Ended |                  |
|--|------------------------|------------------|------------------------|------------------|
|  | 2016                   | 2015             | June 30,               | 2015             |
|  | (In thousands)         |                  | (In thousands)         |                  |
| <b><u>FDIC indemnification asset:</u></b>            |                        |                  |                        |                  |
| <b>Balance at beginning of period</b>                | \$ 20,923              | \$ 75,221        | \$ 22,599              | \$ 97,378        |
| Shared-loss agreements reimbursements from the FDIC  | (332)                  | (24,387)         | (737)                  | (38,087)         |
| Increase in expected credit losses to be             |                        |                  |                        |                  |
| covered under shared-loss agreements, net            | 951                    | 906              | 2,395                  | 2,503            |
| FDIC indemnification asset expense                   | (1,405)                | (22,512)         | (4,269)                | (34,733)         |
| Incurred expenses to be reimbursed under shared-loss |                        |                  |                        |                  |
| agreements   | (1,711)                | (6,524)          | (1,562)                | (4,357)          |
| <b>Balance at end of period</b>                      | <b>\$ 18,426</b>       | <b>\$ 22,704</b> | <b>\$ 18,426</b>       | <b>\$ 22,704</b> |

**TABLE 14 - ACTIVITY IN THE REMAINING FDIC INDEMNIFICATION ASSET DISCOUNT**

|                                       | Quarter Ended June 30, |          | Six-month period ended June 30, |          |
|---------------------------------------|------------------------|----------|---------------------------------|----------|
|                                       | 2016                   | 2015     | 2016                            | 2015     |
|                                       | (In thousands)         |          |                                 |          |
| <b>Balance at beginning of period</b> | \$ 10,026              | \$ 4,755 | \$ 4,814                        | \$ 4,755 |

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|                                   |                  |                 |               |                 |
|-----------------------------------|------------------|-----------------|---------------|-----------------|
| Amortization of negative discount | (1,405)          | (22,531)        | (4,270)       | (22,531)        |
| Impact of lower projected losses  | 2,444            | 27,733          | 10,521        | 27,733          |
| <b>Balance at end of period</b>   | <b>\$ 11,065</b> | <b>\$ 9,957</b> | <b>11,065</b> | <b>\$ 9,957</b> |

