OFG BANCORP
Form 10-Q
May 10, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

or

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

For the transition period from ______________ to ______________

Commission File Number 001-12647

OFG Bancorp

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

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 ¨ Accelerated Filer x Non-Accelerated Filer ¨ Smaller Reporting Company ¨
(Do not check if a smaller reporting company)

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

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

45,626,596 common shares ($1.00 par value per share) outstanding as of April 30, 2013

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FORWARD-LOOKING STATEMENTS

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

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

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

- possible legislative, tax or regulatory changes; and

- difficulties in integrating the acquired Puerto Rico operations of Banco Bilbao Vizcaya Argentaria, S. A. ("BBVAPR") into the Company's operations.

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.

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF MARCH 31, 2013 AND DECEMBER 31, 2012

	March 31, 2013	December 31, 2012
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	$ 548,770	$ 855,490
Money market investments	12,676	13,205
Total cash and cash equivalents	**561,446**	**868,695**
Securities purchased under agreements to resell	**60,000**	**80,000**
Investments:		
Trading securities, at fair value, with amortized cost of $1,835 (December 31, 2012 - $508)	1,787	495
Investment securities available-for-sale, at fair value, with amortized cost of $1,948,685 (December 31, 2012 - $2,118,825)	2,013,155	2,194,286
Federal Home Loan Bank (FHLB) stock, at cost	33,458	38,411
Other investments	66	73
Total investments	**2,048,466**	**2,233,265**
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	77,644	64,544
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of $42,720 (December 31, 2012 - $39,921)	4,757,003	4,722,174
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of $52,974 (December 31, 2012 - $54,124)	379,734	395,307
Total loans, net	**5,214,381**	**5,182,025**
Other assets:		
FDIC shared-loss indemnification asset	266,958	286,799
Foreclosed real estate covered under shared-loss agreements with the FDIC	26,528	22,283
Foreclosed real estate not covered under shared-loss agreements with the FDIC	54,810	53,164
Accrued interest receivable	20,231	17,554
Deferred tax asset, net	112,575	117,201
Premises and equipment, net	83,461	84,997
Customers' liability on acceptances	32,512	26,996
Servicing assets	11,543	10,795
Derivative assets	23,233	21,889
Goodwill	64,021	64,021
Other assets	122,386	123,684

Total assets	$	**8,702,551**	$	**9,193,368**
LIABILITIES AND STOCKHOLDERS' EQUITY				
Deposits:				
Demand deposits	$	2,183,785	$	2,447,152
Savings accounts		892,654		634,819
Certificates of deposit		2,487,075		2,607,588
Total deposits		**5,563,514**		**5,689,559**
Borrowings:				
Short term borrowings		60,846		92,222
Securities sold under agreements to repurchase		1,491,675		1,695,247
Advances from FHLB and other borrowings		462,906		554,177
Subordinated capital notes		98,436		146,038
Total borrowings		**2,113,863**		**2,487,684**
Other liabilities:				
Derivative liabilities		24,024		26,260
Acceptances executed and outstanding		32,512		26,996
Accrued expenses and other liabilities		98,396		99,263
Total liabilities		**7,832,309**		**8,329,762**
Stockholders' equity:				
Preferred stock; 10,000,000 shares authorized; 1,340,000 shares of Series A, 1,380,000 shares of Series B, and 960,000 shares of Series D issued and outstanding, (December 31, 2012 - 1,340,000 ; 1,380,000 ; and 960,000) $25 liquidation value		92,000		92,000
84,000 shares of Series C issued and outstanding (December 31, 2012 - 84,000); $1,000 liquidation value		84,000		84,000
Common stock, $1 par value; 100,000,000 shares authorized; 52,670,878 shares issued; 45,621,199 shares outstanding (December 31, 2012 - 52,670,878; 45,580,281)		52,671		52,671
Additional paid-in capital		537,500		537,453
Legal surplus		54,128		52,143
Retained earnings		83,739		70,734
Treasury stock, at cost, 7,049,679 shares (December 31, 2012 - 7,090,597 shares)		(80,847)		(81,275)
Accumulated other comprehensive income, net of tax of $1,101 (December 31, 2012 - $1,802)		47,051		55,880
Total stockholders' equity		**870,242**		**863,606**
Total liabilities and stockholders' equity	$	**8,702,551**	$	**9,193,368**

See notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

	Quarter Ended March 31,	
	2013	2012
	(In thousands, except per share data)	
Interest income:		
Loans not covered under shared-loss agreements with the FDIC	$ 80,263	$ 18,123
Loans covered under shared-loss agreements with the FDIC	20,229	21,541
Total interest income from loans	**100,492**	**39,664**
Mortgage-backed securities	10,818	28,063
Investment securities and other	2,318	2,192
Total interest income	**113,628**	**69,919**
Interest expense:		
Deposits	10,478	9,123
Securities sold under agreements to repurchase	7,248	17,570
Advances from FHLB and other borrowings	1,660	3,004
FDIC-guaranteed term notes	-	909
Subordinated capital notes	1,660	328
Total interest expense	**21,046**	**30,934**
Net interest income	**92,582**	**38,985**
Provision for non-covered loan and lease losses	7,916	3,000
Provision for covered loan and lease losses, net	672	7,157
Total provision for loan and lease losses	**8,588**	**10,157**
Net interest income after provision for loan and lease losses	**83,994**	**28,828**
Non-interest income:		
Financial service revenue	7,660	5,889
Banking service revenue	12,382	3,080
Mortgage banking activities	3,153	2,502
Total banking and financial service revenue	**23,195**	**11,471**
Net amortization of FDIC shared-loss indemnification asset	(12,871)	(4,827)
Net gain (loss) on:		
Sale of securities	-	7,360
Derivatives	(298)	-
Foreclosed real estate	(1,793)	(398)
Early extinguishment of subordinated capital notes	1,061	-
Other	(38)	(842)
Total non-interest income, net	**9,256**	**12,764**
Non-interest expense:		

Compensation and employee benefits		23,249		10,365
Professional and service fees		9,122		5,420
Occupancy and equipment		9,216		4,209
Insurance		2,678		1,820
Electronic banking charges		3,728		1,558
Advertising, business promotion, and strategic initiatives		1,409		848
Merger and restructuring charges		5,534		-
Foreclosure, repossession and other real estate expenses		1,505		749
Loan servicing and clearing expenses		1,475		967
Taxes, other than payroll and income taxes		2,622		1,174
Communication		864		389
Printing, postage, stationary and supplies		1,166		308
Director and investor relations		236		309
Other		2,128		886
Total non-interest expense		**64,932**		**29,002**
Income before income taxes		**28,318**		**12,590**
Income tax expense		7,126		1,937
Net income		**21,192**		**10,653**
Less: dividends on preferred stock		(3,465)		(1,201)
Income available to common shareholders	**$**	**17,727**	**$**	**9,452**
Earnings per common share:				
Basic	$	**0.39**	**$**	**0.23**
Diluted	$	**0.37**	**$**	**0.23**
Average common shares outstanding and equivalents		**52,892**		**41,162**
Cash dividends per share of common stock	$	**0.06**	**$**	**0.06**

See notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

	Quarter ended March 31,			
	2013		2012	
	(In thousands)			
Net income	**$**	**21,192**	**$**	**10,653**
Other comprehensive loss before tax:				
Unrealized (gain) loss on securities available-for-sale		(10,992)		1,944
Realized gain on investment securities included in net income		-		(7,360)
Unrealized loss (gain) on cash flow hedges		1,462		(2,001)
Other comprehensive loss before taxes		**(9,530)**		**(7,417)**
Income tax effect		701		384
Other comprehensive loss after taxes		**(8,829)**		**(7,033)**
Comprehensive income	**$**	**12,363**	**$**	**3,620**

See notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

	Quarter Ended March 31,	
	2013	2012
	(In thousands)	
Preferred stock:		
Balance at beginning and end of period	**$ 176,000**	**$ 68,000**
Common stock:		
Balance at beginning of year	52,671	47,809
Exercised stock options	-	32
Balance at end of period	**52,671**	**47,841**
Additional paid-in capital:		
Balance at beginning of year	537,453	499,096
Stock-based compensation expense	437	366
Exercised stock options	-	359
Lapsed restricted stock units	(351)	(35)
Common stock issuance costs	(23)	-
Preferred stock issuance costs	(16)	-
Balance at end of period	**537,500**	**499,786**
Legal surplus:		
Balance at beginning of year	52,143	50,178
Transfer from retained earnings	1,985	1,068
Balance at end of period	**54,128**	**51,246**
Retained earnings:		
Balance at beginning of year	70,734	68,149
Net income	21,192	10,653
Cash dividends declared on common stock	(2,737)	(2,442)
Cash dividends declared on preferred stock	(3,465)	(1,201)
Transfer to legal surplus	(1,985)	(1,068)
Balance at end of period	**83,739**	**74,091**
Treasury stock:		
Balance at beginning of year	(81,275)	(74,808)
Stock repurchased	-	(7,022)
Lapsed restricted stock units	351	35
Stock used to match defined contribution plan	77	23
Balance at end of period	**(80,847)**	**(81,772)**
Accumulated other comprehensive income, net of tax:		
Balance at beginning of year	55,880	37,131
Other comprehensive loss, net of tax	(8,829)	(7,033)
Balance at end of period	**47,051**	**30,098**
Total stockholders' equity	**$ 870,242**	**$ 689,290**

See notes to unaudited consolidated financial statements.

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

	Quarter Ended March 31, 2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	$ **21,192**	$ **10,653**
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan origination fees, net of costs	256	142
Amortization of fair value discounts on acquired loans	2,579	-
Amortization of investment securities premiums, net of accretion of discounts	6,200	11,841
Amortization of core deposit and customer relationship intangibles	644	36
Amortization of fair value premiums on acquired deposits	5,267	-
Net amortization of FDIC shared-loss indemnification asset	12,871	4,827
Amortization of prepaid FDIC assessment	860	1,494
Other impairments on securities	7	4
Depreciation and amortization of premises and equipment	3,092	1,210
Deferred income taxes, net	5,265	(1,274)
Provision for covered and non-covered loan and lease losses, net	8,588	10,157
Stock-based compensation	437	366
(Gain) loss on:		
Sale of securities	-	(7,360)
Sale of mortgage loans held for sale	(1,631)	(1,330)
Derivatives	298	1
Early extinguishment of subordinated capital notes	(1,061)	-
Foreclosed real estate	1,793	398
Sale of other repossessed assets	84	(2)
Sale of premises and equipment	-	(82)
Originations of loans held-for-sale	(68,493)	(43,144)
Proceeds from sale of loans held-for-sale	29,347	22,906
Net (increase) decrease in:		
Trading securities	(1,292)	(184)
Accrued interest receivable	(2,677)	1,432
Servicing assets	(748)	(271)
Other assets	1,446	11,239
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(391)	(627)
Accrued expenses and other liabilities	(2,518)	(7,409)
Net cash provided by operating activities	**21,415**	**15,023**
Cash flows from investing activities:		
Purchases of:		