124

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**TABLE 15 - LIABILITIES SUMMARY AND COMPOSITION**

|  | June 30,<br>2016<br>(Dollars in thousands) | December 31,<br>2015 | Variance<br>% |
|--|--|----------------------|---------------|
| <b>Deposits:</b>   |  |                      |               |
| Non-interest bearing deposits  | \$ 917,260                                 | \$ 762,009           | 20.4%         |
| NOW accounts   | 1,055,461                                  | 1,100,541            | -4.1%         |
| Savings and money market accounts  | 1,176,168                                  | 1,179,229            | -0.3%         |
| Certificates of deposit  | 1,493,303                                  | 1,674,431            | -10.8%        |
| <b>Total deposits</b>  | <b>4,642,192</b>                           | <b>4,716,210</b>     | <b>-1.6%</b>  |
| Accrued interest payable   | 1,862                                      | 1,541                | 20.8%         |
| <b>Total deposits and accrued interest payable</b>                                 | <b>4,644,054</b>                           | <b>4,717,751</b>     | <b>-1.6%</b>  |
| <b>Borrowings:</b>   |  |                      |               |
| Securities sold under agreements to repurchase                                     | 626,109                                    | 934,691              | -33.0%        |
| Advances from FHLB   | 306,480                                    | 332,476              | -7.8%         |
| Subordinated capital notes   | 102,983                                    | 102,633              | 0.3%          |
| Other term notes   | 1,753                                      | 1,734                | 1.1%          |
| <b>Total borrowings</b>  | <b>1,037,325</b>                           | <b>1,371,534</b>     | <b>-24.4%</b> |
| <b>Total deposits and borrowings</b>   | <b>5,681,379</b>                           | <b>6,089,285</b>     | <b>-6.7%</b>  |
| <b>Other Liabilities:</b>  |  |                      |               |
| Derivative liabilities   | 5,413                                      | 6,162                | -12.2%        |
| Acceptances outstanding  | 20,984                                     | 14,582               | 43.9%         |
| Other liabilities  | 88,930                                     | 92,043               | -3.4%         |
| <b>Total liabilities</b>   | <b>\$ 5,796,706</b>                        | <b>\$ 6,202,072</b>  | <b>-6.5%</b>  |
| <b>Deposits portfolio composition percentages:</b>                                 |  |                      |               |
| Non-interest bearing deposits  | 19.8%                                      | 16.2%                |               |
| NOW accounts   | 22.7%                                      | 23.3%                |               |
| Savings and money market accounts  | 25.3%                                      | 25.0%                |               |
| Certificates of deposit  | 32.2%                                      | 35.5%                |               |
|  | <b>100.0%</b>                              | <b>100.0%</b>        |               |
| <b>Borrowings portfolio composition percentages:</b>                               |  |                      |               |
| Securities sold under agreements to repurchase                                     | 60.4%                                      | 68.2%                |               |
| Advances from FHLB   | 29.5%                                      | 24.2%                |               |
| Other term notes   | 0.2%                                       | 0.1%                 |               |
| Subordinated capital notes   | 9.9%                                       | 7.5%                 |               |
|  | <b>100.0%</b>                              | <b>100.0%</b>        |               |
| <b>Securities sold under agreements to repurchase (excluding accrued interest)</b> |  |                      |               |
| Amount outstanding at period-end   | \$ 624,500                                 | \$ 932,500           |               |
| Daily average outstanding balance  | \$ 713,653                                 | \$ 1,012,756         |               |
| Maximum outstanding balance at any month-end                                       | \$ 902,500                                 | \$ 1,158,945         |               |

## Liabilities and Funding Sources

As shown in Table 15 above, at June 30, 2016, the Company's total liabilities were \$5.797 billion, 6.5% less than the \$6.202 billion reported at December 31, 2015. Deposits and borrowings, the Company's funding sources, amounted to \$5.681 billion at June 30, 2016 versus \$6.089 billion at December 31, 2015, a 6.7% decrease.

At June 30, 2016, deposits represented 82% and borrowings represented 18% of interest-bearing liabilities. At June 30, 2016, deposits, the largest category of the Company's interest-bearing liabilities, were \$4.644 billion, a decrease of 1.6% from \$4.718 billion at December 31, 2015. Demand and savings deposits increased 3.8% to \$3.083 billion, time deposits, excluding brokered deposits, increased 3.6% to \$999.2 million, and brokered deposits decreased 28.3% to \$561.6 million, as part of our efforts to reduce the cost of deposits, which averaged 0.62% at June 30, 2016 compared to 0.59% at December 31, 2015.

Borrowings consist mainly of repurchase agreements, FHLB-NY advances and subordinated capital notes. At June 30, 2016, borrowings amounted to \$1.037 billion, representing a decrease of 24.4% when compared with the \$1.372 billion reported at December 31, 2015. Repurchase agreements at June 30, 2016 decreased \$308.6 million to \$626.1 million from \$934.7 million at December 31, 2015, as the Company partially unwound \$268.0 million in repurchase agreements at a cost of \$12.0 million during the first quarter of 2016.

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 decreased \$26.0 million to \$306.5 million at June 30, 2016, as they reached maturity and were not renewed. The remaining advances mature from July 2016 through 2020.

## Stockholders' Equity

At June 30, 2016, the Company's total stockholders' equity was \$915.9 million, a 2.1% increase when compared to \$897.1 million at December 31, 2015. This increase in stockholders' equity reflects increases in retained earnings of \$13.5 million, in legal surplus of \$2.8 million, and in accumulated comprehensive income of \$1.8 million, which in turn reflects the realized gains on available-for-sale securities for the six-month period ended June 30, 2016. Book value per share was \$17.08 at June 30, 2016 compared to \$16.67 at December 31, 2015.

From December 31, 2015 to June 30, 2016, tangible common equity to total assets increased to 9.79% from 8.98%, Tier 1 Leverage capital ratio increased to 11.92% from 11.18%, Common Equity Tier 1 capital ratio increased to 12.64% from 12.14%, Tier 1 Risk-Based capital ratio increased to 16.71% from 15.99%, and Total Risk-Based

capital ratio increased to 18.00% from 17.29%.

### **New Capital Rules to Implement Basel III Capital Requirements**

In July 2013, the Board of Governors of the Federal Reserve System (the “Board”), the Office of the Comptroller of the Currency (the “OCC”) and the FDIC (together with the Board and the OCC, the “Agencies”) approved new rules (“New Capital Rules”) to establish a revised comprehensive regulatory capital framework for all U.S. banking organizations. The New Capital Rules generally implement the Basel Committee on Banking Supervision’s (the “Basel Committee”) December 2010 final capital framework referred to as “Basel III” for strengthening international capital standards. The New Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including the Company and the Bank, as compared to the previous U.S. general risk-based capital rules. The New Capital Rules revise the definitions and the components of regulatory capital, as well as address other issues affecting the numerator in banking institutions’ regulatory capital ratios. The New Capital Rules also address asset risk weights and other matters affecting the denominator in banking institutions’ regulatory capital ratios and replace the existing general risk-weighting approach, which was derived from the Basel Committee’s 1988 “Basel I” capital accords, with a more risk-sensitive approach based, in part, on the “standardized approach” in the Basel Committee’s 2004 “Basel II” capital accords. In addition, the New Capital Rules implement certain provisions of Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal agencies’ rules. The New Capital Rules became effective for the Company and the Bank on January 1, 2015, subject to phase-in periods for certain of their components and other provisions. Among other matters, the New Capital Rules: (i) introduce a new capital measure called “Common Equity Tier 1” (“CET1”) and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. Under the New Capital Rules, for most banking organizations, including



the Company, the most common form of Additional Tier 1 capital is noncumulative perpetual preferred stock and the most common form of Tier 2 capital is subordinated notes and a portion of the allocation for loan and lease losses, in each case, subject to the New Capital Rules' specific requirements.

Pursuant to the New Capital Rules, the minimum capital ratios as of January 1, 2015 are as follows:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 *plus* Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital *plus* Tier 2 capital) to risk-weighted assets; and
- 4% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the "leverage ratio").

The New Capital Rules also introduce a new 2.5% "capital conservation buffer", composed entirely of CET1, on top of the three minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. Thus, when fully phased-in on January 1, 2019, the Company and the Bank will be required to maintain an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%.

The New Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1.

In addition (as noted above), under the previous general risk-based capital rules, the effects of AOCI items included in shareholders' equity (for example, mark-to-market adjustments to the value of securities held in the available for sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Pursuant to the New Capital Rules, the effects of certain AOCI items are not excluded; however, non-advanced approach banking organizations may make a one-time permanent election to continue to exclude these items. The Company and the Bank made the election to continue to exclude these items in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of their securities portfolio, concurrently with the first filing of the Company's and Oriental Bank's periodic regulatory reports in the beginning of 2015. The New Capital Rules also preclude certain hybrid securities, such as trust preferred securities, from inclusion in bank holding companies' Tier 1 capital, subject to phase-out, in the case of bank holding companies that had \$15 billion or more in total consolidated assets as of December 31, 2009. Therefore, the Company is permitted to continue to include its existing trust preferred securities as Tier 1 capital.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

With respect to the Bank, the New Capital Rules revise the “prompt corrective action” (“PCA”) regulations adopted pursuant to Section 38 of the Federal Deposit Insurance Act by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3% leverage ratio and still be adequately capitalized. The New Capital Rules do not change the total risk-based capital requirement for any PCA category.

The New Capital Rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the assets, and resulting in higher risk weights for a variety of asset classes.