Investment securities available-for-sale	(1,383)	(77,910)
Investment securities held-to-maturity	-	(119,025)
FHLB stock	(3,150)	-
Maturities and redemptions of:		
Investment securities available-for-sale	163,940	164,804
Investment securities held-to-maturity	-	51,681
FHLB stock	8,103	-
Proceeds from sales of:		
Investment securities available-for-sale	29,062	210,204
Foreclosed real estate	5,620	1,792
Other repossessed assets	416	994
Premises and equipment	155	101
Origination and purchase of loans, excluding loans held-for-sale	(206,229)	(67,024)
Principal repayment of loans, including covered loans	161,912	58,969
Reimbursements from the FDIC on shared-loss agreements	6,650	24,068
Additions to premises and equipment	(1,711)	(431)
Net change in securities purchased under agreements to resell	20,000	(170,000)
Net cash provided by investing activities	**183,385**	**78,223**

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

	Quarter Ended March 31,			
	2013		2012	
	(In thousands)			
Cash flows from financing activities:				
Net increase (decrease) in:				
Deposits		(133,055)		(124,230)
Short term borrowings		(31,382)		3,644
Securities sold under agreements to repurchase		(203,636)		-
FHLB advances		(91,185)		-
Subordinated capital notes		(46,541)		-
FDIC-guaranteed term notes		-		(105,000)
Exercise of stock options		-		391
Issuance of common stock costs		(23)		-
Issuance of preferred stock costs		(16)		-
Purchase of treasury stock		-		(7,022)
Termination of derivative instruments		(9)		9
Dividends paid on preferred stock		(3,465)		(1,201)
Dividends paid on common stock		(2,737)		(2,442)
Net cash used in financing activities		**(512,049)**		**(235,851)**
Net change in cash and cash equivalents		**(307,249)**		**(142,605)**
Cash and cash equivalents at beginning of period		868,695		591,487
Cash and cash equivalents at end of period	**$**	**561,446**	**$**	**448,882**
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:				
Interest paid	$	21,243	$	31,683
Mortgage loans securitized into mortgage-backed securities	$	27,679	$	16,619
Transfer from loans to foreclosed real estate	$	15,459	$	4,143

See notes to unaudited consolidated financial statements

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION

Nature of Operations

OFG Bancorp (the "Company") is a publicly-owned financial holding company incorporated under the laws of the Commonwealth of Puerto Rico. The Company operates through various subsidiaries including, a commercial bank, Oriental Bank (or the "Bank"), two broker-dealers, Oriental Financial Services Corp. ("Oriental Financial Services") and OFS Securities, Inc. ("OFS' Securities"), an insurance agency, Oriental Insurance, Inc. ("Oriental Insurance") and a retirement plan administrator, Caribbean Pension Consultants, Inc. ("CPC"). The Company also has a special purpose entity, Oriental Financial (PR) Statutory Trust II (the "Statutory Trust II"). Through these subsidiaries and their respective divisions, the Company provides a wide range of banking and financial services such as commercial, consumer and mortgage lending, leasing, auto loans, financial planning, insurance sales, money management and investment banking and brokerage services, as well as corporate and individual trust services. On April 25, 2013, the Company changed its corporate name from Oriental Financial Group, Inc. to OFG Bancorp. Note 17 to the unaudited consolidated financial statements presents information about the Company's business segments.

On December 18, 2012, the Company purchased from Banco Bilbao Vizcaya Argentaria, S. A. ("BBVA"), all of the outstanding common stock of each of (i) BBVAPR Holding Corporation ("BBVAPR Holding"), the sole shareholder of Banco Bilbao Vizcaya Argentaria Puerto Rico ("BBVAPR Bank"), a Puerto Rico chartered commercial bank, and BBVA Seguros, Inc. ("BBVA Seguros"), an insurance agency, and (ii) BBVA Securities of Puerto Rico, Inc. ("BBVA Securities," now known as "OFS Securities"), a registered broker-dealer. This transaction is referred to as the "BBVAPR Acquisition" and BBVAPR Holding, BBVAPR Bank, BBVA Seguros and BBVA Securities are collectively referred to as the "BBVAPR Companies" or "BBVAPR.".

Basis of Presentation and Use of Estimates

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

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

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

Certain reclassifications have been made to 2012 unaudited consolidated financial statements and notes to the financial statements to conform to the 2013 presentation.

Significant Accounting Policies

We provide a summary of our significant accounting policies in our 2012 Form 10-K under "Notes to Consolidated Financial Statements—Note 1—Summary of Significant Accounting Policies." Below we describe recent accounting changes.

Reclassification out of Accumulated Other Comprehensive Income - In February 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income,* which required new footnote disclosures of items reclassified from accumulated *Other Comprehensive Income* (OCI) to net income. The requirements became effective for the first quarter of 2013 and are included in Note 13 to the unaudited consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. The ASU is intended to simplify the guidance for testing the decline in the realizable value (impairment) of indefinite-lived intangible assets other than goodwill. Some examples of intangible assets subject to the guidance include indefinite-lived trademarks, licenses and distribution rights. The ASU allows companies to perform a qualitative assessment about the likelihood of impairment of an indefinite-lived intangible asset to determine whether further impairment testing is necessary, similar in approach to the goodwill impairment test. The ASU became effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Our adoption of the guidance had no effect on our unaudited consolidated financial statements.

Offsetting Financial Assets and Liabilities - In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The ASU is intended to enhance current disclosure requirements on offsetting financial assets and liabilities. The new disclosures enable financial statement users to compare balance sheets prepared under U.S. GAAP and IFRS, which are subject to different offsetting models. The guidance require to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to an agreement similar to a master netting arrangement. The disclosures are required irrespective of whether such instruments are presented gross or net on the balance sheet. In January 2013, the FASB issued ASU No. 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, which clarify that the scope of this guidance applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amended guidance was effective for annual and interim reporting periods beginning on or after January 1, 2013, with comparative retrospective disclosures required for all periods presented. We adopted the guidance in the first quarter of 2013. Our adoption of the guidance had no effect on our financial condition, results of operations or liquidity since it impacts disclosures only. The new disclosures required by the amended guidance are included in "Note 17 – Offsetting Arrangements."

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income - In February 2013, the FASB issued an amendment to enhance current disclosure requirements of reclassifications out of accumulated other comprehensive income and their corresponding effect on net income to be presented, in one place, information about significant amounts reclassified and, in some cases, cross-reference to related footnote disclosures. Previously, this information was presented in different places throughout the financial statements. The amendments require to disclose information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, requires to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in its entirety to net

income, the company is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The amended guidance was effective for annual and interim reporting periods beginning on or after December 15, 2012, prospectively. Our adoption of the guidance is presented on note 13 to these unaudited consolidated financial statements.

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Presentation of Comprehensive Income

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. The ASU requires an entity to present the total of comprehensive income, the components of net income, and the components of OCI either in a single continuous statement of comprehensive income or in two separate but consecutive statements. OFG Bancorp selected the two-statement approach. Under this approach, the Company is required to present components of net income and total net income in the Statement of Income. The Statement of Comprehensive Income follows the Statement of Income and includes the components of OCI and a total for OCI, along with a total for comprehensive income. The ASU removed the option of reporting OCI in the statement of changes in stockholders' equity. This ASU became effective for OFG Bancorp on January 1, 2012 and a Statement of

Comprehensive Income is included in these unaudited consolidated financial statements.

Fair Value Measurement — FASB ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" (Topic 820) was issued in May 2011. This update establishes common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Among the changes, additional information about the sensitivity of a fair value measurement categorized within Level 3 of the fair value hierarchy to changes in unobservable inputs and any interrelationships between those unobservable inputs will be required. Also, entities now will be required to categorize by level of the fair value hierarchy items that are not measured at fair value in the statement of financial position, but for which the fair value of such items is required to be disclosed. The amendments in this update are effective during interim and annual periods beginning after December 15, 2011, are to be applied prospectively. The Company adopted this guidance for fair value measurements.

Repurchase Agreements — FASB ASU 2011-03, "Reconsideration of Effective Control for Repurchase Agreements" (Topic 860) was issued in April 2011. This update removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments in this update. The amendments in this update are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption was not permitted. The Company adopted this guidance for the repurchase agreements.

Future Application of Accounting Standards

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

Other Potential Amendments to Current Accounting Standards - The FASB and IASB, either jointly or separately, are currently working on several major projects, including amendments to existing accounting standards governing financial instruments, leases, consolidation and investment companies. As part of the joint financial instruments project, the FASB has issued a proposed ASU that would result in significant changes to the guidance for recognition and measurement of financial instruments, in addition to the proposed ASU that would change the accounting for credit losses on financial instruments discussed above. The FASB is also working on a joint project that would require substantially all leases to be capitalized on the balance sheet. Additionally, the FASB has issued a proposal on principal-agent considerations that would change the way the Company needs to evaluate whether to consolidate VIEs and non-VIE partnerships. Furthermore, the FASB has issued a proposed ASU that would change the criteria used to determine whether an entity is subject to the accounting and reporting requirements of an investment company. The principal-agent consolidation proposal would require all VIEs, including those that are investment companies, to be evaluated for consolidation under the same

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requirements. All of these projects may have significant impacts for the Company. Upon completion of the standards, the Company will need to reevaluate its accounting and disclosures. However, due to ongoing deliberations of the standard setters, the Company is currently unable to determine the effect of future amendments or proposals.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 2 – BUSINESS COMBINATIONS

BBVAPR Acquisition

On December 18, 2012, the Company purchased from BBVA, all of the outstanding common stock of each of BBVAPR Holding and BBVA Securities for an aggregate purchase price of $500 million. Immediately following the closing of the BBVAPR Acquisition, the Company merged BBVAPR Bank with and into Oriental Bank, with Oriental Bank continuing as the surviving entity. The unaudited consolidated financial statements contemplate the effect of the BBVAPR Acquisition.

Merger and Restructuring Charges

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

The following table presents severance and employee-related charges, systems integrations and related charges, and other merger-related charges, related to the BBVAPR Acquisition, for the quarter ended March 31, 2013:

	Quarter ended March 31, 2013 (In thousands)	
Severance and employee-related charges	$	750
Systems integrations and related charges		948
Other-contract cancellation fee		3,836
Total merger and restructuring charges	**$**	**5,534**

Restructuring Reserve

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

The following table presents the changes in restructuring reserves for the quarter ended March 31, 2013:

	Quarter ended March 31, 2013 (In thousands)

Balance at the beginning of the period	$	4,202
Merger and restructuring charges		5,534
Cash payments and other		(3,400)
Balance at the end of the period	**$**	**6,336**

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The FDIC-Assisted Acquisition and FDIC Shared-Loss Indemnification Asset

On April 30, 2010, the Bank acquired certain assets and assumed certain deposits and other liabilities in the FDIC-assisted acquisition of Eurobank. As part of the Purchase and Assumption Agreement between the Bank and the FDIC (the "Purchase and Assumption Agreement"), the Bank and the FDIC entered into shared-loss agreements, whereby the FDIC covers a substantial portion of any losses on loans (and related unfunded loan commitments), foreclosed real estate and other repossessed properties.

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

The assets acquired and liabilities assumed as of April 30, 2010 were presented at their fair value. In many cases, the determination of these fair values required management to make estimates about discount rates, expected cash flows, market conditions and other future events that are highly subjective in nature and were subject to change. The fair values initially assigned to the assets acquired and liabilities assumed were preliminary and subject to refinement for up to one year after the closing date of the acquisition as new information relative to closing date fair values became available. The process was completed on April 29, 2011.