The following are the consolidated capital ratios of the Company under the New Capital Rules at June 30, 2016 and December 31, 2015:

**TABLE 16 — CAPITAL, DIVIDENDS AND STOCK DATA**

|   | <b>June 30,</b>                                      |    | <b>December 31,</b> |                 |
|---|--|----|---------------------|-----------------|
|   | <b>2016</b>  |    | <b>2015</b>         | <b>Variance</b> |
|   | <b>(Dollars in thousands, except per share data)</b> |    |                     | <b>%</b>        |
| <b>Capital data:</b>                                  |  |    |                     |                 |
| Stockholders' equity                                  | \$ 915,890   | \$ | 897,077             | 2.1%            |
| <b>Regulatory Capital Ratios data:</b>                |  |    |                     |                 |
| <b>Common equity tier 1 capital ratio</b>             | <b>12.64%</b>  |    | <b>12.14%</b>       | <b>4.1%</b>     |
| Minimum common equity tier 1 capital ratio required   | 4.50%  |    | 4.50%               | 0.0%            |
| Actual common equity tier 1 capital                   | \$ 596,080   | \$ | 594,482             | 0.3%            |
| Minimum common equity tier 1 capital required         | \$ 212,244   | \$ | 220,344             | -3.7%           |
| Excess over regulatory requirement                    | \$ 383,836   | \$ | 374,138             | 2.6%            |
| Risk-weighted assets                                  | \$ 4,716,534   | \$ | 4,896,539           | -3.7%           |
| <b>Tier 1 risk-based capital ratio</b>                | <b>16.71%</b>  |    | <b>15.99%</b>       | <b>4.5%</b>     |
| Minimum tier 1 risk-based capital ratio required      | 6.00%  |    | 6.00%               |                 |
| Actual tier 1 risk-based capital                      | \$ 788,349   | \$ | 782,912             | 0.7%            |
| Minimum tier 1 risk-based capital required            | \$ 282,992   | \$ | 293,792             | -3.7%           |
| Excess over regulatory requirement                    | \$ 505,357   | \$ | 489,120             | 3.3%            |
| Risk-weighted assets                                  | \$ 4,716,534   | \$ | 4,896,539           | -3.7%           |
| <b>Total risk-based capital ratio</b>                 | <b>18.00%</b>  |    | <b>17.29%</b>       | <b>4.1%</b>     |
| Minimum total risk-based capital ratio required       | 8.00%  |    | 8.00%               |                 |
| Actual total risk-based capital                       | \$ 849,147   | \$ | 846,748             | 0.3%            |
| Minimum total risk-based capital required             | \$ 377,323   | \$ | 391,723             | -3.7%           |
| Excess over regulatory requirement                    | \$ 471,824   | \$ | 455,025             | 3.7%            |
| Risk-weighted assets                                  | \$ 4,716,534   | \$ | 4,896,539           | -3.7%           |
| <b>Leverage capital ratio</b>                         | <b>11.92%</b>  |    | <b>11.18%</b>       | <b>6.6%</b>     |
| Actual tier 1 capital                                 | \$ 788,349   | \$ | 782,912             | 0.7%            |
| Minimum tier 1 capital required                       | \$ 264,633   | \$ | 280,009             | -5.5%           |
| Excess over regulatory requirement                    | \$ 523,716   | \$ | 502,903             | 4.1%            |
| <b>Tangible common equity to total assets</b>         | <b>9.79%</b>   |    | <b>8.98%</b>        | <b>9.0%</b>     |
| <b>Tangible common equity to risk-weighted assets</b> | <b>13.93%</b>  |    | <b>13.02%</b>       | <b>7.0%</b>     |
| <b>Total equity to total assets</b>                   | <b>13.64%</b>  |    | <b>12.64%</b>       | <b>7.9%</b>     |
| <b>Total equity to risk-weighted assets</b>           | <b>19.42%</b>  |    | <b>18.32%</b>       | <b>6.0%</b>     |
| <b>Stock data:</b>                                    |  |    |                     |                 |
| Outstanding common shares                             | 43,913,719   |    | 43,867,909          | 0.1%            |
| Book value per common share                           | \$ 17.08   | \$ | 16.67               | 2.5%            |
| Tangible book value per common share                  | \$ 14.96   | \$ | 14.53               | 3.0%            |
| Market price at end of period                         | \$ 8.30  | \$ | 7.32                | 13.4%           |
| Market capitalization at end of period                | \$ 364,484   | \$ | 321,113             | 13.5%           |



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, 2016 and December 31, 2015:

|  | <b>June 30,<br/>2016</b>   |                  | <b>December 31,<br/>2015</b> |
|--|--|------------------|------------------------------|
|  | <b>(In thousands, except share or per<br/>share information)</b> |                  |                              |
| Total stockholders' equity                       | \$   | 915,890          | \$ 897,077                   |
| Preferred stock                                  |  | (176,000)        | (176,000)                    |
| Preferred stock issuance costs                   |  | 10,130           | 10,130                       |
| Goodwill   |  | (86,069)         | (86,069)                     |
| Core deposit intangible                          |  | (4,777)          | (5,294)                      |
| Customer relationship intangible                 |  | (2,222)          | (2,544)                      |
| <b>Total tangible common equity</b>              | <b>\$</b>  | <b>656,952</b>   | <b>\$ 637,300</b>            |
| Total assets                                     |  | 6,712,596        | 7,099,149                    |
| Goodwill   |  | (86,069)         | (86,069)                     |
| Core deposit intangible                          |  | (4,777)          | (5,294)                      |
| Customer relationship intangible                 |  | (2,222)          | (2,544)                      |
| <b>Total tangible assets</b>                     | <b>\$</b>  | <b>6,619,528</b> | <b>\$ 7,005,242</b>          |
| <b>Tangible common equity to tangible assets</b> |  | <b>9.92%</b>     | <b>9.10%</b>                 |
| Common shares outstanding at end of period       |  | 43,913,719       | 43,867,909                   |
| <b>Tangible book value per common share</b>      | <b>\$</b>  | <b>14.96</b>     | <b>\$ 14.53</b>              |

The tangible common equity ratio and tangible book value per common share are non-GAAP measures and, unlike Tier 1 capital and Common Equity Tier 1 capital, are not codified in the federal banking regulations. 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.

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 following table presents the Company's capital adequacy information under the New Capital Rules:

|  | <b>June 30,<br/>2016</b>      | <b>December 31,<br/>2015</b> |
|--|-------------------------------|------------------------------|
|  | <b>(Dollars in thousands)</b> |                              |
| <b>Risk-based capital:</b>                             |                               |                              |
| Common equity tier 1 capital                           | \$ 596,080                    | 594,482                      |
| Additional tier 1 capital                              | 192,269                       | 188,430                      |
| <b>Tier 1 capital</b>                                  | 788,349                       | \$ 782,912                   |
| Additional Tier 2 capital                              | 60,798                        | 63,836                       |
| <b>Total risk-based capital</b>                        | <b>\$ 849,147</b>             | <b>\$ 846,748</b>            |
| <b>Risk-weighted assets:</b>                           |                               |                              |
| Balance sheet items                                    | \$ 4,585,289                  | \$ 4,742,113                 |
| Off-balance sheet items                                | 131,245                       | 154,426                      |
| <b>Total risk-weighted assets</b>                      | <b>\$ 4,716,534</b>           | <b>\$ 4,896,539</b>          |
| <b>Ratios:</b>   |                               |                              |
| Common equity tier 1 capital (minimum required - 4.5%) | <b>12.64%</b>                 | <b>12.14%</b>                |
| Tier 1 capital (minimum required - 6%)                 | <b>16.71%</b>                 | <b>15.99%</b>                |
| Total capital (minimum required - 8%)                  | <b>18.00%</b>                 | <b>17.29%</b>                |
| Leverage ratio   | <b>11.92%</b>                 | <b>11.18%</b>                |
| Equity to assets                                       | <b>13.64%</b>                 | <b>12.64%</b>                |
| Tangible common equity to assets                       | <b>9.79%</b>                  | <b>8.98%</b>                 |