The Bank agreed to make a true-up payment, also known as clawback liability, to the FDIC on the date that is 45 days following the last day (such day, the "True-Up Measurement Date") of the final shared-loss month, or upon the final disposition of all covered assets under the shared-loss agreements in the event losses thereunder fail to reach expected levels. Under the shared-loss agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of $906.0 million (or $181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or $227.5 million); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the shared-loss agreements during which the shared-loss provisions of the applicable shared-loss agreement is in effect (defined as the product of the simple average of the principal amount of shared-loss loans and shared-loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of $16.2 million and $15.5 million, net of discount, as of March 31, 2013 and December 31, 2012, respectively. This estimated liability is accounted for as a reduction of

the indemnification asset. The indemnification asset represents the portion of estimated losses covered by the shared-loss agreements between the Bank and the FDIC.

The operating results of the Company for the quarters ended March 31, 2013 and 2012 include the operating results produced by the acquired assets and assumed liabilities in the FDIC-assisted acquisition.

The FDIC shared-loss indemnification asset activity for the quarters ended March 31, 2013 and 2012 is as follows:

	Quarter Ended March 31,	
	2013	2012
	(In thousands)	
Balance at beginning of period	$ 286,799	$ 392,367
Shared-loss agreements reimbursements from the FDIC	(6,650)	(24,068)
Increase (decrease) in expected credit losses to be covered under shared-loss agreements, net	(1,822)	12,024
Amortization of FDIC shared-loss indemnification asset, net	(12,871)	(4,827)
Incurred expenses to be reimbursed under shared-loss agreements	1,502	2,948
Balance at end of period	**$ 266,958**	**$ 378,444**

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 3 - INVESTMENTS

Money Market Investments

The Company considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At March 31, 2013 and December 31, 2012, money market instruments included as part of cash and cash equivalents amounted to $12.7 million and $13.2 million, respectively.

Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell consist of short-term investments and are carried at the amounts at which the assets will be subsequently resold as specified in the respective agreements. At March 31, 2013 and December 31, 2012, securities purchased under agreements to resell amounted to $60.0 million and $80.0 million, respectively.

The amounts advanced under those agreements are reflected as assets in the unaudited consolidated statements of financial condition. It is the Company's policy to take possession of securities purchased under agreements to resell. Agreements with third parties specify the Company's right to request additional collateral based on its monitoring of the fair value of the underlying securities on a daily basis. The fair value of the collateral securities held by the Company on these transactions as of March 31, 2013 and December 31, 2012 was approximately $61.2 million and $82.1 million, respectively.

Investment Securities

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

	March 31, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
	(In thousands)				
Available-for-sale					

Mortgage-backed securities					
FNMA and FHLMC certificates	$ 1,492,332	$ 60,779	$ 1	$ 1,553,110	2.99%
GNMA certificates	11,977	927	7	12,897	4.87%
CMOs issued by US Government sponsored agencies	268,739	3,554	685	271,608	1.82%
Total mortgage-backed securities	**1,773,048**	**65,260**	**693**	**1,837,615**	**2.83%**
Investment securities					
US Treasury securities	11,499	1	-	11,500	0.13%
Obligations of US Government sponsored agencies	18,355	181	-	18,536	1.33%
Obligations of Puerto Rico Government and political subdivisions	120,969	-	573	120,396	4.43%
Other debt securities	24,814	294	-	25,108	3.45%
Total investment securities	**175,637**	**476**	**573**	**175,540**	**3.68%**
Total securities available for sale	**$ 1,948,685**	**$ 65,736**	**$ 1,266**	**$ 2,013,155**	**2.90%**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The amortized cost and fair value of the Company's investment securities at March 31, 2013, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2013 Available-for-sale	
	Amortized Cost	Fair Value
	(In thousands)	
Mortgage-backed securities		
Due after 5 to 10 years		
FNMA and FHLMC certificates	$ 36,054	$ 37,194
Total due after 5 to 10 years	**36,054**	**37,194**
Due after 10 years		
FNMA and FHLMC certificates	1,456,278	1,515,916
GNMA certificates	11,977	12,897
CMOs issued by US Government sponsored agencies	268,739	271,608
Total due after 10 years	**1,736,994**	**1,800,421**
Total mortgage-backed securities	**1,773,048**	**1,837,615**
Investment securities		
Due in less than one year		
US Treasury securities	11,499	11,500
Total due in less than one year	**11,499**	**11,500**
Due from 1 to 5 years		
Other debt securities	20,000	20,042
Obligations of Puerto Rico Government and political subdivisions	407	399
Total due from 1 to 5 years	**20,407**	**20,441**
Due after 5 to 10 years		
Obligations of Puerto Rico Government and political subdivisions	11,410	11,205
Obligations of US Government and sponsored agencies	18,355	18,536
Total due after 5 to 10 years	**29,765**	**29,741**
Due after 10 years		
Obligations of Puerto Rico Government and political subdivisions	109,152	108,792
Other debt securities	4,814	5,066
Total due after 10 years	**113,966**	**113,858**
Total investment securities	**175,637**	**175,540**
Total securities available-for-sale	**$ 1,948,685**	**$ 2,013,155**

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The BBVAPR Acquisition and the related deleverage of the investment securities portfolio that the Company completed during the second half of 2012 reduced the interest rate risk profile of the Company. During such quarter the Company did not execute any sale of securities from its portfolio other than $29.1 million of available-for-sale GNMA certificates that were sold as part of its recurring mortgage loan origination and securitization activities. These sales produced a nominal gain during such period. During the quarter ended March 31, 2012, there were certain sales of available-for sale securities because the Company felt that gains could be realized and that there were good opportunities to invest the proceeds in other investment securities with attractive yields and terms that would allow the Company to continue protecting its net interest margin.

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 alternative 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.

For the quarter ended March 31, 2012, the Company recorded a net gain on sale of securities of $7.4 million. The tables below present the gross realized gains by category for such period:

	Quarter Ended March 31, 2012			
Description	**Sale Price**	**Book Value at Sale**	**Gross Gains**	**Gross Losses**
	(In thousands)			
Sale of Securities Available-for-Sale				
Mortgage-backed securities				
FNMA and FHLMC certificates	$ 139,834	$ 133,839	$ 5,995	$ -
GNMA certificates	17,438	17,437	1	-
CMOs issued by US Government sponsored agencies	19,725	18,372	1,353	-
Total mortgage-backed securities	176,997	169,648	7,349	-
Investment securities				
Obligations of U.S. Government sponsored agencies	22,677	22,666	11	-
Structured credit investments	10,530	10,530	-	-
Total investment securities	33,207	33,196	11	-
Total	**$ 210,204**	**$ 202,844**	**$ 7,360**	**$ -**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	March 31, 2013		
	12 months or more		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
		(In thousands)	
Securities Available-for-sale			
Obligations of Puerto Rico Government and political subdivisions	$ 1,692	$ 34	$ 1,658
CMOs issued by US Government sponsored agencies	2,151	176	1,975
	$ 3,843	**$ 210**	**$ 3,633**

		Less than 12 months	
	Amortized Cost	**Unrealized Loss**	**Fair Value**
		(In thousands)	
Securities Available-for-sale			
CMOs issued by US Government sponsored agencies	$ 6,857	$ 509	$ 6,348
Obligations of Puerto Rico Government and political subdivisions	20,587	539	20,048
GNMA certificates	83	7	76
FNMA and FHLMC certificates	67	1	66
	$ 27,594	**$ 1,056**	**$ 26,538**

		TOTAL	
	Amortized Cost	**Unrealized Loss**	**Fair Value**
		(In thousands)	
Securities Available-for-sale			
Obligations of Puerto Rico Government and political subdivisions	$ 22,279	$ 573	$ 21,706
CMOs issued by US Government sponsored agencies	9,008	685	8,323
FNMA and FHLMC certificates	67	1	66
GNMA certificates	83	7	76
	$ 31,437	**$ 1,266**	**$ 30,171**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2012 12 months or more		
	Amortized Cost	Unrealized Loss (In thousands)	Fair Value
Securities Available-for-sale			
Obligations of Puerto Rico Government and political subdivisions	$ 1,673	$ 12	$ 1,661
CMOs issued by US Government sponsored agencies	2,194	178	2,016
	$ 3,867	**$ 190**	**$ 3,677**

	Less than 12 months		
	Amortized Cost	Unrealized Loss (In thousands)	Fair Value
Securities Available-for-sale			
CMOs issued by US Government sponsored agencies	$ 10,671	$ 615	$ 10,056
US Treasury Securities	11,498	2	11,496
Obligations of Puerto Rico Government and political subdivisions	19,086	426	18,660
GNMA certificates	84	8	76
FNMA and FHLMC certificates	68	1	67
	$ 41,407	**$ 1,052**	**$ 40,355**

	TOTAL		
	Amortized Cost	Unrealized Loss (In thousands)	Fair Value
Securities Available-for-sale			
Obligations of Puerto Rico Government and political subdivisions	$ 20,759	$ 438	$ 20,321
CMOs issued by US Government sponsored agencies	12,865	793	12,072
US Treasury Securities	11,498	2	11,496
FNMA and FHLMC certificates	68	1	67
GNMA certificates	84	8	76
	$ 45,274	**$ 1,242**	**$ 44,032**

The Company conducts quarterly reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered by comparing the present value of cash flows expected to be collected from the security, discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the “credit loss.”

Other-than-temporary impairment analysis is based on estimates that depend on market conditions and are subject to further change over time. In addition, while the Company believes that the methodology used to value these exposures is reasonable, the methodology is subject to continuing refinement, including those made as a result of market developments. Consequently, it is reasonably possible that changes in estimates or conditions could result in the need to recognize additional other-than-temporary impairment charges in the future.

Securities in an unrealized loss position at March 31, 2013 are mainly composed of highly liquid securities that in most cases have a large and efficient secondary market. Valuations are performed on a monthly basis. The Company’s management believes that the unrealized losses of such other securities at March 31, 2013 are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer or guarantor. At March 31, 2013, the Company does not have the intent to sell these investments in an unrealized loss position.

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 4 - LOANS RECEIVABLE

The Company’s loan portfolio is composed of covered loans and non-covered loans. The risks of the Eurobank FDIC-assisted acquisition acquired loans are significantly different from those loans not covered under the FDIC loss sharing agreements because of the loss protection provided by the FDIC. Accordingly, the Company presents loans subject to the loss sharing agreements as “covered loans” in the information below and loans that are not subject to FDIC loss sharing agreements as “non-covered loans.” Also, loans acquired in the BBVAPR Acquisition are included as non-covered loans in the unaudited consolidated statements of financial condition. Non-covered loans are furthered segregated between originated loans, acquired loans accounted for under ASC 310-20 (loans with revolving feature and/or acquired at a premium) and acquired loans accounted for under ASC 310-30 (loans acquired with deteriorated credit quality, including those by analogy).

For a summary of the accounting policy related to loans, interest recognition and allowance for loan and lease losses refer to the summary of significant accounting policies included in Note 1 to the unaudited consolidated financial statements.

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	March 31, 2013	December 31, 2012
	(In thousands)	
Loans not covered under shared-loss agreements with FDIC:		
Originated loans and leases:		
Mortgage	$ 792,830	$ 804,942
Commercial	450,312	353,930
Auto and leasing	146,689	50,720
Consumer	65,363	48,136
	1,455,194	**1,257,728**
Acquired loans:		
Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)		
Commercial and industrial	315,706	317,632
Construction and commercial real estate	19,153	20,337
Auto	417,649	457,894
Consumer	65,388	68,878
	817,896	**864,741**
Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)		
Commercial and industrial	934,843	960,502
Construction and commercial real estate	191,521	198,560
Mortgage	791,537	810,235
Auto	506,613	555,510
Consumer	104,257	118,282
	2,528,771	**2,643,089**
	4,801,861	**4,765,558**
Deferred loan fees, net	(2,138)	(3,463)
Loans receivable	**4,799,723**	**4,762,095**
Allowance for loan and lease losses on non-covered loans	(42,720)	(39,921)
Loans receivable, net	**4,757,003**	**4,722,174**
Mortgage loans held-for-sale	77,644	64,544
Total loans not covered under shared-loss agreements with FDIC, net	**4,834,647**	**4,786,718**
Loans covered under shared-loss agreements with FDIC:		
Loans secured by 1-4 family residential properties	129,472	128,811

Construction and development secured by 1-4 family residential properties		13,971		15,969
Commercial and other construction		278,500		289,070
Leasing		2,640		7,088
Consumer		8,125		8,493
Total loans covered under shared-loss agreements with FDIC		**432,708**		**449,431**
Allowance for loan and lease losses on covered loans		(52,974)		(54,124)
Total loans covered under shared-loss agreements with FDIC, net		**379,734**		**395,307**
Total loans receivable, net	**$**	**5,214,381**	**$**	**5,182,025**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Non-covered Loans

<u>*Originated Loans and Leases*</u>

The Company's originated loan transactions are encompassed within five portfolio segments: mortgage, commercial, consumer, auto and leasing.

The following table presents the aging of the recorded investment in gross originated loans, excluding mortgage loans held for sale, as of March 31, 2013 and December 31, 2012 by class of loans. Mortgage loans past due included delinquent loans in the GNMA buy-back option program. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.

	March 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
			(In thousands)				
Mortgage							
Traditional (by origination year):							
Up to the year 2002	$ 9,709	$ 885	$ 9,476	$ 20,070	$ 75,165	$ 95,235	$ -
Years 2003 and 2004	18,813	1,540	15,385	35,738	109,645	145,383	-
Year 2005	7,391	892	7,131	15,414	62,735	78,149	-
Year 2006	12,774	2,125	13,086	27,985	82,302	110,287	-
Years 2007, 2008	7,090	569	7,945	15,604	102,495	118,099	-

and 2009							
Years 2010, 2011, 2012	674	734	946	2,354	76,534	78,888	-
and 2013							
	56,451	6,745	53,969	117,165	508,876	626,041	-
Non-traditional	3,219	186	8,968	12,373	43,375	55,748	-
Loss mitigation program	18,476	2,070	18,261	38,807	51,295	90,102	
	78,146	9,001	81,198	168,345	603,546	771,891	-
Home equity secured personal loans	-	-	12	12	737	749	-
GNMA's buy-back option program	-	-	20,190	20,190	-	20,190	-
	78,146	**9,001**	**101,400**	**188,547**	**604,283**	**792,830**	**-**
Commercial							
Commercial secured by real estate	2,675	825	21,126	24,626	286,409	311,035	-
Other commercial and industrial	546	23	2,519	3,088	136,189	139,277	-
	3,221	**848**	**23,645**	**27,714**	**422,598**	**450,312**	**-**
Consumer	**475**	**205**	**341**	**1,021**	**64,342**	**65,363**	**-**
Auto and leasing	**3,008**	**305**	**72**	**3,385**	**143,304**	**146,689**	**-**
Total non-covered originated loans	**$ 84,850**	**$ 10,359**	**$ 125,458**	**$ 220,667**	**$ 1,234,527**	**$ 1,455,194**	**$ -**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2012						
	30-59 Days Past Due	**60-89 Days Past Due**	**90+ Days Past Due**	**Total Past Due**	**Current**	**Total Loans**	**Loans 90+ Days Past Due and Still Accruing**
				(In thousands)			
Mortgage							
Traditional (by origination year):							
Up to the year 2002	$ 6,906	$ 2,116	$ 11,363	$ 20,385	$ 80,883	$ 101,268	$ -
Years 2003 and 2004	12,048	5,206	18,162	35,416	114,446	149,862	-
Year 2005	4,983	1,746	8,860	15,589	65,312	80,901	-
Year 2006	9,153	3,525	15,363	28,041	85,045	113,086	-
Years 2007, 2008 and 2009	2,632	1,682	8,965	13,279	108,358	121,637	-
Years 2010, 2011 and 2012 and 2012	632	769	1,162	2,563	64,084	66,647	-
	36,354	15,044	63,875	115,273	518,128	633,401	-
Non-traditional	2,850	1,067	11,160	15,077	42,742	57,819	-
Loss mitigation program	8,933	4,649	19,989	33,571	53,739	87,310	
	48,137	20,760	95,024	163,921	614,609	778,530	-
Home equity secured personal loans	-	-	10	10	726	736	-
GNMA's buy-back option program	-	-	25,676	25,676	-	25,676	-
	48,137	**20,760**	**120,710**	**189,607**	**615,335**	**804,942**	**-**
Commercial							
	9,062	271	15,335	24,668	226,606	251,274	-

Commercial secured by real estate							
Other commercial and industrial	345	189	2,378	2,912	99,744	102,656	-
	9,407	**460**	**17,713**	**27,580**	**326,350**	**353,930**	**-**
Consumer	**747**	**92**	**409**	**1,248**	**46,888**	**48,136**	-
Auto and leasing	**251**	**129**	**131**	**511**	**50,209**	**50,720**	**-**
Total non-covered originated loans	**$ 58,542**	**$ 21,441**	**$ 138,963**	**$ 218,946**	**$ 1,038,782**	**$ 1,257,728**	**$ -**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Credit cards, retail and commercial lines of credits, floor plans and performing auto loans with FICO scores over 660 acquired at a premium as part of the BBVAPR Acquisition are to be 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.

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

	March 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Commercial lines of credits	$ 1,211	$ 34	$ 153	$ 1,398	$ 314,308	$ 315,706	$ -
Commercial real estate	-	-	-	-	19,153	19,153	-
Auto	7,096	1,304	572	8,972	408,677	417,649	-
Consumer lines of credit and credit cards	650	-	1,002	1,652	63,736	65,388	-
Total acquired loans accounted for under ASC 310-20	**$ 8,957**	**$ 1,338**	**$ 1,727**	**$ 12,022**	**$ 805,874**	**$ 817,896**	**$ -**

	December 31, 2012						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Commercial lines of credits	$ 715	$ 76	$ 193	$ 984	$ 316,648	$ 317,632	$ -
Commercial real estate	315	-	-	315	20,022	20,337	-
Auto	6,753	1,023	275	8,051	449,843	457,894	-
Consumer lines of credit and credit cards	982	-	1,095	2,077	66,801	68,878	-
Total acquired loans accounted for under ASC 310-20	**$ 8,765**	**$ 1,099**	**$ 1,563**	**$ 11,427**	**$ 853,314**	**$ 864,741**	**$ -**

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Loans acquired as part of the BBVAPR Acquisition, except for credit cards, retail and commercial lines of credits, floor plans and performing auto loans with FICO scores over 660 acquired at a premium, are accounted for by the Company in accordance with ASC 310-30.

The carrying amount corresponding to non-covered loans acquired with deteriorated credit quality, including those accounted under ASC 310-30 by analogy, and covered loans in the statement of financial condition at March 31, 2013 and December 31, 2012 is as follows:

	March 31, 2013	**December 31, 2012**
	(In thousands)	
Contractual required payments receivable	$ 3,770,439	$ 3,941,171
Less: Non-accretable discount	733,564	742,310
Cash expected to be collected	3,036,875	3,198,861
Less: Accretable yield	508,104	555,772
Carrying amount	$ 2,528,771	$ 2,643,089

The following tables describe the accretable yield and non-accretable discount activity of acquired loans accounted for under ASC 310-30 for the quarter ended March 31, 2013, excluding covered loans:

	Quarter Ended March 31, 2013 (In thousands)	
Accretable Yield Activity		
Balance at beginning of period	$	555,772
Accretion		(47,668)
Transfer from non-accretable discount		-
Balance at end of period	**$**	**508,104**

	Quarter Ended March 31, 2013 (In thousands)	
Non-Accretable Discount Activity		
Balance at beginning of period	$	742,310

Principal losses		(8,746)
Transfer to accretable yield		-
Balance at end of period	**$**	**733,564**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Covered Loans

The carrying amount of covered loans included in the consolidated statements of financial condition at March 31, 2013 and December 31, 2012 are as follows:

		March 31, 2013		December 31, 2012
		(In thousands)		
Contractual required payments receivable	$	821,051	$	874,994
Less: Non-accretable discount		214,236		237,555
Cash expected to be collected		606,815		637,439
Less: Accretable yield		174,107		188,008
Carrying amount, gross		432,708		449,431
Less: Allowance for covered loan and lease losses		52,974		54,124
Carrying amount, net	**$**	**379,734**	**$**	**395,307**

The following tables describe the accretable yield and non-accretable discount activity of covered loans for the quarters ended March 31, 2013 and 2012:

	Quarter Ended March 31,			
		2013		2012
	(In thousands)			
Accretable yield activity				
Balance at beginning of period	$	188,008	$	188,822
Accretion		(20,229)		(21,541)
Transfer from non-accretable discount		6,328		7,597
Balance at end of period	**$**	**174,107**	**$**	**174,878**

	Quarter Ended March 31,			
		2013		2012
	(In thousands)			
Non-accretable discount activity				
Balance at beginning of period	$	237,555	$	412,170
Principal losses		(16,991)		(24,793)
Transfer to accretable yield		(6,328)		(7,597)
Balance at end of period	**$**	**214,236**	**$**	**379,780**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Non-accrual Loans

The following table presents the recorded investment in loans in non-accrual status by class of loans as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
	(In thousands)	
Originated loans		
Mortgage		
Traditional (by origination year):		
Up to the year 2002	$ 9,476	$ 11,362
Years 2003 and 2004	15,434	18,162
Year 2005	7,131	8,859
Year 2006	13,086	15,363
Years 2007, 2008 and 2009	8,057	8,967
Years 2010, 2011, 2012 and 2013	946	1,162
	54,130	63,875
Non-traditional	8,968	11,160
Loss mitigation program	36,000	39,957
	99,098	114,992
Home equity secured personal loans	12	10
	99,110	**115,002**
Commercial		
Commercial secured by real estate	27,190	26,517
Other commercial and industrial	3,566	2,989
	30,756	**29,506**
Consumer	**371**	**442**
Auto and leasing	**219**	**131**
Acquired loans accounted under ASC 310-20		
Commercial lines of credit	153	193
Auto	605	275
Consumer lines of credit and credit cards	1,001	1,095

		1,759		**1,563**
Total non-accrual loans	**$**	**132,215**	**$**	**146,644**

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

At March 31, 2013 and December 31, 2012, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-accrual loans amounted to $48.3 million and $52.0 million, respectively.

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 5 - ALLOWANCE FOR LOAN AND LEASE LOSSES

Non-Covered Loans

The Company maintains an allowance for loan and lease losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Company's allowance for loan and lease losses policy provides for a detailed quarterly analysis of probable losses. The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors. While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond the Company's control.

We also maintain an allowance for loan losses on acquired loans when: (i) for loans accounted for under ASC 310-30, there is deterioration in credit quality subsequent to acquisition, and (ii) for loans accounted for under ASC 310-20, the inherent losses in the loans exceed the remaining credit discount recorded at the time of acquisition.