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, 2016 and December 31, 2015:

|   | <b>June 30,<br/>2016</b>      | <b>December 31,<br/>2015</b> | <b>Variance<br/>%</b> |
|---|-------------------------------|------------------------------|-----------------------|
|   | <b>(Dollars in thousands)</b> |                              |                       |
| <b>Oriental Bank Regulatory Capital Ratios:</b>             |                               |                              |                       |
| <b>Common Equity Tier 1 Capital to Risk-Weighted Assets</b> | <b>16.33%</b>                 | <b>15.40%</b>                | <b>6.1%</b>           |
| Actual common equity tier 1 capital                         | \$ 769,424                    | \$ 751,886                   | 2.3%                  |
| Minimum capital requirement (4.5%)                          | \$ 211,992                    | \$ 219,762                   | -3.5%                 |
| Minimum to be well capitalized (6.5%)                       | \$ 306,210                    | \$ 317,434                   | -3.5%                 |
| <b>Tier 1 Capital to Risk-Weighted Assets</b>               | <b>16.33%</b>                 | <b>15.40%</b>                | <b>6.1%</b>           |
| Actual tier 1 risk-based capital                            | \$ 769,424                    | \$ 751,886                   | 2.3%                  |
| Minimum capital requirement (6%)                            | \$ 282,656                    | \$ 293,016                   | -3.5%                 |
| Minimum to be well capitalized (8%)                         | \$ 376,874                    | \$ 390,688                   | -3.5%                 |
| <b>Total Capital to Risk-Weighted Assets</b>                | <b>17.62%</b>                 | <b>16.70%</b>                | <b>5.5%</b>           |
| Actual total risk-based capital                             | \$ 830,002                    | \$ 815,458                   | 1.8%                  |
| Minimum capital requirement (8%)                            | \$ 376,874                    | \$ 390,688                   | -3.5%                 |
| Minimum to be well capitalized (10%)                        | \$ 471,093                    | \$ 488,360                   | -3.5%                 |
| <b>Total Tier 1 Capital to Average Total Assets</b>         | <b>11.68%</b>                 | <b>10.80%</b>                | <b>8.2%</b>           |
| Actual tier 1 capital                                       | \$ 769,424                    | \$ 751,886                   | 2.3%                  |

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|                                     |    |         |    |         |       |
|-------------------------------------|----|---------|----|---------|-------|
| Minimum capital requirement (4%)    | \$ | 263,464 | \$ | 278,399 | -5.4% |
| Minimum to be well capitalized (5%) | \$ | 329,330 | \$ | 347,999 | -5.4% |

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130



The Company's common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "OFG." At June 30, 2016 and December 31, 2015, the Company's market capitalization for its outstanding common stock was \$364.5 million (\$8.30 per share) and \$321.1 million (\$7.32 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:

|                    |    | <b>High</b> | <b>Price</b> |    | <b>Low</b> |    | <b>Cash<br/>Dividend<br/>Per share</b> |
|--------------------|----|-------------|--------------|----|------------|----|--|
| <b>2016</b>        |    |             |              |    |            |    |  |
| June 30, 2016      | \$ | 9.14        |              | \$ | 6.32       | \$ | 0.06                                   |
| March 31, 2016     | \$ | 7.32        |              | \$ | 4.77       | \$ | 0.06                                   |
| <b>2015</b>        |    |             |              |    |            |    |  |
| December 31, 2015  | \$ | 10.52       |              | \$ | 6.39       | \$ | 0.06                                   |
| September 30, 2015 | \$ | 10.20       |              | \$ | 6.63       | \$ | 0.10                                   |
| June 30, 2015      | \$ | 17.04       |              | \$ | 10.67      | \$ | 0.10                                   |
| March 31, 2015     | \$ | 17.70       |              | \$ | 14.88      | \$ | 0.10                                   |
| <b>2014</b>        |    |             |              |    |            |    |  |
| December 31, 2014  | \$ | 16.76       |              | \$ | 14.35      | \$ | 0.10                                   |
| September 30, 2014 | \$ | 18.89       |              | \$ | 14.92      | \$ | 0.08                                   |
| June 30, 2014      | \$ | 18.88       |              | \$ | 16.38      | \$ | 0.08                                   |
| March 31, 2014     | \$ | 17.54       |              | \$ | 14.30      | \$ | 0.08                                   |

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 \$7.7 million of authority remains. The shares of common stock repurchased are to be held by the Company as treasury shares. There were no repurchases during the first half of 2016 and 2015. The number of shares that may yet be purchased under the \$70 million program is estimated at 931,428 and was calculated by dividing the remaining balance of \$7.7 million by \$8.30 (closing price of the Company common stock at June 30, 2016).

### **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") and implemented by management through the adoption of a risk management program, which is overseen and monitored by the Chief Risk Officer and the Risk Management 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 executing 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 quarterly 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 five-year time horizon, assuming certain gradual upward and downward interest rate movements, achieved during a twelve-month period. Instantaneous interest rate movements are also modeled. 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, 2016 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 |
| <u>Change in interest rate</u> | Change   | Change  | Change             | Change  |
|                                | (Dollars in thousands)                         |         |                    |         |
| + 200 Basis points             | \$ 4,275                                       | 1.62%   | \$ 3,259           | 1.23%   |
| + 100 Basis points             | \$ 2,346                                       | 0.89%   | \$ 1,841           | 0.69%   |
| - 50 Basis points              | \$ (845)                                       | -0.32%  | \$ (624)           | -0.23%  |

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, 2016 .

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 \$3.7 million (notional amount of \$237.3 million) was recognized at June 30, 2016 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, 2016, interest rate swaps offered to clients not designated as hedging instruments represented a derivative asset of \$1.7 million (notional amounts of \$16.2 million), and the mirror-image interest rate swaps in which the Company entered into represented a derivative liability of \$1.7 million (notional amounts of \$16.2 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, 2016, 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 \$187 thousand (notional amounts of \$425 thousand) and the options sold to customers embedded in the certificates of deposit represented a liability of \$181 thousand (notional amount of \$411 thousand).

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, 2016, the Company had \$237.3 million in interest rate swaps at an average rate of 2.6% designated as cash flow hedges for \$237.3 million in advances from the FHLB-NY that repriced 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 ten years, due to a shrinking population, a protracted economic recession, a housing sector that remains under pressure, the Puerto Rico government's fiscal and liquidity crisis, and the recent credit or payment defaults on certain Puerto Rico government bonds, with additional defaults expected if the Puerto Rico government is unable to restructure its debts and/or access the capital markets to place new debt or refinance its upcoming maturities. Also, the Company's banking subsidiary has an outstanding \$183.0 million credit facility to PREPA that is classified on non-accrual status,

which now stands at \$129.7 million, net of allowances. The Company recorded a \$53.3 million loss provision for such credit facility in 2015.

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 external 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, 2016, the Company had \$624.5 million in repurchase agreements, excluding accrued interest, and \$561.6 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.

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, 2016, the Company had approximately \$517.0 million in unrestricted cash and cash equivalents, \$546.5 million in investment securities that are not pledged as collateral, and \$895.0 million in borrowing capacity at the FHLB-NY 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 Chief Compliance Officer who reports to the CEO and the BSA Officer who reports to the Chief Risk Officer. The Chief Compliance Officer is responsible for the oversight of regulatory compliance and implementation of a company-wide compliance program, except for the Bank Secrecy Act/Anti-Money Laundering compliance program, which is overseen and implemented by the BSA Officer.

#### **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, 2016, 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***

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, 2015. 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.

**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:**

- 10 Employment Agreement between the Company and José R. Fernández.
- 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 June 30, 2016, 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 5, 2016

José Rafael Fernández  
President and Chief Executive Officer

By: /s/ Ganesh Kumar

Date: August 5, 2016

Ganesh Kumar  
Executive Vice President and Chief Financial  
Officer

By: /s/ Maritza Arizmendi

Date: August 5, 2016

Maritza Arizmendi  
Senior Vice President and Chief Accounting  
Officer