The following table presents the activity in our allowance for loan and lease losses on loans and related recorded investment of the associated loans in our originated loan portfolio by segment for the period indicated:

	Quarter Ended March 31, 2013					
	Mortgage	**Commercial**	**Consumer**	**Auto and Leasing**	**Unallocated**	**Total**
			(In thousands)			
Allowance for loan and lease losses for non-covered originated loans:						
Balance at beginning of period	$ 21,092	$ 17,072	$ 856	$ 533	$ 368	$ 39,921
Charge-offs	(2,588)	(557)	(246)	(91)	-	(3,482)
Recoveries	-	28	65	7	-	100
Provision for non-covered loan and lease losses	4,385	(229)	638	1,292	(291)	5,795

Balance at end of period	**$**	**22,889**	**$**	**16,314**	**$**	**1,313**	**$**	**1,741**	**$**	**77**	**$**	**42,334**

	March 31, 2013											
	Mortgage		**Commercial**		**Consumer**		**Auto and Leasing**		**Unallocated**		**Total**	
	(In thousands)											
Allowance for loan and lease losses for originated loans:												
Ending allowance balance attributable to loans:												
Individually evaluated for impairment	$	5,385	$	4,065	$	-	$	-	$	-	$	9,450
Collectively evaluated for impairment		17,504		12,249		1,313		1,741		77		32,884
Total ending allowance balance	**$**	**22,889**	**$**	**16,314**	**$**	**1,313**	**$**	**1,741**	**$**	**77**	**$**	**42,334**
Loans:												
Individually evaluated for impairment	$	78,564	$	45,964	$	-	$	-	$	-	$	124,528
Collectively evaluated for impairment		714,266		404,348		65,363		146,689		-		1,330,666
Total ending loan balance	**$**	**792,830**	**$**	**450,312**	**$**	**65,363**	**$**	**146,689**	**$**	**-**	**$**	**1,455,194**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Quarter Ended March 31, 2012					
	Mortgage	Commercial	Consumer	Auto and Leasing	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for non-covered originated loans:						
Balance at beginning of period	$ 21,652	$ 12,548	$ 1,423	$ 845	$ 542	$ 37,010
Charge-offs	(922)	(1,637)	(182)	(31)	-	(2,772)
Recoveries	-	67	52	4	-	123
Provision for (recapture of) non-covered loan and lease losses	(1,763)	4,067	35	(308)	969	3,000
Balance at end of period	**$ 18,967**	**$ 15,045**	**$ 1,328**	**$ 510**	**$ 1,511**	**$ 37,361**

	December 31, 2012					
	Mortgage	Commercial	Consumer	Auto and Leasing	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for originated loans:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 5,334	$ 4,121	$ -	$ -	$ -	$ 9,455
Collectively evaluated for impairment	15,758	12,951	856	533	368	30,466
Total ending allowance balance	**$ 21,092**	**$ 17,072**	**$ 856**	**$ 533**	**$ 368**	**$ 39,921**
Loans:						
	$ 74,783	$ 46,199	$ -	$ -	$ -	$ 120,982

Individually evaluated for impairment												
Collectively evaluated for impairment		730,159		307,731		48,136		50,720		-		1,136,746
Total ending loans balance	**$**	**804,942**	**$**	**353,930**	**$**	**48,136**	**$**	**50,720**	**$**	**-**	**$**	**1,257,728**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the activity in our allowance for loan losses and related recorded investment of the associated loans in our non-covered acquired loan portfolio, excluding loans accounted for under ASC 310-30, for the quarter ended March 31, 2013:

	Quarter Ended March 31, 2013					
	Mortgage	Commercial	Consumer	Auto	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for non-covered loans:						
Acquired loans						
Charge-offs	-	-	(1,456)	(1,715)	-	(3,171)
Recoveries	-	-	207	1,230	-	1,437
Provision for non-covered loan and lease losses	-	386	1,249	485	-	2,120
Balance at end of period	**$ -**	**$ 386**	**$ -**	**$ -**	**$ -**	**$ 386**

	March 31, 2013					
	Mortgage	Commercial	Consumer	Auto	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for acquired loans:						
Ending allowance balance attributable to loans:						
Collectively evaluated for impairment	-	386	-	-	-	386
Total ending allowance balance	**$ -**	**$ 386**	**$ -**	**$ -**	**$ -**	**$ 386**
Loans:						
Collectively evaluated for impairment	-	334,859	65,388	417,649	-	817,896
	$ -	**$ 334,859**	**$ 65,388**	**$ 417,649**	**$ -**	**$ 817,896**

Total ending loan balance

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 $46.0 million and $46.2 million at March 31, 2013 and December 31, 2012, respectively. The impaired commercial loans were measured based on the fair value of collateral or the present value of cash flows method, including those identified as troubled-debt restructurings. The valuation allowance for impaired commercial loans amounted to approximately $4.1 million and $4.1 million at March 31, 2013 and December 31, 2012, respectively. The total investment in impaired mortgage loans was $78.6 million and $74.8 million at March 31, 2012 and December 31, 2012, respectively. Impairment on mortgage loans assessed as troubled-debt restructurings was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately $5.4 million and $5.3 million at March 31, 2013 and December 31, 2012, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company's recorded investment in commercial and mortgage loans that were individually evaluated for impairment, excluding loans accounted for under ASC 310-30, and the related allowance for loan and lease losses at March 31, 2013 and December 31, 2012 are as follows:

	March 31, 2013			
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage
	(In thousands)			
Impaired loans with specific allowance				
Commercial	$ 10,490	$ 10,047	$ 4,065	40%
Residential troubled-debt restructuring	81,362	78,564	5,385	7%
Impaired loans with no specific allowance				
Commercial	42,483	35,917	N/A	N/A
Total investment in impaired loans	**$ 134,335**	**$ 124,528**	**$ 9,450**	**8%**

	December 31, 2012			
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage
	(In thousands)			
Impaired loans with specific allowance				
Commercial	$ 16,666	$ 14,570	$ 4,121	28%
Residential troubled-debt restructuring	76,859	74,783	5,334	7%
Impaired loans with no specific allowance				
Commercial	36,293	31,629	N/A	N/A
Total investment in impaired loans	**$ 129,818**	**$ 120,982**	**$ 9,455**	**8%**

There were no impaired acquired loans accounted for under ASC 310-20 at March 31, 2013 and December 31, 2012.

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 ended March 31, 2013

and 2012:

	Quarter Ended March 31,							
	2013				2012			
	Interest Income Recognized		Average Recorded Investment		Interest Income Recognized		Average Recorded Investment	
	(In thousands)							
Impaired loans with specific allowance								
Commercial	$	4	$	15,472	$	149	$	24,927
Residential troubled-debt restructuring		443		78,748		424		56,385
Impaired loans with no specific allowance								
Commercial		293		30,360		38		18,698
Total interest income from impaired loans	**$**	**740**	**$**	**124,580**	**$**	**611**	**$**	**100,010**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Modifications

The following table presents the troubled-debt restructurings modified during the quarters ended March 31, 2013 and 2012:

	Quarter Ended March 31, 2013						
	Number of contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
	(Dollars in thousands)						
Mortgage loans	57	$ 7,518	6.28%	331	$ 8,040	4.35%	409

	Quarter Ended March 31, 2012						
	Number of contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
	(Dollars in thousands)						
Mortgage loans	58	$ 9,445	6.49%	328	$ 10,039	4.96%	403
Commercial loans	4	811	6.67%	71	1,173	7.18%	48

The following table presents troubled-debt restructurings modified and for which there was a payment default during the twelve-month periods ended March 31, 2013 and 2012:

	Twelve-Month Period Ended March 31,			
	2013		2012	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
	(Dollars in thousands)			
Mortgage loans	32	$ 4,295	36	$ 4,425

Consumer	1	$	18	-	$	-
Commercial	-	$	-	1	$	357

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Credit Quality Indicators

The Company categorizes non-covered originated 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:

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 affected 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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As of March 31, 2013 and December 31, 2012, and based on the most recent analysis performed, the risk category of gross non-covered originated and acquired loans accounted for under ASC 310-20 subject to risk rating by class of loans is as follows:

	March 31, 2013 Risk Ratings					
	Balance Outstanding	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Individually Measured for Impairment**
	(In thousands)					
Commercial - originated loans						
Commercial secured by real estate	$ 311,304	$ 233,917	$ 30,185	$ 5,907	$ 89	$ 41,206
Other commercial and industrial	139,009	120,780	9,905	3,565	-	4,759
	450,313	354,697	40,090	9,472	89	45,965
Commercial - acquired loans (under ASC 310-20)						
Commercial secured by real estate	19,153	18,623	245	285	-	-
Other commercial and industrial	315,706	313,737	582	1,387	-	-
	334,859	332,360	827	1,672	-	-
Total	**$ 785,172**	**$ 687,057**	**$ 40,917**	**$ 11,144**	**$ 89**	**$ 45,965**

	December 31, 2012 Risk Ratings					
	Balance Outstanding	Pass	Special Mention	Substandard	Doubtful	Individually Measured for Impairment
	(In thousands)					
Commercial - originated loans						
Commercial secured by real estate	$ 251,274	$ 183,033	$ 23,928	$ 2,127	$ 99	$ 42,087
Other commercial and industrial	102,656	85,806	8,569	4,169	-	4,112
	353,930	268,839	32,497	6,296	99	46,199
Commercial - acquired loans (under ASC 310-20)						
Construction and commercial real estate	20,337	19,701	245	391	-	-
Commercial and industrial	317,632	315,085	213	2,334	-	-
	337,969	334,786	458	2,725	-	-
Total	**$ 691,899**	**$ 603,625**	**$ 32,955**	**$ 9,021**	**$ 99**	**$ 46,199**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

For residential and consumer loan classes, the Company evaluates credit quality based on the delinquency status of the loan. As of March 31, 2013 and December 31, 2012, and based on the most recent analysis performed, the risk category of non-covered gross originated loans and acquired loans accounted for under ASC 310-20 not subject to risk rating by class of loans is as follows:

	March 31, 2013							
	Delinquency							
	Balance Outstanding	0-29 days	30-59 days	60-89 days	90-119 days	120-364 days	365+ days	Individually Measured for Impairment
	(In thousands)							
Originated loans								
Mortgage								
Traditional (by origination year)								
Up to the year 2002	$ 95,235	$ 75,167	$ 9,603	$ 886	$ -	$ 3,255	$ 6,218	$ 106
Years 2003 and 2004	145,383	109,546	18,812	1,490	-	4,953	10,318	264
Year 2005	78,149	62,692	7,391	892	-	1,664	5,297	213
Year 2006	110,287	82,251	12,634	2,125	-	4,552	8,352	373
Years 2007, 2008 and 2009	118,099	102,143	6,978	569	-	2,446	5,342	621
Years 2010, 2011, 2012 and 2013	78,888	76,534	674	734	-	500	365	81
	626,041	508,333	56,092	6,696	-	17,370	35,892	1,658
Non-traditional	55,748	43,375	3,219	186	-	2,230	6,738	-
Loss mitigation program	90,102	8,802	973	-	-	206	3,215	76,906
	771,891	560,510	60,284	6,882	-	19,806	45,845	78,564
Home equity secured personal loans	749	737	-	-	-	-	12	-

GNMA's buy-back option program	20,190	-	-	-	-	12,211	7,979	-
	792,830	561,247	60,284	6,882	-	32,017	53,836	78,564
Consumer	65,363	64,342	475	205	214	124	3	-
Auto and Leasing	146,689	143,304	3,008	305	69	3	-	-
	1,004,882	768,893	63,767	7,392	283	32,144	53,839	78,564
Acquired loans (under ASC 310-20)								
Auto	417,649	408,677	7,096	1,304	420	152	-	-
Consumer	65,388	63,736	650	-	991	9	2	-
	483,037	472,413	7,746	1,304	1,411	161	2	-
Total	**$ 1,487,919**	**$ 1,241,306**	**$ 71,513**	**$ 8,696**	**$ 1,694**	**$ 32,305**	**$ 53,841**	**$ 78,564**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2012							
		Delinquency						
	Balance Outstanding	0-29 days	30-59 days	60-89 days	90-119 days	120-364 days	365+ days	Individually Measured for Impairment
	(In thousands)							
Originated loans								
Mortgage								
Traditional (by origination year):								
Up to the year 2002	$ 101,268	$ 80,715	$ 6,907	$ 2,116	$ 886	$ 3,720	$ 6,442	$ 482
Years 2003 and 2004	149,862	114,341	12,048	5,206	2,082	3,994	11,533	658
Year 2005	80,900	65,245	4,983	1,746	1,202	1,846	5,727	151
Year 2006	113,086	84,926	9,012	3,525	1,530	5,103	8,695	295
Years 2007, 2008 and 2009	121,639	108,357	2,632	1,682	641	2,532	5,732	63
Years 2010, 2011 and 2012	66,646	64,084	632	769	249	452	460	-
	633,401	517,668	36,214	15,044	6,590	17,647	38,589	1,649
Non-traditional	57,819	42,742	2,850	1,067	455	2,287	8,418	-
Loss mitigation program	87,310	9,595	606	128	102	253	3,492	73,134
	778,530	570,005	39,670	16,239	7,147	20,187	50,499	74,783
Home equity secured personal loans	736	726	-	-	-	-	10	-

GNMA's buy back option program	25,676	-	-	-	6,064	10,659	8,953	-
	804,942	570,731	39,670	16,239	13,211	30,846	59,462	74,783
Consumer	48,136	46,888	747	92	188	218	3	-
Auto and leasing	50,720	50,209	251	129	46	85	-	-
	903,798	667,828	40,668	16,460	13,445	31,149	59,465	74,783
Acquired loans (under ASC 310-20)								
Auto	457,894	449,843	6,753	1,023	264	11	-	-
Consumer	68,878	66,801	982	-	1,089	4	2	-
	526,772	516,644	7,735	1,023	1,353	15	2	-
Total	**$ 1,430,570**	**$ 1,184,472**	**$ 48,403**	**$ 17,483**	**$ 14,798**	**$ 31,164**	**$ 59,467**	**$ 74,783**

Non-covered Acquired Loans Accounted under ASC 310-30

Loans acquired in the BBVAPR Acquisition accounted for under ASC 310-30 were recognized at fair value as of December 18, 2012, which included the impact of expected credit losses, and therefore, no allowance for credit losses was recorded at the acquisition date. To the extent credit deterioration occurs after the date of acquisition, the Company would record an allowance for loan and lease losses. Management determined that there was no need to record an allowance for loan and lease losses on loans acquired in the BBVAPR Acquisition accounted for under ASC 310-30 as of March 31, 2013 and December 31, 2012.

Covered Loans

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

During the first quarter of 2012, the Company reviewed certain pools composed of commercial real estate, construction and development loans, which have been in non-accrual status since acquisition, whose cash flows were lower than the expectations exceeding the established thresholds. The Company reviewed the timing of the collections expected through workouts and/or the timing assessed for the particular workout loan to foreclose for the most significant loans comprising the particular pools selected for review. The credit quality assumptions for these pools were updated to reflect increases in default rates, severities and extension of

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

recovery lags resulting in an increase in the provision for covered loan and lease losses. For other pools composed of performing commercial real estate loans and leases, the Company noted that the actual cash flows were better than expected. Thus, for these pools a reversal of previously recorded allowance and a re-yielding of the leasing pools were recorded. As a result of such assessment, during the first quarter of 2012, the Company recorded a net increase in the allowance for covered loans of $19.2 million which was partially offset by an increase in the FDIC shared-loss indemnification asset of $12.0 million.

During the quarter ended March 31, 2013, the assessment of actual versus expected cash flows resulted in a net provision of $672 thousand as certain pools of real estate backed loans and of commercial and industrial loans underperformed. The net provision also included the reversal of a previously recorded allowance in certain commercial real estate and commercial and industrial pools whose loans the Company has managed to workout with better outcomes than forecasted. The loss share portion of the reversal of allowance during the quarter ended March 31, 2013 was proportionally higher than the allowance reversal recorded on the impaired loans. This resulted from the fact that there were some pools in which an additional allowance was recognized but no offsetting adjustment was done to the FDIC shared-loss indemnification asset as these losses were not covered by a loss share agreement.

The changes in the allowance for loan and lease losses on covered loans for the quarters ended March 31, 2013 and 2012 were as follows:

	Quarter Ended March 31,	
	2013	2012
	(In thousands)	
Balance at beginning of the period	$ 54,124	$ 37,256
Provision for covered loan and lease losses, net	672	7,157
FDIC shared-loss portion of provision for (recapture of) covered loan and lease losses, net	(1,822)	12,024
Balance at end of the period	**$ 52,974**	**$ 56,437**

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company's recorded investment in covered loan pools that have recorded impairments and their related allowance for covered loan and lease losses as of March 31, 2013 and December 31, 2012 are as follows:

	March 31, 2013			
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage
		(In thousands)		
Impaired covered loan pools with specific allowance				
Loans secured by 1-4 family residential properties	$ 39,309	$ 27,001	$ 7,062	26%
Construction and development secured by 1-4 family residential properties	66,429	13,255	6,796	51%
Commercial and other construction	241,848	115,932	38,441	33%
Consumer	13,690	8,125	675	8%
Total investment in impaired covered loan pools	**$ 361,276**	**$ 164,313**	**$ 52,974**	**32%**

	December 31, 2012			
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage
		(In thousands)		
Impaired covered loan pools with specific allowance				
Loans secured by 1-4 family residential properties	$ 45,208	$ 29,482	$ 4,986	17%
Construction and development secured by 1-4 family residential properties	68,255	15,185	6,137	40%
Commercial and other construction	252,373	121,237	42,323	35%
Consumer	14,494	8,493	678	8%
Total investment in impaired covered loan pools	**$ 380,330**	**$ 174,397**	**$ 54,124**	**31%**

NOTE 6 — PREMISES AND EQUIPMENT

Premises and equipment at March 31, 2013 and December 31, 2012 are stated at cost less accumulated depreciation and amortization as follows:

	Useful Life (Years)	March 31, 2013	December 31, 2012
		(In thousands)	
Land	—	$ 2,876	$ 2,876
Buildings and improvements	40	63,877	63,133
Leasehold improvements	5 — 10	23,608	23,602
Furniture and fixtures	3 — 7	11,638	10,441
Information technology and other	3 — 7	22,145	20,874
		124,144	120,926
Less: accumulated depreciation and amortization		(40,683)	(35,929)
		$ 83,461	**$ 84,997**

Depreciation and amortization of premises and equipment totaled $3.1 million in the quarter ended March 31, 2013 and $1.2 million in the quarter ended March 31, 2012. These are included in the unaudited consolidated statements of operations as part of occupancy and equipment expenses.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 7 — DERIVATIVE ACTIVITIES

During the quarter ended March 31, 2013, losses of $298 thousand were recognized and reflected as “Derivative Activities” in the unaudited consolidated statements of operations, which were mainly related to the options tied to the S&P Index. During the quarter ended March 31, 2012, there were no significant transactions impacting the Group’s operations reflected as “Derivative Activities” in the unaudited consolidated statements of operations.

The following table details “Derivative Assets” and “Derivative Liabilities” as reflected in the unaudited consolidated statements of financial condition at March 31, 2013 and December 31, 2012:

		March 31, 2013		December 31, 2012
		(In thousands)		
Derivative assets:				
Options tied to S&P 500 Index	$	15,404	$	13,233
Interest rate swaps not designated as hedges		7,599		8,426
Interest rate caps		230		230
	$	**23,233**	**$**	**21,889**
Derivative liabilities:				
Interest rate swaps designated as cash flow hedges	$	16,202	$	17,665
Interest rate swaps not designated as hedges		7,546		8,365
Interest rate caps		230		230
Other		46		-
	$	**24,024**	**$**	**26,260**

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 borrowings transactions and are properly documented as such, and therefore, qualify for cash flow hedge accounting. Any gain or loss associated with the effective portion of our cash flow hedges was recognized in other comprehensive income and is subsequently reclassified into earnings in the period during which the hedged forecasted transactions affects earnings. Changes in the fair value of these derivatives are recorded in accumulated

other comprehensive income to the extent there is no significant ineffectiveness in the cash flow hedging relationships. Currently, the Company does not expect to reclassify any amount included in other comprehensive income related to these interest rate swaps to earnings in the next twelve months.

The following table shows a summary of these swaps and their terms at March 31, 2013:

Type		Notional Amount (In thousands)	Fixed Rate	Variable Rate Index	Trade Date	Settlement Date	Maturity Date
Interest Rate Swaps	$	25,000	2.4365%	1-Month Libor	05/05/11	05/04/12	05/04/16
		25,000	2.6200%	1-Month Libor	05/05/11	07/24/12	07/24/16
		25,000	2.6350%	1-Month Libor	05/05/11	07/30/12	07/30/16
		50,000	2.6590%	1-Month Libor	05/05/11	08/10/12	08/10/16
		100,000	2.6750%	1-Month Libor	05/05/11	08/16/12	08/16/16
	$	**225,000**					

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

An unrealized loss of $16.2 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at March 31, 2013, and the related liability is being reflected in the accompanying unaudited consolidated statements of financial condition.

At March 31, 2013 and December 31, 2012, interest rate swaps not designated as hedging instruments that were offered to clients represented an asset of $7.6 million and $8.4 million, respectively, and were included as part of derivative assets in the unaudited consolidated statements of financial position. At March 31, 2013 and December 31, 2012, interest rate swaps not designated as hedging instruments that are the mirror-images of the derivatives offered to clients represented a liability of $7.5 million and $8.4 million, respectively, and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition.

The following table shows a summary of these interest rate swaps not designated as hedging instruments and their terms at March 31, 2013:

Type		Notional Amount (In thousands)	Fixed Rate	Variable Rate Index	Settlement Date	Maturity Date
Interest Rate Swaps - Derivatives Offered to Clients	$	4,278	5.1300%	1-Month Libor	07/03/06	07/03/16
		12,500	5.5050%	1-Month Libor	04/11/09	04/11/19
		29,157	4.6200%	1-Month Libor	12/31/07	12/31/14
		19,858	4.6200%	1-Month Libor	12/31/07	12/31/14
		1,905	3.5000%	1-Month Libor	03/28/08	04/01/13
		2,036	3.8500%	1-Month Libor	04/18/08	04/18/13
		1,169	5.1500%	3-Month Libor	10/24/08	10/24/13
	$	**70,903**				
Interest Rate Swaps - Mirror Image Derivatives	$	4,278	5.1300%	1-Month Libor	07/03/06	07/03/16
		12,500	5.5050%		04/11/09	04/11/19

			1-Month Libor		
	29,157	4.5600%	1-Month Libor	12/31/07	12/31/14
	19,858	4.5600%	1-Month Libor	12/31/07	12/31/14
	1,905	3.5000%	1-Month Libor	03/28/08	04/01/13
	2,036	3.8000%	1-Month Libor	04/18/08	04/18/13
	1,169	4.9550%	3-Month Libor	10/24/08	10/24/13
$	**70,903**				

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 March 31, 2013 and December 31, 2012, the purchased options used to manage the exposure to the S&P 500 Index on stock indexed deposits represented an asset of $15.4 million (notional amount of $58.6 million) and $13.2 million (notional amount of $66.6 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 $14.8 million (notional amount of $56.6 million) and $12.7 million (notional amount of $62.3 million), respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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. The Company simultaneously enters into mirror-image interest rate cap transactions with financial counterparties. None of these cap transactions qualify for hedge accounting; therefore, they are marked to market through earnings. The outstanding total notional amount of interest rate caps was $94 million at both March 31, 2013 and December 31, 2012. At both March 31, 2013 and December 31, 2012, the interest rate caps sold to clients represented a liability of $230 thousand and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition. At both March 31, 2013and December 31, 2012, the interest rate caps purchased as mirror-images represented an asset of $230 thousand and were included as part of derivative assets in the unaudited consolidated statements of financial condition.

NOTE 8 — ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable at March 31, 2013 and December 31, 2012 consists of the following:

		March 31, 2013		December 31, 2012
		(In thousands)		
Non-covered loans	$	13,435	$	10,533
Investments		6,796		7,021
	$	**20,231**	**$**	**17,554**

Other assets at March 31, 2013 and December 31, 2012 consist of the following:

		March 31, 2013		December 31, 2012
		(In thousands)		
Prepaid FDIC insurance	$	5,592	$	6,451
Other prepaid expenses		17,338		19,674
Servicing advances		11,400		7,976
Mortgage tax credits		8,706		8,706
Core deposit and customer relationship intangibles		13,846		14,490
Investment in Statutory Trust		1,086		1,086
Other repossessed assets		7,739		6,084

Accounts receivable and other assets		56,679		59,217
	$	**122,386**	**$**	**123,684**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay on December 31, 2009 their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The prepayment balance of the assessment amounted to $5.6 million and $6.5 million at March 31, 2013 and December 31, 2012, respectively. Pursuant to guidelines issued by the FDIC, the assessment due for the first quarter of 2013 payable on June 28, 2013 will be offset by the amount of the credit for prepaid assessments, and the Company will be billed or refunded the difference, as the case may be, on such payment date.

Other prepaid expenses amounting to $17.3 million and $19.7 million at March 31, 2013 and December 31, 2012, respectively, include prepaid municipal, property and income taxes aggregating to $10.1 million and $12.0 million, respectively.

Servicing advances amounting to $11.4 million and $8.0 million at March 31, 2013 and December 31, 2012, respectively, represent the advances made to Bayview Loan Servicing, LLC in order to service some of the loans acquired in the FDIC-assisted acquisition of Eurobank. This servicing agreement will be terminated effective May 31, 2013.

At both March 31, 2012 and December 31, 2012, tax credits for the Company amounted $8.7 million. Mortgage loan tax credits acquired as part of the BBVAPR Acquisition amounted to $6.3 million and $7.4 million at March 31, 2013 and December 31, 2012, respectively. These tax credits do not have an expiration date.

As part of the FDIC-assisted acquisition of Eurobank and the recent BBVAPR Acquisition, the Company recorded a core deposit intangible representing the value of checking and savings deposits acquired. At March 31, 2013 and December 31, 2012, this core deposit intangible amounted to $8.0 million and $8.4 million, respectively. In addition, as part of the BBVAPR Acquisition on December 18, 2012, the Company recorded a customer relationship intangible amounting to $5.0 million representing the value of customer relationships acquired in the broker-dealer and insurance subsidiaries as of December 31, 2012. At March 31, 2013 this customer relationship intangible amounted to $4.8 million.

Other repossessed assets totaled $7.7 million and $6.1 million at March 31, 2013 and December 31, 2012, respectively. Repossessed auto loans acquired as part of the BBVAPR Acquisition amounted to $7.4 million and $5.9 million at March 31, 2013 and December 31, 2012, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 9 — DEPOSITS AND RELATED INTEREST

Total deposits as of March 31, 2013 and December 31, 2012 consist of the following:

	March 31, 2013	December 31, 2012
	(In thousands)	
Non-interest bearing demand deposits	$ 753,291	$ 799,667
Interest-bearing savings and demand deposits	2,323,153	2,282,305
Individual retirement accounts	368,637	376,611
Retail certificates of deposit	684,477	699,983
Total core deposits	**4,129,558**	**4,158,566**
Institutional deposits	593,524	602,828
Brokered deposits	840,432	928,165
Total deposits	$ **5,563,514**	$ **5,689,559**

At March 31, 2013 and December 31, 2012, the weighted average interest rate of the Company's deposits was 0.75% and 1.33%, respectively, inclusive of non-interest bearing deposits of $753.3 million and $799.7 million, respectively. Interest expense for the quarters ended March 31, 2013 and 2012 was as follows:

	Quarter Ended March 31,	
	2013	2012
	(In thousands)	
Demand and savings deposits	$ 5,962	$ 3,176
Certificates of deposit	4,516	5,947
	$ 10,478	**$ 9,123**

At March 31, 2013 and December 31, 2012, demand and interest-bearing deposits and certificates of deposit included deposits of the Puerto Rico Cash & Money Market Fund, which amounted to $95.9 million and $101.5 million, respectively, with a weighted average rate of 0.76% and 0.77%, and were collateralized with investment securities with a fair value of $74.5 million and $80.3 million, respectively.

At March 31, 2013 and December 31, 2012 time deposits in denominations of $100 thousand or higher, excluding accrued interests and unamortized discounts, amounted to $1.75 billion and $1.87 billion, including public fund time deposits from various Puerto Rico government municipalities, agencies, and corporations of $114.5 million and $78.3 million, respectively, at a weighted average rate of 0.55% in March 31, 2013 and 0.72% in December 31, 2012.

At March 31, 2013 and December 31, 2012, public fund deposits from various Puerto Rico government agencies were collateralized with investment securities with a fair value of $98.7 million and $114.6 million, respectively, and with commercial loans amounting to $513.5 million at March 31, 2013 and $485.8 at December 31, 2012.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Excluding equity indexed options in the amount of $15.4 million, which are used by the Company to manage its exposure to the S&P 500 Index, and also excluding accrued interest of $3.2 million and unamortized deposit discounts in the amount of $2.0 million, the scheduled maturities of certificates of deposit at March 31, 2013 are as follows:

		March 31, 2013 (In thousands)
Within one year:		
Three (3) months or less	$	688,183
Over 3 months through 1 year		840,542
		1,528,725
Over 1 through 2 years		595,683
Over 2 through 3 years		152,285
Over 3 through 4 years		123,153
Over 4 through 5 years		56,606
Thereafter		11,491
	$	**2,467,943**

The aggregate amount of overdraft in demand deposit accounts that were reclassified to loans amounted to $4.1 million and $2.8 million as of March 31, 2013 and December 31, 2012, respectively.

NOTE 10 — BORROWINGS

Short term borrowings

At March 31, 2013 and December 31, 2012, short term borrowings amounted to $60.8 million and $92.2 million, respectively, which mainly consist of unsecured fixed rate borrowings with a weighted average rate of 0.35% and 0.30%, respectively.

Securities Sold under Agreements to Repurchase

At March 31, 2013, 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 the agreements.

At March 31, 2013 and December 31, 2012, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of $2.4 million and $2.3 million, respectively, were as follows:

	March 31, 2013		December 31, 2012	
	Borrowing Balance	**Fair Value of Underlying Collateral**	**Borrowing Balance**	**Fair Value of Underlying Collateral**
	(In thousands)			
UBS Financial Services Inc.	$ 500,000	$ 608,861	$ 500,000	$ 616,751
JP Morgan Chase Bank NA	275,019	297,606	412,837	443,436
Credit Suisse Securities (USA) LLC	255,000	269,656	255,000	269,943
Deutsche Bank	255,000	271,194	255,000	273,288
Citigroup Global Markets Inc.	204,276	226,644	150,000	162,652
Barclays Bank	-	-	68,650	77,521
Wells Fargo	-	-	51,444	54,943
Total	**$ 1,489,295**	**$ 1,673,961**	**$ 1,692,931**	**$ 1,898,534**

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NOTES TO UNAUDITED 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 $2.4 million, at March 31, 2013:

Year of Maturity	Borrowing Balance (In thousands)	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
2013					
	$ 22,178	0.400%	3/7/2013	4/8/2013	N/A
	182,098	0.490%	3/7/2013	4/8/2013	N/A
	20,019	0.420%	3/15/2013	4/9/2013	N/A
	224,295				
2014					
	255,000	0.500%	12/13/2012	1/7/2014	N/A
	255,000	0.550%	12/10/2012	6/13/2014	N/A
	85,000	0.675%	12/3/2012	12/3/2014	N/A
	170,000	0.675%	12/6/2012	12/8/2014	N/A
	765,000				
2017					
	500,000	4.665%	3/2/2007	3/2/2017	6/3/2013
	500,000				
	$ 1,489,295	**1.933%**			

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Advances from the Federal Home Loan Bank

Advances are received from the FHLB 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 March 31, 2013 and December 31, 2012, these advances were secured by mortgage and commercial loans amounting to $1.4 billion and $1.3 billion, respectively. Also, at March 31, 2013, the Company had an additional borrowing capacity with the FHLB of $599.7 million. At March 31, 2013 and December 31, 2012, the weighted average remaining maturity of FHLB's advances was 8.8 months and 3.5 months, respectively. The original terms of these advances range between one month and five years, and the FHLB does not have the right to exercise put options at par on any advances outstanding as of March 31, 2013. The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of $468 thousand and unamortized premium in the amount of $191 thousand, at March 31, 2013:

Year of Maturity		Borrowing Balance (In thousands)	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
2013						
	$	25,000	0.410%	2/28/2013	4/1/2013	N/A
		40,000	0.380%	3/28/2013	4/2/2013	N/A
		25,000	0.390%	3/4/2013	4/4/2013	N/A
		50,000	0.410%	3/11/2013	4/10/2013	N/A
		100,000	0.400%	3/18/2013	4/16/2013	N/A
		25,000	0.380%	3/25/2013	4/24/2013	N/A
		100,000	1.950%	6/11/2010	6/11/2013	N/A
		365,000				
2017						
		4,901	1.240%	4/3/2012	4/3/2017	N/A
		4,901				
2018						
		30,000	2.187%	1/16/2013	1/16/2018	N/A
		25,000	2.177%	1/16/2013	1/16/2018	N/A
		55,000				
	$	**424,901**	**1.003%**			

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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.

FDIC-Guaranteed Term Notes — Temporary Liquidity Guarantee Program

On March 16, 2012, the Company's banking subsidiary repaid at maturity the $105 million in senior unsecured notes that it issued in March 2009 under the FDIC's Temporary Liquidity Guarantee Program.

Subordinated Capital Notes

Subordinated capital notes amounted to $98.4 million and $146.0 million at March 31, 2013 and December 31, 2012, respectively.

In August 2003, the Statutory Trust II, a special purpose entity of the Company, was formed for the purpose of issuing trust redeemable preferred securities. In September 2003, $35.0 million of trust redeemable preferred securities were issued by the Statutory Trust II as part of a pooled underwriting transaction. Pooled underwriting involves participating with other bank holding companies in issuing the securities through a special purpose pooling vehicle created by the underwriters.

The proceeds from this issuance were used by the Statutory Trust II to purchase a like amount of a floating rate junior subordinated deferrable interest debenture issued by the Company. The subordinated deferrable interest debenture has a par value of $36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.23% at March 31, 2013; 3.26% at December 31, 2012), is payable quarterly, and matures on September 17, 2033. It may be called at par after five years and quarterly thereafter (next call date June 2013). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated deferrable interest debenture. The subordinated deferrable interest debenture issued by the Company is accounted for as a liability denominated as a subordinated capital note on the unaudited consolidated statements of financial condition.

The subordinated capital note is treated as Tier 1 capital for regulatory purposes. Under Federal Reserve Board rules, restricted core capital elements, which are qualifying trust preferred securities, qualifying cumulative perpetual

preferred stock (and related surplus) and certain minority interests in consolidated subsidiaries, are limited in the aggregate to no more than 25% of a bank holding company's core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability. However, under the Dodd-Frank Act, bank holding companies are prohibited from including in their Tier 1 capital hybrid debt and equity securities, including trust preferred securities, issued on or after May 19, 2010. Any such instruments issued before May 19, 2010 by a bank holding company, such as the Company, with total consolidated assets of less than $15 billion as of December 31, 2009, may continue to be included as Tier 1 capital. Therefore, the Company is permitted to continue to include its existing trust preferred securities as Tier 1 capital.

As part of the BBVAPR Acquisition on December 18, 2012, the Company's banking subsidiary assumed three subordinated capital notes issued by BBVAPR Bank consisting of the following:

- Subordinated capital notes issued in September 2004 amounting to $50.0 million at a variable rate of three-month LIBOR plus 1.44% (1.75% at December 31, 2012), that was due September 23, 2014. During the quarter ended March 31, 2013, the Bank repurchased and cancelled these subordinated capital notes in whole before maturity and realized a gain of $1.1 million in the Company's unaudited consolidated statements of operations.

- Subordinated capital notes issued in September 2006 amounting to $37.0 million at a fixed rate of 5.76% through September 29, 2011, and three-month LIBOR plus 1.56% thereafter (1.84% at March 31, 2013; 1.87% at December 31, 2012), due September 29, 2016. Interest on these subordinated notes is payable quarterly during the floating-rate period. The Bank has the option to redeem these subordinated capital notes in whole or in part from time to time before maturity at 100% of the principal amount plus any accrued but unpaid interest to the date of redemption, beginning September 29, 2011, and at each payment date thereafter.

- Subordinated capital notes issued in September 2006 amounting to $30.0 million at a variable rate of three-month LIBOR plus 1.56% thereafter (1.84% at March 31, 2013; 1.87% at December 31, 2012), due September 29, 2016. Interest on these subordinated notes is payable quarterly. The Bank has the option to redeem these subordinated capital notes in whole or in part from time to time before maturity at 100% of the principal amount plus any accrued but unpaid interest to the date of redemption, beginning September 29, 2011, and at each payment date thereafter.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

These notes qualify as Tier 2 capital at a discounted rate, which totals $40.2 million at March 31, 2013 and $50.2 million at December 31, 2012. Generally speaking, subordinated notes are included as Tier 2 capital if they have an original weighted average maturity of at least 5 years and comply with certain other requirements. As the notes approach maturity, they begin to take on characteristics of a short term obligation. For this reason, the outstanding amount eligible for inclusion in Tier 2 capital is reduced, or discounted, as the instruments approach maturity: one fifth of the outstanding amount is excluded each year during the instruments last five years before maturity. When the remaining maturity is less than one year, the instrument is excluded from tier 2 capital.

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

		Redemption fund (In thousands)
2013	$	48,575
2014		6,700
2015		6,700
2016		5,025
	$	**67,000**

Other borrowings

Other borrowings, presented in the unaudited consolidated statement of financial condition within “Advances from FHLB and other borrowings”, amounted to $37.3 million and $17.6 million at March 31, 2013 and December 31, 2012, respectively. These borrowings mainly consists of federal funds purchased of $29.6 million and $9.9 million at March 31, 2013 and December 31, 2012, respectively, with a weighted average interest rate of 0.30% at both dates; and unsecured fixed-rate borrowings of $7.7 million at both March 31, 2013 and December 31, 2012, with a weighted average interest rate of 0.67% and 0.67%, respectively.

NOTE 11 — RELATED PARTY TRANSACTIONS

The Bank grants loans to its directors, executive officers and to certain related individuals or organizations in the ordinary course of business. These loans are offered at the same terms as loans to unrelated third parties. As of March 31, 2013 and December 31, 2012, these loan balances amounted to $8.7 million and $6.1 million, respectively. The activity and balance of these loans for the quarters ended March 31, 2013 and 2012, were as follows:

	Quarter Ended March 31,			
	2013		2012	
	(In thousands)			
Balance at the beginning of period	$	6,055	$	3,772
New loans		4,234		1,505
Repayments		(833)		(39)
Credits of persons no longer considered related parties		(768)		-
Balance at the end of period	**$**	**8,688**	**$**	**5,238**

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 12 — INCOME TAXES

At March 31, 2013 and December 31, 2012, the Company's net deferred tax asset amounted to $112.6 million and $117.2 million, respectively. Income tax expense for the quarters ended March 31, 2013 and 2012 totaled $7.1 million and $1.9 million, respectively.

At March 31, 2013 and December 31, 2012, OIB had $458 thousand and $504 thousand in the income tax effect of unrecognized gain on available-for-sale securities included in other comprehensive income, respectively. Following the change in OIB's applicable tax rate from 5% to 0% as a result of new Puerto Rico legislation adopted in 2011, this remaining tax balance will flow through income as these securities are repaid or sold in future periods. During the quarters ended March 31, 2013 and 2012, the income tax provision included $47 thousand and $558 thousand, respectively, related to this residual tax effect from OIB.

The Company classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. The balance of unrecognized tax benefits at March 31, 2013 was $4.9 million (December 31, 2012 - $18.8 million). The Company had accrued $1.6 million at March 31, 2013 (December 31, 2012 - $1.5 million) for the payment of interest and penalties relating to unrecognized tax benefits.

NOTE 13 — STOCKHOLDERS' EQUITY

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 and the Bank'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 are required to establish minimum leverage and risk-based capital requirements, on a consolidated basis, for insured institutions, depository institutions, depository institution holding companies, and non-bank financial

companies supervised by the Federal Reserve Board. The minimum leverage and risk-based capital requirements are to be determined based on the minimum ratios established for insured depository institutions under prompt corrective action regulations.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average assets (as defined in the regulations). As of March 31, 2013 and December 31, 2012, the Company and the Bank met all capital adequacy requirements to which they are subject. As of March 31, 2013 and December 31, 2012, the Bank is “well capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well capitalized,” an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company's and the Bank's actual capital amounts and ratios as of March 31, 2013 and December 31, 2012 are as follows:

	Actual		Minimum Capital Requirement	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
Company Ratios				
As of March 31, 2013				
Total capital to risk-weighted assets	$ 805,320	**15.26%**	$ 422,159	**8.00%**
Tier 1 capital to risk-weighted assets	$ 698,786	**13.24%**	$ 211,080	**4.00%**
Tier 1 capital to total assets	$ 698,786	**8.07%**	$ 346,284	**4.00%**
As of December 31, 2012				
Total capital to risk-weighted assets	$ 794,195	**15.15%**	$ 419,269	**8.00%**
Tier 1 capital to risk-weighted assets	$ 678,127	**12.94%**	$ 209,634	**4.00%**
Tier 1 capital to total assets	$ 678,127	**6.42%**	$ 422,307	**4.00%**

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
Bank Ratios						
As of March 31, 2013						
Total capital to risk-weighted assets	$ 735,713	**14.23%**	$ 413,616	**8.00%**	$ 517,020	**10.00%**
Tier 1 capital to risk-weighted assets	$ 630,498	**12.19%**	$ 206,808	**4.00%**	$ 310,212	**6.00%**
Tier 1 capital to total assets	$ 630,498	**7.34%**	$ 343,805	**4.00%**	$ 429,756	**5.00%**
As of December 31, 2012						
Total capital to risk-weighted assets	$ 719,675	**14.03%**	$ 410,268	**8.00%**	$ 512,835	**10.00%**
Tier 1 capital to risk-weighted assets	$ 604,997	**11.80%**	$ 205,134	**4.00%**	$ 307,701	**6.00%**
Tier 1 capital to total assets	$ 604,997	**5.75%**	$ 420,298	**4.00%**	$ 525,373	**5.00%**

The Company's ability to pay dividends to its shareholders and other activities can be restricted if its capital falls below levels established by the Federal Reserve Board's guidelines. In addition, any bank holding company whose capital falls below levels specified in the guidelines can be required to implement a plan to increase capital.

Additional paid-in capital

Additional paid-in capital represents contributed capital in excess of par value of common and preferred stock net of costs of the issuance. As of March 31, 2013, accumulated issuance costs charged against additional paid in capital amounted to $10.1 million and $13.6 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 March 31, 2013 and December 31, 2012, the Bank's legal surplus amounted to $54.1 million and $52.1 million, respectively. The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Earnings per Common Share

The calculation of earnings per common share for the quarters ended March 31, 2013 and 2012 is as follows:

	Quarter Ended March 31,			
	2013		2012	
Net income	$	21,192	$	10,653
Less: Dividends on preferred stock				
Non-Convertible Preferred Stock (Series A, B, and D)		(1,628)		(1,201)
Convertible preferred stock (Series C)		(1,837)		-
Income available to common shareholders	**$**	**17,727**	**$**	**9,452**
Effect of assumed conversion of the Convertible Preferred Stock		1,837		**-**
Income available to common shareholders assuming conversion	$	**19,564**	$	**9,452**
Weighted average common shares and share equivalents:				
Average common shares outstanding		45,595		41,043
Effect of dilutive securities:				
Average potential common shares-options		159		119
Average potential common shares-assuming conversion of convertible preferred stock		7,138		-
Total weighted average common shares outstanding and equivalents		**52,892**		**41,162**
Earnings per common share - basic	**$**	**0.39**	**$**	**0.23**
Earnings per common share - diluted	**$**	**0.37**	**$**	**0.23**

In computing diluted earnings per common share, the 84,000 shares of convertible preferred stock, which remained outstanding at March 31, 2013, with a conversion rate, subject to certain conditions, of 84.9798 shares of common stock per share, were included as average potential common shares from the date they were outstanding. Moreover, in computing diluted earnings per common share, the dividends declared during the quarter ended March 31, 2013 on the convertible preferred stock were added back as income available to common shareholders.

For the quarters ended March 31, 2013 and 2012, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 653,843 and 759,453, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Treasury Stock

Repurchased common stock is held by the Company as treasury shares. The Company records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock.

The activity in connection with common shares held in treasury by the Company for the quarters ended March 31, 2013 and 2012 is set forth below:

	Quarter Ended March 31,			
	2013		2012	
	Shares	Dollar Amount	Shares	Dollar Amount
	(In thousands, except shares data)			
Beginning of period	7,090,597	$ 81,275	6,564,124	$ 74,808
Common shares used upon lapse of restricted stock units	(33,600)	(351)	(3,333)	(35)
Common shares repurchased as part of the stock repurchase program	-	-	603,000	7,022
Common shares used to match defined contribution plan, net				